

# AID-FOR-TRADE CASE STORY

LESOTHO

## LESOTHO: AID FOR TRADE NEEDS

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## Introduction

This case story examines the impact of Aid for Trade (AfT) in Lesotho and challenges met in the process. Statistics from the OECD show that official development assistance (ODA) in the period 2002-2009 has grown appreciably. ODA has primarily targeted social issues (i.e. health, education). AfT has received less emphasis, in a relative sense, and funding has mainly gone to infrastructure development, notably energy and road transport projects.

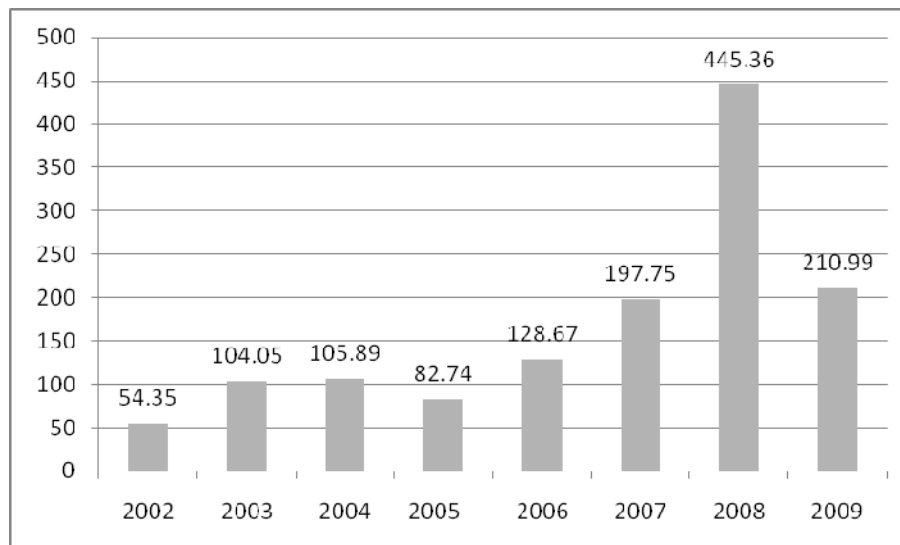
International trade and regional integration are fundamental elements for Lesotho's growth and prosperity. Experience with the garment manufacture highlights the potential of export growth for employment and poverty alleviation, but also how fragile this process can be when it is conditional on temporary tariff preferences and narrowly focused on one or more markets.

The EIF offers an important avenue to mobilize additional AfT support for Lesotho, particularly in the area of building productive capacity. Projects to assist Lesotho in building productive capacity have mainly been channelled through regional programmes at the level of the Southern African Development Community (SADC). The EIF can also offer valuable support to assist the government in mainstreaming trade into the new national development strategy.

### 1. ODA support to Lesotho

Official development assistance (ODA) offered by development partners to Lesotho has grown significantly since 2002. However a downfall was realised in 2009. According to figures reported to the OECD, ODA commitments to Lesotho increased from USD 48 million in 2002 to USD 210 million in 2009.<sup>1</sup> Figure 1 shows the trend in ODA since 2002.

**Figure 1: Official Development Assistance to Lesotho in USD millions (at 2009 current prices)**



Source: OECD Query Wizard for International Development Statistics

<sup>1</sup> OECD CRS, data is expressed in current prices.

In 2009, six development partners accounted for 83% of total ODA commitments to Lesotho: the African Development Fund, International Development Association, Global Fund, Ireland, the US and the EU. Table 1 shows donors active in Lesotho and the value of their ODA commitments over the period 2006-2009.

**Table 1: Donors active in Lesotho and their ODA programmes (2006-2009)**

Donor	Commitments (current USD millions)			
	2006	2007	2008	2009
<a href="#">Australia</a>	0.24	0.32	0.68	0.88
<a href="#">Austria</a>	..	0.14	..	..
<a href="#">Belgium</a>	..	0.12	0.01	..
<a href="#">Canada</a>	0.00	0.62	0.08	1.79
<a href="#">Denmark</a>	0.67	..	..	..
<a href="#">Finland</a>	..	..	..	0.17
<a href="#">France</a>	0.50	0.28	0.56	0.23
<a href="#">Germany</a>	4.34	13.58	2.75	6.31
<a href="#">Greece</a>	..	..	0.06	..
<a href="#">Ireland</a>	13.83	17.72	19.16	17.12
<a href="#">Italy</a>	..	..	0.07	..
<a href="#">Japan</a>	2.17	5.73	13.17	2.57
<a href="#">Korea</a>	..	..	..	0.09
<a href="#">Luxembourg</a>	..	..	..	0.31
<a href="#">New Zealand</a>	0.01	0.06	0.00	0.00
<a href="#">Norway</a>	0.74	1.36	0.60	0.13
<a href="#">Spain</a>	..	1.18	0.00	7.94
<a href="#">Sweden</a>	..	..	..	0.93
<a href="#">Switzerland</a>	0.15	0.18	0.52	0.27
<a href="#">United Kingdom</a>	4.26	0.11	8.04	5.67
<a href="#">United States</a>	3.50	33.81	325.23	34.39
<a href="#">AfDF</a>	..	23.57	..	16.96
<a href="#">EU Institutions</a>	24.48	60.56	40.39	5.57
<a href="#">GAVI</a>	..	0.06	0.46	0.33
<a href="#">GEF</a>	..	..	..	0.97

<u>Global Fund</u>	31.77	3.80	10.63	64.73
<u>IDA</u>	23.50	8.10	15.90	30.00
<u>IFAD</u>	..	8.69	..	..
<u>UNAIDS</u>	0.33	0.71	0.61	0.86
<u>UNDP</u>	2.59	2.94	1.64	1.91
<u>UNFPA</u>	0.55	0.83	1.25	1.45
<u>UNICEF</u>	1.12	1.99	1.14	1.36
<b>Total</b>	114.75	186.46	442.94	202.92

Source: OECD Query Wizard for International Development Statistics

## 2. Aid for Trade to Lesotho

Table 2 lists the aid for trade reported to the OECD. It shows that AfT as a proportion of total aid has varied significantly: moving from 35.9 % in 2007 to 10.6% in 2009. Furthermore, it highlights that AfT could be somewhat under-reported – various programmes with an AfT content (most notably the Millennium Challenge compact signed in July 2007) are not fully reflected in the OECD statistics. For example, the MCC Compact contains an important private sector development component. There may be similar under-reporting of activities for IDA, AfDB and the EU.

AfT to Lesotho in the period 2002-2009 has focused primarily on infrastructure development, in particular road transport construction and maintenance. Total funding for transport and storage accounted for 57% of total AfT between 2002-2009; adding energy projects (in particular electricity projects funded by AfDB in 2009 ) increases the amount of AfT spent on infrastructure to 70%. Funds have been channelled through the *Integrated Transport Project*, a joint initiative of the World Bank, European Union and Government of Lesotho for the period 2006-2012, which aims at fostering sector reforms, capacity building and civil work on new and existing infrastructure.

**Table 2: Aid for Trade commitments to Lesotho by sector, 2002-2009**

(in USD millions at 2009 current prices)

	2002	2003	2004	2005	2006	2007	2008	2009	Total
Transport & Storage	1.70	2.72	2.05	1.14	16.37	50.63	1.25	2.29	78.16
Communications	0.03	0.02	..	..	..	0.05	0.02	..	0.12
Energy	0.01	..	0.05	0.08	0.05	0.01	..	17.78	17.98
Banking & Financial Services	..	..	0.03	0.09	0.09	8.01	..	0.04	8.25
Business & Other Services	..	0.03	0.02	0.08	1.26	0.24	0.06	0.08	1.76
Agriculture	2.05	0.89	10.72	0.10	0.47	3.84	0.15	0.95	19.16
Forestry	..	0.01	0.17	0.10	0.10	0.14	0.12	0.10	0.72
Fishing	..	..	..	..	..	..	..	..	..
Industry	0.36	0.16	0.02	0.00	..	3.37	1.32	0.01	5.23
Mineral Resources & Mining	..	..	..	..	..	..	..	..	..
Trade Policies & Regulations	..	..	0.00	0.03	1.70	0.67	2.79	0.33	5.52
Tourism	..	..	0.09	0.07	0.22	..	..	0.02	0.39
<b>Total Aid for Trade</b>	<b>4.15</b>	<b>3.82</b>	<b>13.14</b>	<b>1.69</b>	<b>20.26</b>	<b>66.94</b>	<b>5.70</b>	<b>21.59</b>	<b>137.29</b>

Source: OECD

Overall, the statistics convey the impression that donor funding has tended to focus more on social expenditure, in particular HIV control, and less in relative terms on investment in building productive capacity to trade.

### **3. Aid for Trade to Lesotho in a regional context**

Analysis of regional programmes directed to the southern African region shows trade and trade-related issues have featured more prominently. One obvious reason for this is the economic growth and regional integration focus of these programmes and their focus on infrastructure development, human resources skills improvement and business support.

One on-going programme is the TradeMark Southern Africa (TMSA), a 5-year programme funded by the UK Department for International Development (DFID). TMSA's activities for the period 2009-2014, contained in its *Southern Africa Regional Aid-for-Trade Programme*, include trade facilitation, capacity-building and other aid for trade components. The programme also includes technical support for LDCs and the LDC Group in the framework of the WTO negotiations. TMSA is a successor programme to the Regional Trade Facilitation programme funded by DFID between 2003-09. DFID funding has also been channelled through the non-profit Trust ComMark that provides technical assistance in southern Africa. Between 2003 and 2009, ComMark ran the Lesotho Textile and Apparel Sector Programme. The ODI wrote a case study on this project in 2009.

USAID is also present in the region with the Southern Africa Trade Hub (SATH). The SATH works to promote the competitiveness of regional supply chains and provides further technical assistance, facilitation, and outreach for the countries in the region to take advantage of market opportunities available. In Lesotho, the USAID's trade hub has been successful in helping a Lesotho garment firm, Presitex, strike a deal with a South African knitting mill for the supply of inputs. The success story is regarded as a first step in building a competitive regional supply chain that would make growth and prosperity more sustainable for all southern African countries. The SATH has also concentrated its activities on improving customs legislation and processes and prepared an assessment of the status of trade facilitation in Lesotho.

At the regional level, UNDP also provides funding under the project *Trade Capacity Development for sub-Saharan Africa* for technical assistance activities aimed at developing African countries' human, institutional and policy capacity to effectively engage in trade negotiations and implement trade policies.

USAID's and ComMark's activities show that good results can be achieved where targeted action is undertaken in support of trade development activities. More such programmes are needed, particularly in view of Lesotho's AfT needs, discussed in the next section. It is suggested that these regional initiatives should be complemented with more such assistance targeting directly Lesotho's national needs and priorities through national projects. The EIF can play a critical role in this regard.

### **4. Lesotho's Aid for Trade Needs**

Lesotho is a small, landlocked, least developed country, characterized by limited natural resources and a labour force with a low skills base. Since the 1970s, Lesotho has been moving away from a traditional dependence on agriculture towards the mining, manufacturing and services sectors.

Various studies of Lesotho's economy highlight that it is performing below its potential. Lesotho's landlocked status, inadequate infrastructure, low human capital, narrow production base and partial integration into the regional economy are among the factors that hamper Lesotho's competitiveness in the region and internationally. It remains highly vulnerable to external shocks, as evidenced by the impact of the current economic crisis.

In 2002, the government formulated a plan for long-term development contained in *Lesotho Vision 2020*. Within the framework of this overarching long-term plan, a Poverty Reduction Strategy Paper (PRSP) was prepared - a document which is currently being updating. The Government of the Kingdom of Lesotho has just launched preparation of the Seventh National Strategic Development Plan 2012/13 – 2016/17. The present Strategic Development Plan marks, as point of departure, the need and urgency for Lesotho to radically transform its economy, intellectual and skills profiles by taking advantage of its location and defining a future that is characterised by the capacity to produce goods and services for the large Southern African markets, the African continent and global markets. The Plan puts the emphasis on promotion of peace, democracy and good governance, pursuit of high, sustainable and equitable economic growth, poverty reduction through employment creation and reduction of social vulnerability; protection of the environment and promotion of climate friendly technologies and practices; promotion of HIV/AIDS prevention, care and treatment; and radically transforming technical, vocational and higher education to produce world class skills and expanding access to technology applications, innovation and networks., improved agricultural production, food security and development of basic infrastructure. The proposed pillars of the Plan – employment creation & income generation, health & education, improved governance & public sector performance – reinforce the notion that economic growth, accompanied by better-quality health, widespread education and public sector reforms, is the precondition for achieving poverty reduction, improved quality of life and sustainable development.

Lesotho faces a series of short to medium terms challenges and a series of long-term structural constraints. Short to medium challenges include declining public revenue as a result of falling receipts from the Southern African Customs Union (SACU) and uncertainty regarding continuity in market access for textile exports to the US market after the expiry of the current African Growth and Opportunity Act (AGOA) provisions in 2015. Longer term structural constraints include the low skill base, the impact of HIV/AIDS and making the business climate more favourable.

Lesotho's experience in the garment industry show both how international trade can be an important driver for economic growth, employment and poverty alleviation. Given a limited domestic market, garment manufacture developed on the back of production for export markets, driven by investment from Asia. Duty-free, quota-free market access opportunities through the African Growth and Opportunity Act (AGOA) have played an important role in this regard, notably relating to third country fabric provisions. Rates of growth have been impressive: averaging 8.9% for the period 1990 to 1999, and touching a high of 33.1% in 2004.<sup>2</sup> Income generated by the manufacturing industry led to a reduction of the percentage of the population living below US\$1.25 a day from 48% to 43% between 1995 and 2003.<sup>3</sup>

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<sup>2</sup> Data computed from the World Bank World Development Indicators.

<sup>3</sup> World Bank World Development Indicators



However, the garment industry is also an example of how fragile growth is when it is too narrowly based and too focused on one main market (i.e. the US). Since 2005, the garment sector has faced greater competition from Asian suppliers in the US market as a result of the end of the WTO Agreement on Textiles and Clothing. Appreciation of the Loti against major currencies has aggravated this situation. The preferential conditions under which Lesotho exports to the US are temporary: AGOA will expire in September 2015, while the third country fabric provision, which has allowed garment firms in Lesotho to import fabric from the Far East, is due to expire in 2012. The expiry date on these preferential programmes represents a serious challenge for Lesotho.

The ODI case story concludes that: "Lesotho's textile and apparel industry remains in a precarious position, as attempts to diversify the markets for textile and apparel exports have seen limited success. Reliance on the US market renders Lesotho's textile and apparel industry vulnerable to changes in the international trade environment (e.g. removal of AGOA preferences in 2015, falling demand in the US)." *ODI, 2009*

Despite the Government's commitment, Lesotho's ability to implement its development objectives has been hampered by human, financial and administrative capacity constraints. This is also the case when it comes to mainstreaming trade into the national development strategy and designing operational objectives. This is why the government of Lesotho places so much importance on the Enhanced Integrated Framework.

## **5. The Enhanced Integrated Framework and Future Aid for Trade Support**

Lesotho acceded to the IF in 2003. As the first step in implementation of Lesotho's IF programme, a Diagnostic Trade Integration Study (DTIS) was prepared by the World Bank, as lead agency, in cooperation with the Government and the other five IF Core Agencies<sup>4</sup>. The DTIS sought to identify the constraints that Lesotho faces in integrating into the multilateral trading system and the global economy, and to draft an Action Matrix, a set of priority recommendations for policy actions and technical assistance implications. The revised draft DTIS for Lesotho was submitted to the Government in January 2003. A national workshop was convened for 12 February 2003 to discuss the DTIS with all the agencies involved and the IF Donor Facilitator for Lesotho (the United Kingdom).

The DTIS identifies five major challenges for Lesotho: the pervasive level of poverty, especially rural poverty; the HIV/AIDS pandemic which affects mainly the economically active population; the lack of positive spillovers so far from investment by foreign firms in the garment industry, and their low contribution to tax revenue; the mounting pressures on infrastructure caused by the rapid development of the clothing sector; and the risk that the preferential advantages that Lesotho currently gains under AGOA and the that time quota structure of the Agreement on Textiles and Clothing (ATC) may evaporate.

The DTIS identified a number of parallel, and mutually reinforcing, trade policy strategies for Lesotho. First, it calls for the active pursuit of gains from Lesotho's participation in regional trade agreements: the focus is to be on the reduction of the "costs of trading" with South Africa and other SACU partners through the removal of various remaining barriers to trade and to movement of

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<sup>4</sup> These are IMF, ITC, UNCTAD, UNDP and the WTO.

capital and labour within SACU, and the alignment of tax and regulatory conditions on the South African norms. Second, the DTIS suggests that Lesotho can use its integration in the SACU region as a springboard to greater integration into the world economy, *inter alia* by using the new, democratic SACU structure to encourage greater liberalization of the common external tariff and to limit non-tariff barriers, as well as encouraging regional cooperation on trade-facilitating measures. Lastly, the study urges Lesotho, as a sovereign entity, to take actions aimed at improving its investment climate for foreign and domestic investors, by removing various administrative barriers impeding the conduct of business activities

With the assistance of the UNDP and the DFID as main donor, some of the priorities identified under the IF have been addressed. Between 2006 and 2009, UNDP has implemented the Integrated Framework for Trade project, which aimed at building national capacity to formulate and implement effective trade and investment strategies for poverty reduction and wealth creation. DFID has also been active in addressing the concerns and weaknesses raised in the DTIS and in supporting the country in the implementation of its PRS in the fields of job creation and food security.

The World Bank addressed the issue in the IF matrix related to the improvement of the business environment and economic diversification in Lesotho with the 5-year Private Sector Competitiveness and Economic Diversification project. The project's components include SME support, export development and competitiveness, as well as regulation issues and reviewing of licensing and companies registration policy. Important funds have also come from the Millennium Challenge Corporation (MCC) and the European Commission. IF Window II funding also went to the development of two projects: the Product and Market Development of Agro-based Products implemented by the ITC and a project for the implementation of effective trade and investment strategies.

Most recently, a Tier 1 project approved in January 2010 has incorporated guidelines and recommendations contained in the DTIS. The first priority of this project will be to help Lesotho to update its DTIS so that a new list of priorities is identified. Secondly, the project can support Lesotho to integrate these priorities into the new strategic plan currently under preparation. Since the latter has a clear time-frame, the DTIS update should be fast-tracked and synchronised with the strategy time-table. This should help include trade as an important element of the dialogue with donors. In addition, through the EIF's Tier 2 resources can also be made available for priority projects to complement the regional programmes

## **6. Conclusions**

Lesotho has many pressing Aft needs. These are exemplified by the garment industry where the temporary nature of trade preferences provided by the US poses a challenge for the survival of the sector. Securing trade preferences and ensuring that production can be diversified away from dependence on the US market are essential trade policy objectives which Aft can help support. Making Lesotho less highly vulnerable to external shocks, such as that experienced in 2009, is a major policy objective.

This review of Aid for Trade in Lesotho indicates that there was a tendency by donors to focus on challenges in the social sector through their ODA between 2002-2009. ODA offered for Aft

objectives has focused primarily on energy and transport infrastructure. AfT provided at regional levels has tended to offer more assistance in the area of productive capacity.

The EIF is a key programme for Lesotho. It offers a way to overcome challenges related to mainstreaming trade into the national development strategy. It also offers a route through which to mobilize further AfT support particularly in the area of building productive capacity, with the goal of lessening Lesotho's economic vulnerability and generating employment outside of the agriculture sector.

#### **List of references**

*Lesotho DTIS, 2003*

*Lesotho Vision 2020, 2002*

*Poverty Reduction Strategy Paper*

OECD Query Wizard for International Development Statistics