A Comparative Study on the Role of Institutions in Promotion of Foreign Direct Investment: The Case of Lesotho and Mauritius

By

BANDA, Elita

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF DEVELOPMENT POLICY

2015

A Comparative Study on the Role of Institutions in Promotion of Foreign Direct Investment: The Case of Lesotho and Mauritius

By

BANDA, Elita

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF DEVELOPMENT POLICY

2015

Professor Jong-Il You

\

A Comparative Study on the Role of Institutions in Promotion of Foreign Direct Investment: The Case of Lesotho and Mauritius

By

BANDA, Elita

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF DEVELOPMENT POLICY

Committee in charge:

Professor Jong Il YOU, Supervisor

Professor Jung Ho YOO

Professor Seung Joo LEE

Approval as of July, 2015

Abstract

Resource poor countries depend on international trade for economic and social development. Countries that do not have domestic exporting industries attract foreign investors to help start and grow such industries. Together with integrating an economy into the world market, foreign direct investment (FDI) brings with it a number of other spillovers such as; technology and know-how transfers and human capital enhancement. These spillovers, however, do not happen automatically. They depend much on the domestic environment and the types of institutions present to facilitate the spillovers into the domestic economy. Mauritius; a country seen by many as an African success story, made a lot of economic and social gains from its textile exporting industry which came into the country through foreign direct investment. It ranks 1st on the African Governance Index and has one of the highest per capita GDP in Africa. Much of Mauritius' success is attributed to the quality of its institutions. Lesotho; a least developed African country received foreign investments in the textile industry around the same time Mauritius did. However, today the situations in the two countries are very different. This paper takes a comparative look at the two countries to see what roles institutions played in facilitating spillovers from the foreign owned textile industries. We see that in Mauritius much effort was made to facilitate exports through the creation of an export processing zone (EPZ), to enhance human capital through vocational training and to facilitate the domestic ownership of the textile industry. When we examine the case of Lesotho we find that there is little if any local ownership of the industry. Learning and Vocational training infrastructure that feeds the needs of this industry is non-existent and efforts to promote entrepreneurship to create linkages have since failed. This lackluster performance, this paper attributes to the type of institutions that prevail in

Lesotho, extractive political and economic institutions that do not work for the benefit of the country and its people.

Table of Contents

CHAPTER 1

1.1 Introduction

The kingdom of Lesotho is a small, mountainous country completely surrounded by its neighbor, South Africa. It gained its independence from Britain in 1966. Covering an area of 30,355 square km, Lesotho has a population of 2.074 million (World bank 2013) and is a least developed country (LDC) with a per capita income of US$1074.85 (World Bank 2013), it ranks 162 out of 187 countries in the UNDP Human Development Index (UNDP 2014) and has a youth unemployment rate of 35% (UNDP).

Food insecurity, Poverty, unemployment and HIV/Aids are major development challenges. Even though it is located in the center of South Africa, Africa's second largest and most sophisticated economy, Lesotho has not been able to take advantage of this opportunity and is heavily dependent on South Africa for employment, Education, and government revenue (NSDP 2012,1).

Diamonds, Water and a breathtaking mountain landscape, with potential for tourism, are amongst Lesotho's few exploitable natural resources. The manufacturing sector, driven mainly by the textile and Apparel industry has been the main driver of growth and job creation over the past years. Its contribution to GDP rose from 10.4% in 1999 to almost 16 percent in 2011(lesothoreview 2014) and it is the largest private employer.

Lesotho's textile and Apparel industry which existed since the early 1980's (LTEA) saw a great increase in exports upon the enactment of the United States' African Growth and Opportunity Act (AGOA) in 2000.

The non-reciprocal preferential trade agreement offers duty and quota free access for goods from 40 Sub-Saharan African (SSA) countries. Together with the Generalized System of Preferences (GSP), under the World Trade Organization (WTO), together with the GDP, AGOA offers preferential access for 6400 products into the United States market from selected SSA countries, including Lesotho. Lesotho gained eligibility on 23 April 2001.

Although the textile and Apparel industry, owned by Taiwanese foreign investors, saw a major increase in exports and contributed significantly to GDP and employment, it failed to contribute to the sustained development of Lesotho's industry. There has been a limited spillover effect to the rest of the economy. No transfer of technology, skills and know-how at the managerial level and no sustainable linkages with local firms which can lead to Basotho establishing their own factories and exporting to international markets.

The textile and Apparel industry offers a monetary and employment contribution to Lesotho's economy. In 2011 textiles contributed 16% to GDP (Lesotho investment review) and the industry is the largest employer out doing the public service (LTEA). 30% of Apparel from SSA to the United States came from Lesotho, making it the largest SSA exporter to the U.S. surpassing large exporters such as Kenya and Madagascar (Manoeli 2016, 11). This has been a great achievement for Lesotho although it has depended on foreign investors seizing the opportunity of preferential access to large markets such as that of the United States.

AGOA is due for renewal; however, major changes need to take place if Lesotho is to make full use of the benefits that arise from trade and FDI under preferential trade access to major world markets. The textile industry has been the main industry in Lesotho; its experience has shown

that more needs to be done if Lesotho is to build industry that will benefit the country in a sustainable manner.

Lesotho is not alone in its quest to develop though industrialization, particularly through the textile and Apparel industry. Countries such as Swaziland, Madagascar and Kenya have tried the same with limited success (Chemengich 2010). A real success story however, has been that of Mauritius; an island state covering an area of 2040 square kilometers. Its performance has been likened to that of countries such as South Korea and Taiwan (The Asian tigers). Mauritius like the Asian tigers was able to not only achieve high growth rates, but also achieve high standards of living for its population. With a GDP per capita of $9202.58, Mauritius has an unemployment rate of 7.5% (statsmauritius, 2014), and it ranks 80 out of 187 countries on the UNDP Human Development index (UNDP 2014).

Mauritius' success in this regard has been attributed to the creation of an Export Processing Zone (EPZ) that helped ward off inequality by creating jobs and bringing in much needed revenue. Most importantly, the role that government institutions played in facilitating Foreign Direct Investment (FDI) and promoting trade (Subramanian, 2009). This paper studies domestic institutions in Lesotho to determine whether they are truly responsible for the lackluster performance in FDI facilitation and trade Promotion.

1.2 Statement of Problem

Lesotho as a least developed country (LDC) has had preferential access of its trade goods to a number of countries including Canada, Australia, Japan, the European Union and the United States through the Generalized system of preferences and other non-reciprocal preferential trade agreements since 1971 (WTO). Lesotho is member to 16 preferential trade agreements listed in

the WTO. However the country has not been able to fully integrate itself into the world market, despite these preferences. With the provision of AGOA, an act by the United States congress to allow quota and duty free access to products from Sub-Saharan countries, Lesotho has been able to significantly increase the volume of trade goods to the United States. For a country limited in resources and trying to develop through industrialization, this has been a very good step. However, export goods to the United States are limited to textile and Apparel products. The factories within the country that produce these products are Foreign owned textile firms and there has been little, if any, local ownership of the textile and Apparel industry. The monetary benefit gained from the industry is the remuneration of workers as well as the payment of utilities and overhead costs (Manoeli, 2013). This increase in export has not led to substantial, sustainable economic and social economic growth. Trade preferences under AGOA are due to expire in September 2015. Questions arise on whether Lesotho's textile industry, with the renewal of AGOA, will really be able to take advantage of non-reciprocal trade agreement to bring about much needed growth and development for its people. This study looks at the case of Mauritius, which has been exemplary in using trade to bring about economic and social development. Based on a comparison to Mauritius, a country that fared well under AGOA and other preferential trade agreements; it will extract lessons and give policy recommendations on how Lesotho can better use trade preferences to further development goals.

1.3 Importance of the Study

Lesotho is a small Least Developed African country that has its land totally boarded by its neighbour South Africa. The country does not have an abundance of natural resources and the economy has in the past relied heavily on remittances from workers in South African mines. A lot of Basotho have returned as South African mines prioritize employing locals. Young Basotho

are looking for Jobs and the unemployment rate was recorded at 35.4% (ILO 2008). Lesotho needs to improve its economic situation and get out of the Least Developed Country status. This I believe can be done through a proactive approach to development. Creating, implementing an evaluating the impact of policies so as to take advantage of the world trade market and reap some gains for the domestic market. This study sheds light on why Lesotho has been unable to achieve sustainable development in the trade industry by comparing with the case of successful Mauritius and derives from it lessons to be learnt by Lesotho; its Government and the private sector in order to bring about sustainable economic and social growth through trade by utilizing non-reciprocal preferential trade agreement.

1.4 Purpose of the Study

The purpose of this study is to

- Find out the role that institutions in Lesotho have played in promoting, facilitating and regulating foreign direct investment so that it benefits and grows the country in a sustainable manner

1.5 Research Questions

Based on the problem put forward in this paper, the research will pay attention to the following questions:

1. What role has institutions within Lesotho played/not played with regard to promoting, facilitating and regulating FDI

1.6 Hypothesis

1. **Inclusive Institutions can help reap the benefits provided by Foreign Direct Investment.**

Empirical evidence showing a conclusive direct link between Foreign Direct Investment and economic growth is hard to come by, however, a multitude of studies indicate that provided a host country has appropriate policies, FDI can produce benefits such as; technology spillovers, aiding human capital formation, contributes to international trade integration, creating a more competitive business environment and enhances enterprise development (OECD 2002,5). The benefits of FDI, in this case, do not come automatically. Simply attracting FDI to a host nation does not guarantee the above mentioned benefits. Host countries are advised to develop sound institutions (Nunnerkamp and Spatz; 2004) that can produce a good policy regime to maximise the benefits presented by FDI. And it is based on this approach that this paper makes the above mentioned hypothesis

CHAPTER 2

2.1 Literature Review

2.1.1 Introduction

Lesotho's textile industry has existed since the 1980s. Textile exporting firms are mostly foreign owned. The African Growth and Opportunity Act (AGOA) came into law in the United States in the year 2000. Since then, Lesotho's textiles exports have grown at a remarkable rate making Lesotho the largest Sub-Saharan African textile exporter to the United States (Lall, 2005). This has benefited the country in terms of income and employment.

The benefits gained however, have been very shallow. Lesotho is a country with limited natural resources. Growing a sustainable export industry seems a great opportunity to strengthen Lesotho's growth economically and raise the standard of living of its citizens. Mauritius, a fellow sub-Saharan African country has been able to achieve this. Limited in natural resources and relying on preferential trade treatment, foreign direct investment as well as strong inclusive institutions the country has been able to achieve unprecedented economic development.

In order to understand why Mauritius has come to be the exemplary African success story, we need to understand the role that each of the stated success factors can play in the quest for economic development. Examining modern literature on the subjects, first we will look at the Role of Foreign Direct Investment and its spillover mediating factors, followed but the role of institutions then the trade and the role that institutions play in trade facilitation

2.1.2 Foreign Direct Investment and Economic Development

The role that Foreign Direct Investment (FDI) plays in the economic development of a host country has been a largely argued subject matter. There have always existed views for FDI and those against it. Those who argue for FDI say that it leads to economic growth through increased productivity which leads to benefits in the economy as a whole. However, those against it stress the risk that FDI poses. FDI some say: "destroys local capabilities and extracts natural resources without adequately compensating poor countries" (Velde 2, 2006).

However, in recent years, countries have come to view FDI in a more positive light. They even go as far as establishing national FDI promotion agencies in order to attract FDI. This is done with the belief that FDI contributes to development because of the technology and capital it provides (OECD 3, 2002). The benefits of FDI are also seen as increasing employment, income and foreign exchange.

As countries take a more positive view towards FDI, researchers on the matter have come to not only view the role of FDI as negative, or positive. Rather, the impact that FDI has on a host country's economy has attracted more focus. There has also been increased awareness of the role that policies play in facilitation FDI and growth (Velde 17, 2006). Velde (2006) also writes; " General and specific policies in areas covering investment, trade, innovation and human resources are now seen as crucial in affecting the linkage between FDI and Development. While FDI is often superior in terms of capital and technology, spill over to local economic development is not automatic. "

In this chapter, we review from existing literature the mechanisms by which FDI leads to sustained industrial development. We also identify the role that institutions play in reinforcing or obstructing these mechanisms.

Past the initial macroeconomic (investment capital, export and foreign exchange earnings, and tax revenue) boost that investments from foreign entities bring to a host country, FDI can "allow the creation of entirely new production possibilities for a host country" or "all the country to use its resources more efficiently in carrying out activities already present in the economy" (Moran, 2005) which can lead to sustained industrial development.

This increase in domestic capacity is brought about by: 1) the transfer of technology and know-how 2) human capital enhancement 3) integration into the global economy 4) creating a more competitive business environment (Lall & Narula; 2004) (OECD; 2002).

2.1.2.1 Transfer of technology and know-how

The transfer of technology and know-how is perhaps the most important of the mechanisms as it is able to increase productivity and competition levels of domestic firms. Foreign firms normally possess more advanced production technology and know-how then domestic firms. Although they might not be familiar with the domestic market upon entry, foreign firms are still able to operate on a cost curve that is lower than that of the domestic firms because of their more advanced technologies. Technology can be transferred from foreign firms to domestic firms through horizontal or vertical transfers (spillovers).

A horizontal transfer of technology is when technology and know-how from a foreign firm is transferred to local firms within the same industry. This can occur through who channels; labour turnover or the "demonstration effect". A skilled worker from a foreign firm can join a local firm

and share the superior knowledge gained from working in the foreign firm. The worker can also open up his own firm and use the knowledge gained from working at the foreign firm. In order to inhibit the transfer of their superior technological know-how, foreign firms can raise employee wages (Fosfuri et al,. 2001). In that way employees are encouraged to join or stay in foreign firms because of the higher wages in comparison to local firms or the burden of starting up. Domestic institutions also restrict the transfer process if strict laws concerning labour mobility are put in place (Crespo & Fantoura, 2006).

The "demonstration effect" takes place when locals adopt the technologies and know-how of foreign firms. Local firms realise that such capability and knowledge is useful and therefore imitate it or it is demonstrated by foreign firms (Crespo & Fantoura, 2006). However, the effectiveness of this channel or transfer depends on the similarity of the products produced by foreign and domestic firms (Barrios and Stoble, 2002) and the absorptive capacity of local firms. Absorptive capacity will be discussed later on in the chapter.

Vertical spillovers occur though backward and forward linkages. A backward linkage is formed when established domestic firms locally produce and supply foreign firms with the intermediate inputs they require (Hirschman, 1958). If foreign firm procure intermediate inputs from local suppliers, they might have incentive to provide technical assistance and share knowledge with them so as to improve the quality of the supplied goods (Blalock & Gertler, 2005). An increased demand for intermediate inputs from domestic firms by foreign firms can also allow the domestic firms to realise economies of scale and therefore become more productive in their operations (Crespo &Fantoura, 2007). Competition may arise between domestic firms looking to supply inputs to foreign firms. If this competition leads the firms to be more innovative, that's yet another gain for the domestic industry.

Similar to the demonstration effect, the absorptive capacity of local firms is also important when it comes to backward linkages.

Forward linkages take place when a domestic firm uses the out puts of a foreign firm as its inputs (Hirschman, 1958). In this way the productivity of local firms can be increased. However, this depends on the foreign firms producing goods of a high quality or offering goods at a lower price or both (high quality, low price) Markusen &Venables (1997). Whether foreign firms are looking to sell their products domestically or export the products is a factor in this kind of linkage. The anticipated spillovers might not be realised by local firms if the foreign firm is aiming their product toward other markets.

In all, transfer of technology and know-how through FDI can have a positive impact on domestic industry by creating linkages and spillovers. This can help increase productivity, encourage creation of more industries and benefit local customers through better quality products and/or lower prices. However, this diffusion of technology and expertise depends on a number of factors: the ability of domestic firms to absorb them, domestic institutional factors e.g.: labour mobility laws, and the motivation of foreign investors to share know-how and also to supply products to the local market.

2.1.2.2 Human Capital enhancement

The relationship between human capital enhancement and FDI is a complementary one. In as much as foreign firms are able to provide training, share information and bring in new skills and technologies, a highly skilled labour force can determine the amount of FDI that a county can attract (OECD, 2002). Michie (2001:4) identifies the direct and indirect benefits of an enhanced labour force as: 1) Higher productivity and profitability as a result of increased capacity to

perform tasks, 2) workers are better equipped to absorb and utilize both the codified and tacit knowledge gained through working in foreign firms, and 3) improved willingness, commitment and motivation of employees to deliver greater productivity. According to (Rothwell and Dodgson; 1991) a highly skilled works are more likely to form relationships with other individuals outside of their firm who have similar competencies, thus improving the likelihood of linkages.

Like technology transferring spillovers, spillovers that enhance human capital do not occur automatically. (Blomstorm and Kokko; 2003) in a paper on government's foreign investment policies emphasize that; they (governments) should support learning and innovation. They should also create incentives for foreign and local firms to engage in activities that promote linkages between firms, training, education and Research and development (R&D).

When investigation the role of human capital in economic development, (Hanushek; 2013) finds that quality of education rather than quantity plays a part in contribution to economic development. He discovers that educational policies that focus on quantity leave the population incompetent in terms of international skill levels. Upon finding that the effect of FDI on economic growth is a positive one, however, not by means of human capital accumulation, (Adefabi; 2011) suggests that the type of education could be of more importance.

The health of the labour force is also crucial. A healthy work force is more productive and better positioned to learn new things. (Majeed and Ahmed; 2008) find that health expenditure has a positive and significant effect on FDI flows.

2.1.2.3 Economic Intergration

Some of the important dimensions of globalization and global economic integration are that of trade in goods and services, movement of capital, integrated financial markets and human migration (Mussa, 2000). The role that trade in goods and services play is particularly significant as it means that once a country is integrated through trade, it is able to share in the international division of labour and benefit from the gains made.

However, few local firms in developing countries have the skills and resources needed to manage international markets, distribution and servicing of products, which is needed to enter foreign markets (Bloomstrome & Kokko; 1996). Foreign firms can help the domestic economy integrate into the world economy by what is termed the "Export Effect" or "trade effect". The effect on local exporting capacity can either be a direct or indirect one. Directly, the host country's export capacity is increased by the foreign firms, themselves, exporting. The export oriented production of foreign firms in host countries can be divided in the following way (Athukorala 2006:6):

- Resource-based manufacturing
- Labour intensive final consumer goods
- Assembly processes within vertically integrated global production systems

On the first bullet; foreign firms may be at a better position to export local resources than local firms because of their international business contacts, marketing skills, superior production and processing technology and general know-how (Bloomstrome &Kokko; 1996).

Secondly, the results on the role that foreign investors play in aiding produces of labour intensive good to exports to international markets is a controversial one (Athukorala 2006) as it is observed that labour intensive domestic industries are more than capable of exporting goods themselves as was the case of the Newly Industrialised Countries , (NICs) of South East Asia (ibid). However, Bloomstrome & Kokko (1996) in this case, the role that foreign firms play may be understated. Entering foreign markets requires setting up distribution channels, keeping in touch with rapid changing consumer tastes, mastering industrial norms and safely standard technicalities and building up product image. Skills which local firms do not readily have and can only gain through affiliating with foreign firms.

Lastly, in response to increasing wages in their home country and other factors that can increase costs of production, firms may decide to transfer component assembly operations abroad. This happens mostly in industries where the technology of production allows the breaking up of labour-intensive production processes from other stages of production (Athukorala 2006). Operations are set up in a foreign country and components are exported to other international firms, thereby increasing the export capacity of the FDI recipient country.

Foreign firms can also indirectly affect the export capacity of a local economy. Through increased competition local firms will either be forced to increase their productivity or to exit the industry. Should productivity increase, they might grow to a point where they are able to export to foreign markets. They can also gain exporting capacity by observing how foreign firms operate. Information about foreign markets can also be attained from foreign affiliates. (Atkin, Hanson and Harrison; 1997) posit that local firms located in close proximity of each other are best able to observe and learn exporting know-how from other firms. They suggest that local

firms should be in close proximity to multinational firms in order to gain exporting expertise from them.

2.1.2.4 Competition Effect

The competition posed by foreign firms when entering a domestic industry can either have a positive or a negative effect on local firms in the industry. Due to their superior productivity, foreign firms can lead local firms to losing their market share and thereby be driven out of an industry. However, firms that stay on can become more innovative, more efficient and more productive in their operations so as to compete with foreign firms and other local firms (Bloomstome & kokko, 1996). The total effect of competition or the direct of the effect is unclear as it could either be negative or positive. However, Caves (1971) posits that entry of a foreign firm is more likely to bring about more competition and improvements into an industry than a domestic entry at the same initial level.

All in all, there are great productivity gains to be made by a host country economy through foreign direct investment. The gains can lead to sustainable development and growth that can benefit the whole country. However, these productivity spillovers from FDI do not come automatically. The next section will look at the FDI spillover determining factors.

Mediating Factors

Substantial spillovers from FDI do not happen automatically. Numerous researchers agree that if FDI is to produce a significant, sustainable impact on a country's economic growth and development, there needs to be certain mediating factors in place (Thomas and Winkler, 2014, Straritz and Morris, 2013, Jovorcik and Spatareanu, 2008, Numennkamp and Spatz, 2004 and OECD 2003). These factors can be divided in three parts, namely; the characteristics of the

foreign firm, the characteristic of domestic firms, as well as, host country factors and Institutional framework, which are the focus of this study.

2.1.2.5 Foreign firm Characteristics – FDI Spillover potential

The characteristics of the foreign firm play a role in determining its spillover potential to the domestic economy. Blomstrom, Globerman and Kokko (1999) think of spillover potential in the traditional market demand and supply context. With regard to the supply side (whether foreign firms will be willing to "supply" positive spillovers to the domestic market) engaging in activities that promotes technology spillovers depends on the cost to be incurred by the foreign firm. If the foreign firm stands to benefit from sharing technology with domestic firms, the less protective the firm will be of its technology. Benefits may be; the foreign firm stands to gain more valuable technology from the host country, it can promote realization of economies of scale and scope in Research and Development (R&D) activities, in some cases host governments may provide advantages to the foreign firm's domestic affiliates that are potentially worth more than the transferable technology belonging to the firm. However, if the firm stands to incur a loss due to the diffusion of technology to the host economy then the firm will choose not to engage in technology sharing activities and will in fact protect its technology by, such as, hiring top level managers from their home country to avoid local managers taking their technology to competing firms in exchange for higher pay and/or better working conditions.

Degree and structure of Ownership

There are a number of ways in which foreign firm characteristics influence spillover potential. One of those ways is the degree of ownership. Using a sample of 3732 firms operation in Greece in the year 1997, Dimelis and Louri (2001) found that small firms with minority foreign

ownership produced more spillovers than larger, majority foreign owned firms. Another study by the same authors showed that a higher share of foreign ownership has a positive correlation with the firm's incentive to transfer knowledge. Abraham, koning and Slootmaekers (2006) support this with a study done on the Chinese manufacturing industry; they conclude that foreign owners are less likely to transfer knowledge to Joint- Ventures where they have limited control over management.

FDI Motive

Another aspect that affects spillovers is the motive of the foreign direct investor. Dunning (1993) classifies the motives as follows, depending on the nature of the advantages a foreign firm is seeking; Resource seeking, Efficiency seeking, Market seeking and Asset seeking. Each of these motives has a certain potential for spillovers on to the local economy. Research has shown that foreign investment that seeks to exploit a country's natural resources tends to have a negative effect on the county's growth Alfaro (2003). Resource seeking FDI's low spillover potential is due to its high capital intensity and limited involvement with the local market. However when looking at investment in agriculture across African counties Gerlash and liu (2010) found that in some countries such as Morocco, Uganda, Ghana and Egypt positive spillovers were observed in areas such as technology transfer, Infrastructure development, job creation and productivity output even though the Multinational firms were producing for their home markets.

Market Seeking FDI, particularly in the retail sector, is seen to have a higher potential for spillovers as retailers look to source from the local market. The potential of these spillovers however, depend on the capabilities of local suppliers as well as the support they get from local institutions (Farole, Starliz and Winkler 32, 2014).

Asset Seeking FDI seeks to utilize the technology or the skills embedded within a country. This kind of investment has a high potential for sustainable spillovers because of the close relations it creates with local suppliers, customers and workers. Chen (2004) found that Taiwanese firms investing in the U.S were more active in promoting local linkages than in the host country than were their counterparts in South East Asia and China. This he argues is due to the fact the U.S offered more strategic and knowledge resources than those available in the home country.

Efficiency seeking FDI is often associated with the manufacturing industries. The spillover potential efficiency seeking FDI is seen as being higher with relation to Resource seeking FDI. This high potential is due to its labor intensity, the need for different goods and service inputs, and its low barrier to domestic forward linkages Farole and Winkler (2014). An increase in high value added manufacturing has been instrumental in transforming production structures in several East Asian countries since the 1960s says Willem te Velde (2006). However, this kind of FDI also has "resource seeking" characteristics explain Farole and Winkler, as MNC go to certain countries mainly to utilize the cheap, uneducated labor.

Global Production and Sourcing strategy

The production and sourcing of a foreign firm affects its spillover potential greatly. Unlike local firms that use local input, foreign firms leverage functions, skills and expertise from their head offices located in their home countries and/or other foreign production plants. The kind of operation that takes place in a given location is based on how that location fits in the Companies' Global Production Network (GPN). Therefore, the role locations (particular foreign firm in a host country) have in the production network of foreign firms is a determinant of the spillover potential that firm has in that country (Morris et al 2011). In Lesotho for example, Staritz and

Morris (2013) identified two types of foreign investors in the textile industry; Taiwanese investors and South African investors. The Taiwanese firms who keep their higher value added operations in Taiwan concentrate more on wage costs, lead times and speed delivery, and have brought limited improvements since their arrival. The South African investors however, are interested in moving their production function from South Africa to take advantage of the geographic proximity to their major market and lower labor costs in Lesotho. They have a high spillover potential as they take skills and capacity development more seriously.

Technology Intensity

The technological intensity of the goods or services produced by a foreign company a host country has an effect on its spillover potential to the specific country. Gorg, Hijzen and Marukozy (2009) found that in Hungary, the potential for spillovers was very much related to the production technology of the sectors and the foreign companies. The average production technology of foreign plants determined its spillover potential. In Global Value Chain organized production it is often the case that knowledge-Capital intensive (High- tech) processes are geographically separated from the labor intensive (Low-tech) of the same product (Plank and Staritz, 2013).

FDI home country

The country from which an investing firm comes from has an effect on the production strategy pursued by the firm and the technology used in host countries therefore having an effect on the firm's spillover potential The country of FDI origin has a weight on managerial practices and cultures which determine whether investors will engage in employee training and skills development as well as using expatriates or local to fill management positions. Farole and

Wikler (2014) , Catteneo, Gerreffi and Strautz (2011) Also state that it is common for end-market segmentation to occur due to historical, cultural, language as well as trade policy reasons.

Entry Mode

The entry mode influences the extent or pace of FDI induces benefits for local firms Farole and Winkler, (2014) Research has found that Joint Ventures (JVs) bring about more local linkages than wholly owned subsidiaries Farole and Winker 2014, Chen Chen and Ku (2004). This is according to Javorcik and Spatareanu (2008) because Joint Ventures may face a lower cost if finding local suppliers of intermediates and thus be more likely to engage in local sourcing from wholly-owned foreign subsidiaries.

Length of presence

There also exists the notion that foreign firms need to be in a host country for some time so that local firms can learn and apart new technologies from foreign firms (Crespo and Fontura, 2007). Firms that have been in a country longer may also get to know the context of the country better and be able to identify local suppliers and labor skills (Farole and Winker 2014).

2.1.2.6 Domestic Firm Characteristics - Absorptive capacity

In as much as the foreign Direct Investment coming into a host country needs to have the potential to provide spillovers to the local economy, the host countries needs to have an environment that's able to take in the capital, technology and know-how of foreign firms and convert them into benefits for the county's economy. This is defined by academics as the Absorptive capacity of local agents. As mentioned before the relation between FDI and growth is ambiguous, however, macroeconomic studies show that FDI may speed up growth conditioned

on the absorptive capacity of the host country (Farkas, 2012). This capacity which is the maximum amount of FDI a host country can assimilate or integrate into the economy in a meaningful manner (Kalotay, 2000) is determined by; The Technology gap between local and foreign firms, The research and development (R&D) capabilities of local firms, Human Capital, Scale, Firm location, Exporting capabilities, Sector Dynamics, and Competition. These will be discussed in this section.

Technology Gap

Technology gap is usually measured as the domestic firm's productivity level relative to a benchmark productivity level within the same sector - often of the leading firms Farole and Winkler (2014). Views on the role technology gap plays in FDI spillover differs. Some research shows that a large technology gap is beneficial as it can increase firm's potential for catching up. However, some scholars find that firms are less able to absorb spillovers if the technology gap is too big. Using data from firms in Morocco, Bouoiyour (2005) finds that; "technology gap is a condition for spillovers, but only within a certain range".

Research and Development (R&D)

Another factor that can be considered when assessing the absorptive capacity of a local firm is the Research and Development (R&D) conducted by a firm. R&D activities are linked to a firm's ability to recognize new information, assimilate and apply it to commercial ends Blalock and Gertler, (2005). Using R&D as a proxy for absorptive capacity, Blalock and Gertler (2005) found, using a data set from Indonesia, that firms with greater spending on R&D acquire more technology from FDI. Dutse (2012) also concludes that in Nigeria manufacturing firms are unable to absorb spillovers due to amongst other factors insufficient R&D.

Human Capital

The ability of a domestic firm to absorb foreign technology can also be related to the type of labor the firm hires. On a wider scale, Van den Berg (2001; 226) states that amongst other factors the human capital and education system of a country determine its ability to create new ideas and adopt old ones. Skilled labor is more likely to absorb new knowledge. In an investigation done in Argentina, Narula and Marin (2003) found that even though FDI spillovers where ambiguous between foreign and Domestic firms, where spillovers did occur was where the firms invested more in absorptive capacities. In Indonesia, Blalock and Gertler (2005) found that firms with highly educated employees were more able to adopt technology form foreign Firms.

Scale

Firm size is seen to be positively related to the capacity of a domestic firm to absorb spillovers (Thomas and Winkler 2014). When doing research on Central and Eastern European countries, Damijan et al. (2007;18) found that; “It was only the more productive firms that were able to compete with foreign affiliates and also benefit from increased downstream demand for intermediates created by foreign affiliates”. Within the same research Damijan et al (2007). find that Smaller sized firms can also be affected by the presence of foreign firms but this effect can be either positive of negative. They can either get positive spillovers from the firms or they might not meet the needs of foreign firms due to low productivity or lack of technological knowhow. They can be crowded out by foreign firm presence.

Firm Location

Where firms are located can also determine whether they are rightly positioned to absorb spillovers from foreign firms. When doing research on Chinese firms; Li, Chen and Shapiro (2009) found that firms that were located in areas where there were concentrated foreign activities benefited positively from technological spillovers by these firms. However, they found that even though firms benefited from such clusters, it was only in those cases where foreign firms actively conducted innovative activities.

Exporting

There isn't any clear cut evidence on whether a domestic firm producing to export its product has a higher FDI - spillover - absorption - capacity then one that produces for the local market. Looking at results from various research papers Crespo and Fontoura (2007;12) find that while some investigations find that non-exporting firms are more receptive of spillovers from foreign firms (Blomstrom and Sjoholm, (1999) and Ponomareva (2000)) some find that it's the firms that export that absorb spillovers from Firms. The results are thus inconclusive. Farole and Winkler (2014; 40) state that exporting has been linked to absorptive capacity because exporting firms generally have a higher productivity then inward oriented firms and can thus be more competitive.

Sector Dynamics

Another factor that contributes to a firm's absorptive capacity is the sector in which the firm operates. This is in part related to the global value chain discussed earlier. Research has found that there are more spillovers in technology-intensive industries than in labor intensive industries. These spillovers are mostly driven by efficiency improvement and technology progress. Looking

at manufacturing firms in Indonesia from 1975 to 2000, Temenggun (2007) found that horizontal spillovers occurred only in the Food and Beverages as well as the textile and leather industries

Competition

Host nations attract FDI with the hope that foreign firm activities will lead to the global integration of the national economy and the increased competitiveness and productivities of local firms. However, the is a potential of FDI being a barrier to exports and in fact promoting imports as foreign firms seek low cost inputs. Foreign firm can also out-compete local firms that seek to export (WDR, 235,199). Dunning (1994) warns against governments using FDI to "prop-up" industries in which the host country has no comparative or competitive advantage. He advises that governments focus on attracting FDI that will further enhance a county's competitive advantage and make full use of its comparative advantage

2.1.2.7 The role of Institutions in FDI promotion and facilitation

In the World Bank publication; "making FDI work for Sub-Saharan FDI", the authors outline six host country and institutional factors that may mediate the extent of FDI spillovers in a host country. These factors, they say, have a bearing on the type of foreign investment attracted to a host nation as well as the spillover potential of foreign firms. They also determine the characteristics of domestic firms and their absorptive capacity. Lastly, they affect the channels through which spillovers can be transferred from foreign firms to domestic ones.

The factors are namely; Labor market regulations; Intellectual property rights; Access to finance, Learning and innovation infrastructure; Trade, Investment and Industrial policy; as well as Governance.

Research has shown that labor market policies can affect FDI either positively or negatively. Parcon (2008) shows that labor market standards and regulations can either decrease FDI inflow by increasing the cost of hiring and firing employees or increase FDI inflow by increasing productivity due to better labor relations. Also, according to research done in OECD countries, strict employment protection legislation, can divert investment to where regulation is less tight (OECD). Olney (2010) also found that a reduction in employment protection rules in some countries, led to an increase in FDI. Javorick and Spatareanu (2004) also support this point with research from 25 western and Eastern European countries.

Literature on the effect of intellectual property rights on FDI inflows and spillovers is ambiguous. With regard to intellectual property rights, Researchers suggest that strong intellectual property rights, in a developing host county, lead to foreign firms transferring more of its production to the host country and thus contributing to the growth of the particular country Branstetter et al (2007) and Kashcheeva (2013). However, Havrenek and Irsova (2011) posit that strong intellectual property right work as a barrier to the transfer of knowledge and technology to local firms. Branstetter et al (2007) find that the foreign firm production activity that is brought about by stronger intellectual property rights more than makes up for the barrier to imitation by local firms.

Another mediating factor is access to finance. Foreign firms can either easy financial constraint to domestic firms by bringing in much needed capital or they can increase the constraints if they themselves are borrowing from domestic financial institutions (Thomas and Winkler 2014; 44). When looking at firms in Kenya, Ndambuki (2013) finds that with private and collectively owned firms access to finance was positively associated with growth through Research and Development (R&D). In china; Grima, Gong and Gorg (2008) find that firms that have good

access to domestic bank loans or foreign capital innovated more than those that did not. In both cases the evidence showed more effect to private and collectively owned enterprises, as opposed to State owned enterprises (SOEs).

Learning and innovation infrastructure is another factor that is identified as having an effect of FDI inflow and FDI spillovers. Thomas and Winkler (2014) state that: "The share of human capital at the firm level is influenced by the local learning and Innovation infrastructure, which includes the basic, higher, and vocational education system; the interaction between education and training institutions and the private sector and the existence and embeddedness of technology research institutions." A highly educated work force increases the absorptive capacity of local firms and their ability to learn, adapt and innovate. FDI can play a role in enhancing skills and general education within the host country, particularly in the sectors relevant to the foreign firm. However, it is largely the role of the host country to upgrade general skill levels and provide highly specialized technical manpower. UNCTAD (1999;42).

Trade, Investment and Industrial policy; A positive correlation has generally been found between low trade barriers and FDI inflow. Also, FDI within an open trade regime has been said to more efficient with the efficiency resulting directly from foreign firm activity. Lesher and Miroudot (2008) when using firm level data to identify FDI spillovers across countries, sectors and time, find a "positive correlation between the degree of trade openness and output when measuring the impact of foreign presence in the domestic economy".

Investment policies and FDI promotion play a part in attracting FDI and formulating policies that are targeted specifically at promoting spillovers to the domestic market. A firm level investigation done by Du, Harrison and Jefferson (2014) in china shows that tax policy

(corporate income and VAT subsidies) have attracted FDI into strategic industries and brought about significant spillovers.

Industrial policies that support the development of Small and Medium enterprises (SMEs) are crucial in assuring local firms ability to absorb spillovers from foreign firms. An OECD report on integrating SMEs into the Global Value Chain (GVC) identifies the role of governments as that of 1) facilitating the improvement of technology and innovation capacity 2) Providing financial and capable human resources 3) providing SMEs with the capacity to respond to GVC standards and certification requirements. Another report by the UN office of the special advisor on Africa (2009) reiterated the importance of skills development and capacity building as well as the provision of accurate and accessible information about the GVC for local SMEs.

Literature on the role of governance on FDI attraction and spillovers is inconclusive. Institutional matters such as political climate, corruption, red tape, regulations that make it hard to do business are said to have an effect on the type of FDI a country attracts as well as the absorptive capacity of local businesses Farole and Winkler, 2014). Pedersen and McCormick (1999) also state that a weak relationship between the public and the private sector as well as lack of integration amongst foreign, state-owned and domestic enterprises can hinder policy intervention that aim at facilitating spillovers and promoting foreign investment. Using World Bank governance indicators, Adeoye (2009) finds that corporate governance does have an effect on inward flows of FDI. While, Sadi, Ochi and Ghadri (2013) find that only political stability and regulatory quality have a significant effect on FDI inflows. While looking at some Latin American countries, Subasat and Bello (2013) find that poor governance attracts rather than defers FDI. Dixit (2012) find that the amount and type of foreign investment adapts to the conditions and institutions of governance in host countries. Gorodnichenko, Svejnor and Terrel

(2013) find that corruption has little effect on direct or indirect spillovers. They state that this is a surprising finding and that research needs to look more into the magnitude of this effect and methods of measuring them.

The following section emphasizes the role of institutions in development

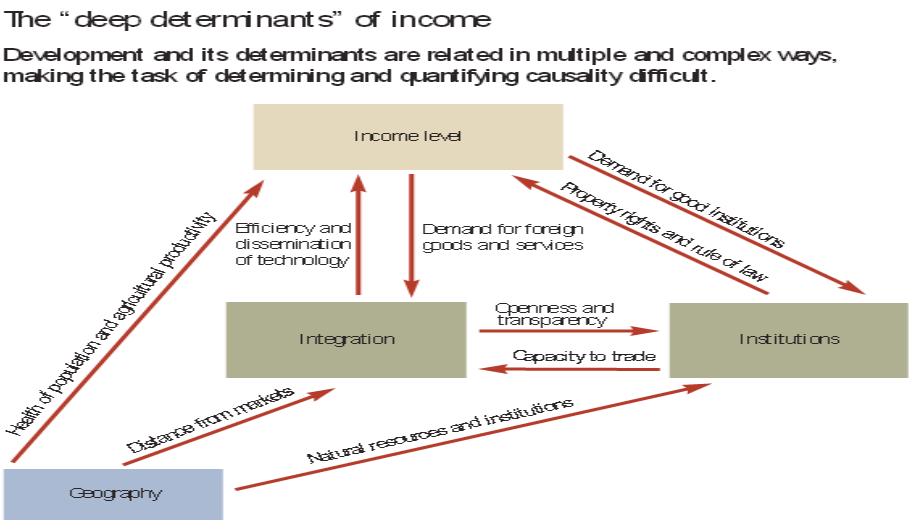
2.1.3 Institutions and development

The great divide between the average income between the richest and poorest countries in the world has been an important research issue for those in the field of development economics- the richest country, Norway, is 469 times richer than the poorest country, Burundi (World Bank data). Institutions have been found to play a determining role in the difference between national incomes. The important role that institutions play has been highlighted by various scholars and international organizations which including; North (1990), World Bank (2002), DFID (2003), and Rodrick (2007).

North (1990) defines institutions as the humanly devised constraints that structure human interaction. He distinguishes between formal and informal intuitions. Formal institutions being written laws (such as laws, legal agreements, constitutions etc.) and the informal ones being the unwritten rules (such as customs, traditions, norms, social conducts etc.) which are imbedded in the way a society conducts itself. Institutions he adds; determine the incentive structure of a society and reduce uncertainty by establishing a stable structure of human interaction. A distinction is also made between institutions and organizations. Institutions are defined as the "rules or the game" while organizations are the "players" in the game (This point will be discussed later on in the review).

Using a regression analysis to determine the causal relation between national income levels and its three imperative determinants; geography, world market integration through trade, and institutions, Rodrick and Subramanina (2003) find that the quality of institutions overrides the two other determinants. They acknowledge that determining the causality of the three determining factors to income levels is complex. The difficulty they say: "lies in disentangling the complex web of causality involving these factors and income levels". As depicted in the below figure, Geography is the only factor that can be treated as not being influenced my income. Geography can influence income directly (by for example a healthy population and agricultural productivity) and indirectly (through its impact on market integration or institutions). When looking at market integration and institutions, however, causal relation can move in both direct. While good quality institutions can lead to increased income levels through investment promotion and supporting technological progress, economic development can also lead to better institutions. In the same manner, in as much as integration into the world market calls for better institutions, quality institutions will lead to further integration into the world trading market.

Graph1: Complex Causality between Income, Institutions, Geography and Integration



It is widely agreed that building institutions cannot be a "one size fits all" intervention (Basu 2008, UNCTAD). Countries are different and therefore they require different focuses, priorities and approaches to institutional building. However development economists agree that at least 5 institutions are necessary for inclusive economic growth and development. Those are;

1. Market creating institutions; Property rights and legally binding contracts
2. Market regulating institutions; Regulatory institutions
3. Market stabilizing institutions; institutions for macroeconomic stability
4. Market legitimizing institutions; Social insurance institutions
5. Market legitimizing institutions; Institutions for conflict management

Rodrick (1999)

Acemoglu and Robinson (2012) in their book "Why nations fail; the origins of power, prosperity, and poverty', state that every society functions with a set of economic and political rules (institutions) created and enforced by the state and citizens collectively. Economic institutions shape economic incentives, while political institutions include the power and capacity of the state to regulate and govern society. They differentiate between extractive institutions and inclusive ones. Inclusive institutions are defined as; "those that allow and encourage participation by the great mass of people in economic activities that make best use of their talents and skills and that enable individuals to make the choices they wish." Extractive institutions on the other hand are; "those policies and practices designed to extract income and wealth from one subset of society [the masses] to benefit a different subset [the governing elite]". Furthermore, it is stressed that; "while economic institutions are critical for determining whether a country is poor or prosperous, it is the political institutions that determine what economic institutions a county has".

Reiterating this point is a research compilation by the Research Programme Consortium for Improving Institutions for Pro-Poor Growth (IPPG). It illustrates; “the importance of the interaction between economic and political institutions in shaping growth and poverty reduction, as well as the way organizations and institutions interact to produce different outcomes. Taking from a broad range of political, economic and social research and looking at the state-business relations across Africa, Latin America and India, the paper concludes that institutions do matter and understanding their effect on growth and poverty reduction is a matter of understanding the politics of how individual players, organized interests and institutions interact.

In its report World Development Report (2002) the World Bank identifies the role of institutions in “promoting inclusive and integrated markets and ensuring stable growth”. The report states institutions that support growth and enhance poor people’s access to economic markets help increase income and reduce poverty. It identifies firms, government, and society at large as have a role in creating effective institutions. The reports also stresses that in order to build effective institutions, policy makers need to design institutions to; 1) Complement what exists in terms of human capacity, supporting institutions, and available technologies. 2) Innovate by identifying which institutions work, and which don’t. Promoting those that do and letting go of those that don’t. 4) Connect by being open to trade and facilitating open information exchanges between market players. 5) Compete; promote competition amongst regions, firms, and individuals.

The role of institutions in trade facilitation

When writing on institutions and international trade, Grief (1992), argues that although international trade theory overlooks institutions as an enabler of trade during the commercial revolution, they (institutions) where part and parcel of the social, economic, political and technological fabric of that time. Institutions at that time he states; "constrained decision makers and determined the relations between profitability and efficiency in the exchange relations that constituted and enabled trade." He stresses that even today, actual trade is determined not by factor endowments only but also by institutions that govern, amongst other things; "commodity future prices, international accumulation of knowledge, the relation between foreign investors and government, and the relation between producers and overseas suppliers and distributors".

In a study by Meon and Sekkat (2006) on institutional quality and trade, they find that "defective institutions hurt a country's capacity to export manufactured goods" and "improvement in institutional quality would lead to an increase in manufactured exports". In a guide on trade mainstreaming, using trade proactively to attain development goals, the U.N.D.P (2011) finds that; "trade mainstreaming works best when appropriate institutional frameworks exist."

2.1.4 Trade and Development (the link)

Traditional International trade theory centers on the principle of Comparative Advantage described by David Ricardo (1951). The principle states that a country benefits from exporting a good which it produces at the lowest cost compared to its trading partners. It states that even if a country produces all goods cheaply, it will benefit more by producing the good of which production is relatively the cheapest. This principle thus forms the basis of Free trade and trade liberalization. The classical view of free trade amongst countries, associated with Adam Smith

(1986), is that liberalizing trade (the international division of labor) will lead to the most efficient use of a country's resources and thus lead to high national income.

The end of the 2nd World War (WW2) saw countries looking inward for answers to economic development. Export pessimism was dominant between the 1930s and 1960s as assumptions were that open trade policies would leave poor countries specializing in low value-added goods of which export demand was inelastic. So that they too could industrialize developing countries needed to protect their infant industries/sectors up until a point where they would be able to compete with those in the more industrialized countries (Import Substitution strategy). "Observing that developed countries often had much larger manufacturing sectors, developed countries sought to mimic this mixture by subsidizing industry and taxing agriculture and primary activities. Thus, industrialization – with a stress on capital accumulation and manufacturing – was believed to be the key to economic growth and development" (Irwin 2003; 5). Following this school of thought, many countries' policies focused on import substitution as a means to economic growth and development.

The economic success of the East Asian countries, South Korea, Taiwan and Hong Kong in the 1970s deepened further the debate on whether it was trade liberalization that leads to their success or interventions by government through Industrial, trade and fiscal policies. Joo (2008) states that the growth of South Korea for example was due to 1) removal of the impediments to growth (letting the market operate freely), 2) making gains from the large world market and taking advantage of the international division of labor (exporting manufactured goods and importing natural resources, capital goods and industrial raw material) , meaning that openness to trade and less intervention by government was the key to economic growth.

There exists an alternative view which asserts that developing countries need to protect their infant industries from competition from more industrialized countries which may hinder growth and keep them from catching up in the process of industrialization. Rodriquez and Rodrick (1999) argue that methods used to find a correlation between trade policies and economic growths have serious shortcomings. Looking at the case of South Korea and Taiwan, Rodirick (1994) states that other explanations such as; governments intervening to rectify coordination failure and low initial inequality levels are a more suitable explanation for the rapid growth that took place in these countries.

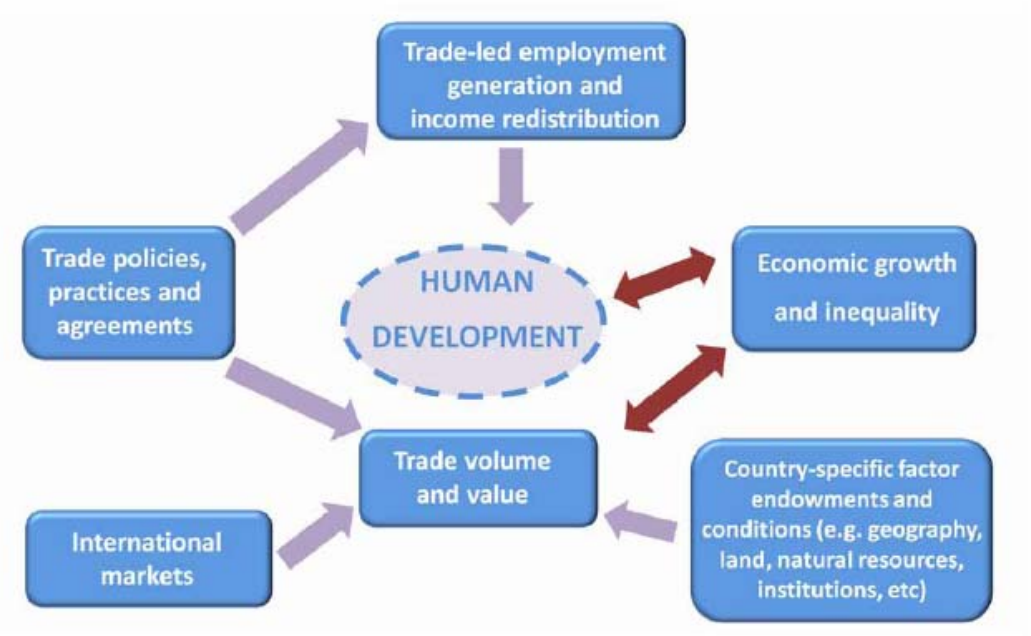
A study done by Sach and Warner (1995) shows that those that were countries open to trade[1] grew, in a year, 2.4 percentage points faster than those that were not. However, Rodriguez and Rodrick (2001) state that this definition of openness correlates with plausible alternative explanation variables - macroeconomic, instability, poor institutions, location in Africa- that a conclusion cannot be made on the effect of openness on economic growth.

There is little consensus on the effects of trade liberalization on economic growth. However, it is widely agreed that trade does contribute to economic growth by: increasing allocation efficiency, raising capacity use, achieving scale economies in production and making a wide variety of products available for consumption, although none of these are automatic or guaranteed states UNDP (2003). Growth in the economy can then contribute to human development in two ways as described by UNDP (2003; 26); Firstly; 'Employment led growth raises household income. Depending on how it's spent, the additional income can be used to improve nutrition, augment child's education or increase skills – all of which enhance human capabilities'. Secondly;

[1] Openness to trade indicators: average tariff rates, non-tariff barriers, black market exchange rate, presence of export market boards (sachs and warner,1995)

'Growth can contribute to human development through government policies and spending. Growth can increase government revenue - which if used to reduce income inequality and improve health and education, benefits human development'. Diagram 2 shows the link between international trade and human development. The figure shows how the volume and value of trade export can assist economic growth and inequality which will then lead to human development. However, this benefit from trade can only be acquired if and when appropriate (country-specific) trade policies and practices are in place. International and regional agreements also have to be conducive.

Graph 2: The link between international trade and human development



Source: UNDP. Aid for Trade and Human Development, 2008.

Chapter 3

3.1 Research Methodology

The design of this study will be a case study. An in-depth look at the role Lesotho's Political and economic institutions have played in promoting, facilitating and regulating foreign direct investment so that it benefits and grows the country in a sustainable manner. According to Hancock and Algazzine (2006) a case study allows a researcher to explore or describe a phenomenon in context using a variety of data sources.

The study will also take a comparative approach as it looks at the case of Mauritius, a country which was able to develop significantly from FDI and trade led by trade preferences. Mauritius's institutions are believed to have played a significant role in its development. The economic and political institutions of the country are said to rank above the average African country and are attributed to the country overcoming its macroeconomic imbalance in the 1980s, the success of its Export Processing Zones (EPZs) and the success of its sugar sector (Subramanian and Roy 2001: 27-28).

Research Population

McBurney (2001), states that a population is a sampling frame, it is the totality of persons, events, organization units, case records or other sampling units with which the research problem is concerned. It is the base where the sample for this study will be selected from. The population of this particular research will be the Ministry of Trade and cooperatives in Lesotho, The Lesotho National Development Corporation, and The Basotho Enterprise Development Corporation as well as any other bodies or individuals who will contribute to answering the questions posed in this research paper.

Research Instruments

For the purpose of this research I will analyze documents from the various institutions as well as any other document that will meet the goals of the research project. I will also conduct interviews with relevant individuals from the research population.

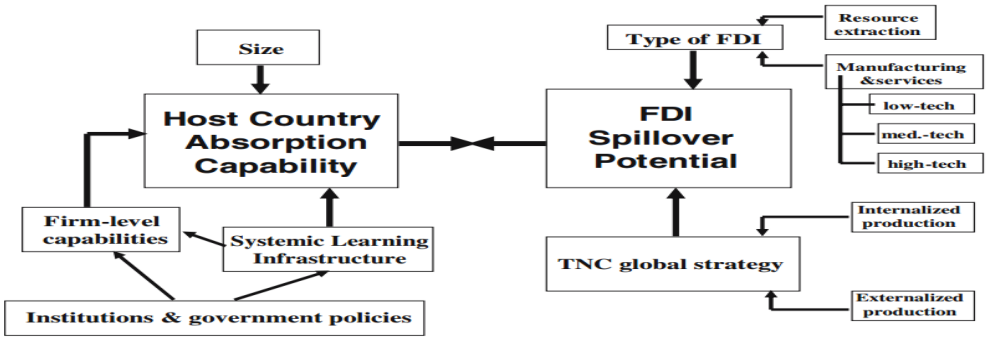
I will also review documents from various sources on Mauritius' development for the purpose of making comparisons.

The approach adopted for this study will be qualitative in nature. This implies that the data will be analyzed in a descriptive methodology.

3.2 Analytical Framework

This study is guided by Paus and Gallagher (2007) model on the critical contingencies for the realization of FDI related spillovers[2].

Graph 3: Critical contingencies for the realization of FDI related spillovers



[2] Also adopts the conceptual framework in FDI spillovers in: Farole, Thomas and Deborah Winkler, eds. 2014. *Making*
Foreign Direct Investment Work for Sub-Saharan Africa: Local Spillovers and Competitiveness in Global Value Chains. Directions in Development. Washington, DC: World Bank. doi: 10.1596/978-1-4648-0126-6. License: Creative Commons Attribution CC BY 3.0

The model states that both the spillover potential of foreign investors and the Absorptive capacity of host country contribute to actual spillovers. In the case of Mauritius and Lesotho, the Type of FDI in the textile and Apparel sector is very much the same and thus could conclusively have the same potential for spillovers; Export oriented, cheap labor seeking and tariff skipping investments that are have linked to an extensive Global Production Value chain.

The host country factors that determine the absorptive capacity particularly those determined by Institutions and government policies are those that seem to differ and are thus the focus of this study.

Chapter 4

4.1 Introduction

Upon independence Lesotho and Mauritius, together with some other African countries were registering high rates of economic growth (averaging 9.9% and 5.4% respectively) Subramanian and Roy (2001). Mauritius continued to grow and achieve remarkable developments, whereas Lesotho's high growth rates of that time came to a halt in 1982.

Differences that might explain the divergent economic performances of the two countries can be spotted; Mauritius is an island and therefore has access to the sea whereas Lesotho is a landlocked country; Lesotho has a homogeneous population while Mauritius has diverse ethnic groups. Mauritius was occupied by three different nations (the Dutch, French and British) and Lesotho was colonized only by the British. However, significant similarities can also be drawn between the two; they both gained their dependence from the British, they both have a small domestic market (Population: Lesotho: 2024 Million, Mauritius 1291 Million) both states had their economic growth based on Agriculture and were transitioning to industrialization via textiles and Apparel however their paths diverged. The two countries rely on exports as a driver for industrialization due to their small domestic markets and both countries enjoy non-reciprocal preferential trade access to various European countries, North America (Canada and the U.S), Australia and New Zealand.

Today Mauritius is one of Africa's leading economies. It has a GDP per capita of $9202.53 (2013), higher than that of South Africa ($6617.91) and more than 8 times that of Lesotho (1125.59). On the Human development index (HDI) Mauritius registers 0.77 (2013) and Lesotho 0.44 with 0 being the lowest level of development and 1 being the highest. Mauritius has

diversified its economy away from agriculture (3% of GDP in 2013) to textile and Apparel (4%), financial services and tourism (10.1%) (WTO Trade Policy Review and Mauritius Chamber of Commerce and Industry).

On the index of African Governance Mauritius ranks 1st (81.7%) and Lesotho 10th (62.3%). Mauritius is the most business friendly economy is Sub-Saharan Africa, ranking 1st first on the World Bank Group *Doing Business* ranking with Lesotho ranking 14th out of 189 economies. "Mauritius is one of the few countries to successfully deploy FDI to maximize the opportunities of preferential trade status, notwithstanding limited supply capacities and remoteness from world markets." (UNCTAD, 2001).

What could be the possible reasons for the differences in the performance of these two economies? In this paper we will take a look at two key contributors to economic growth; Foreign Direct Investment and Trade exports. We will examine critically the case of Mauritius, in particular, the textile industry and the role that the Export Processing Zone (EPZ) played in growing and promoting the industry.

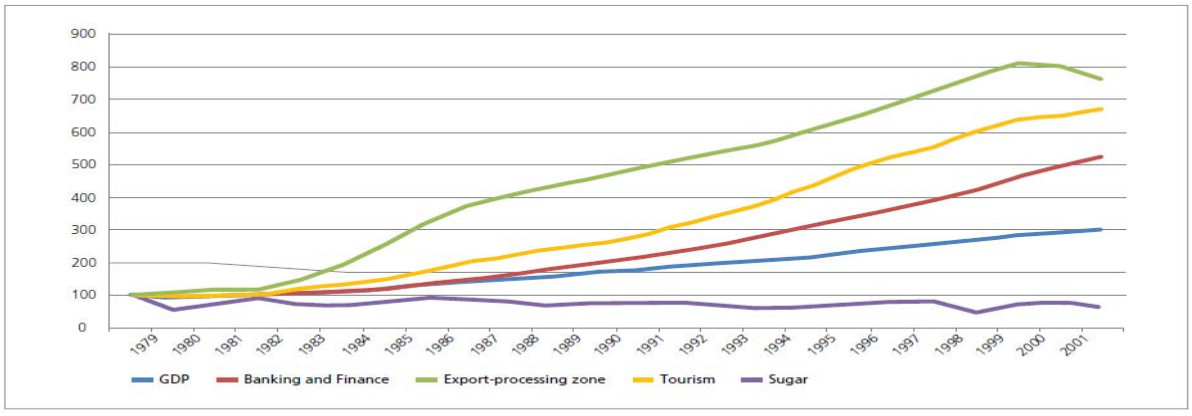
4.2 The case of Mauritius

Mauritius gained its independence in 1968. Prior to independence, economist and Nobel Prize Laureate; James Meade, led a report by a commission that was assigned to study the economic and social structure of the Mauritius. This report pronounced the island country predestined for economic difficulties. The report stated that dues to high rates of population growth, Mauritius would face very high unemployment rates. The island has no natural resources and relied mainly on its uneducated work force and a single crop; sugar. Therefore, recommendation was made that the government encourage industrialization through labor intensive activities. These activities

were to be run with utmost efficiency while keeping aware of costs. Capital from these activities was to be channeled preferably into the fundamentals that contribute to industrial efficiency (e.g.: Hydroelectric power, roads and communication).

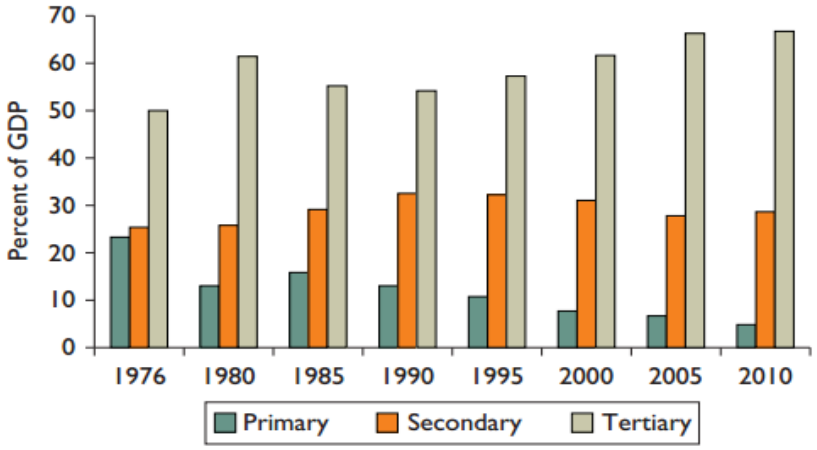
Most likely taking heed of the report, the Mauritian government in 1970 enact the Export Processing Act. An export processing zone (EPZ) was created in 1971 and located in the zone was mostly Textile and Apparel firms. Foreign investors were attracted to the EPZ due to incentives provided by the government. Government also invested in infrastructure to assist productivity in the industries located in the EPZ. In the 1980s a boom in the textile industry found Mauritius ready and the number of firms in the sector rose from 74 in 1983 to 435 in 1988 (World bank, 2008).

Graph 4: Key components of economic growth in Mauritius 1979/80-2002/3 (GDP at constant 1992 prices, Index 1979/80 = 100)



Note: Fiscal years run from July to June.
Source: Mauritian authorities and IMF staff estimates, in Sacerdoti et al. (2005).

Graph 5: Sector composition of GDP in Mauritius (1976 -2010)



Source: Zafar (2006)

Table1: Growing contribution to GDP of textile industry via EPZs: GDP at current basic prices (1990-2004)

	1990	1995	2000	2004
Manufacturing	8,143	14,289	24,701	31,850
Sugar	1,150	1,010	840	1,587
EPZ products*	3,965	7,067	12,523	13,134
Other	3,028	6,212	11,338	17,129
Gross Domestic Product (at basic prices)	33,415	62,260	104,271	151,296

Source Central Statistical Office
* Textile and Clothing products represent almost 80% of EPZ products

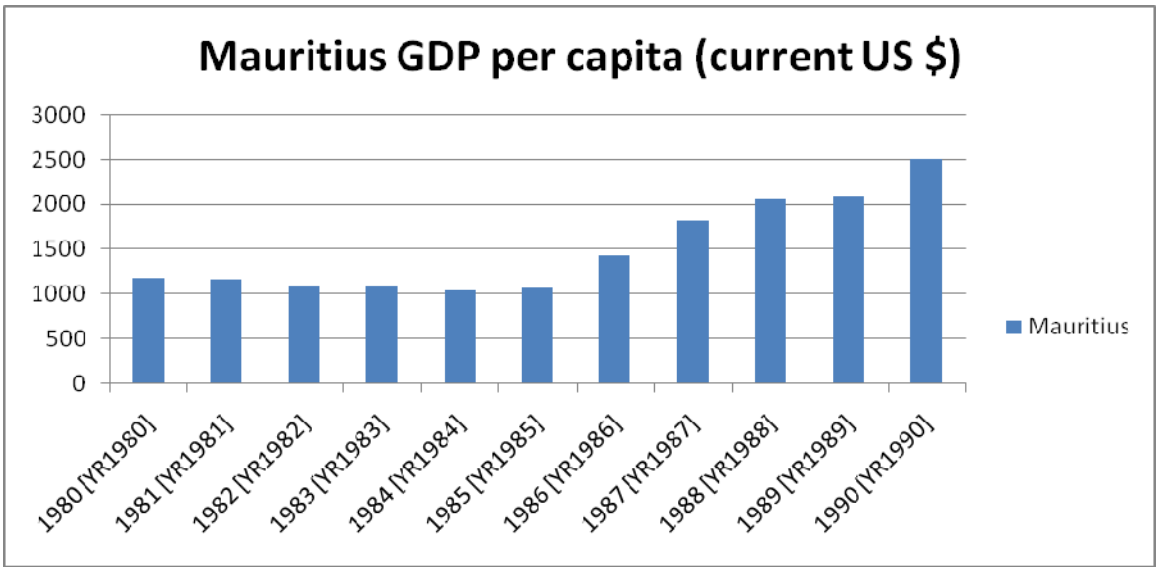
The Mauritius government, determined not to fall into a Malthusian Trap set itself an ambitious development plan between 1975 and 1980. It sought to attain full employment by the end of 1980, diversify its economy, adapt education and training to meet its specific economic

development requirements, and to improve its infrastructure. By early 1989 some 88,658 jobs had been created (Investment review report, 2001)

Table 2: Enterprise and Employment Growth in EPZ between 1972 and 1999

Year	Number of Entreprises	Employment*
1972	19	2,500
1979	94	20,700
1989	563	88,658
1999	586	91,374

Graph 6: GPD per capita growth (1980 -1990)



Contributors to the Success of Mauritius' Textile Industry

The key success factors in success of Mauritius' textile and Apparel industry are stated by researchers as; 1) An enabling institutional framework, 2) A favorable environment for investment, and 3) the existence of preferential trading agreement. (Subramainian and Roy, 2001; World Bank, 2008, Investment Policy Review (WTO), 2001).

- An enabling institutional Framework

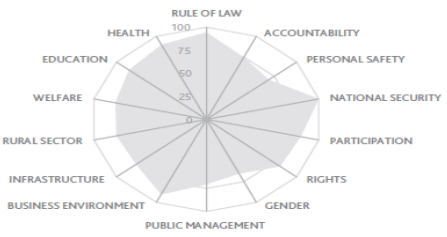
Governance: Exclusion and inequality are major hindrances to develop that multi-ethnical countries face. However Mauritius was able to circumvent this problem by pursuing a one-nation strategy early one after independence. This was done through strategic partnerships between major ethnic groups. Negotiations on economic redistribution and discussions on how to avoid ethnical exclusion and ethnical conflicts took place after independence (Sriskandarajah, 2005). In this manner they were able to inculcate institutions that assured societal and economic inclusion of minority groups and that took a consultative approach to policy creation (Vandermoortele and Bird, 13; 2011). The Mauritian state is modeled after the British system of Government and has a cabinet which is lead by a prime minister and a legislative body that makes the law. Power is separated between the executive, legislative and the judiciary. Upon independence, the national leader, Sir Seewoosagur Ramgoolam recruited people from all ethnical groups into his Labor party and set the example for national unity (Vandermoortele and Bird, 13; 2011). No party political party has ever secured a majority is the assembly and therefore been able to form a government on its own. The need for coalition parties to work together for national development has always been recognized (Zafar: 20, 2011).

Table 3: Mauritius Ranked 1st in 2013 on the overall score of the Mo Ibrahim index of African Governance

Country Results

RANK 2013	CATEGORY & SUB-CATEGORY	SCORE/100 2000	...	2009	2010	2011	2012	2013	CHANGE '09-'13
1	**Overall Governance**	74.3	...	80.4	80.3	81.0	81.4	81.7	+1.3
2	**Safety & Rule of Law**	85.1	...	87.2	86.8	86.5	86.8	84.5	-2.7
2	Rule of Law	94.6	...	95.1	94.6	94.9	95.3	94.4	-0.7
2	Accountability	71.8	...	77.4	76.2	74.9	74.7	74.6	-2.8
2	Personal Safety	79.3	...	76.5	76.3	76.4	77.3	69.2	-7.3
2	National Security	95.0	...	100.0	100.0	100.0	100.0	100.0	-0.0
2	**Participation & Human Rights**	71.3	...	73.5	72.7	73.9	74.7	77.0	+3.5
2	Participation	85.9	...	86.2	81.7	83.9	83.9	83.9	-2.2
2	Rights	78.1	...	77.5	77.5	77.6	80.1	81.7	+4.3
14	Gender	49.9	...	56.9	58.8	60.1	60.1	65.3	+8.4
1	**Sustainable Economic Opportunity**	64.0	...	76.7	77.5	77.8	78.5	79.7	+3.0
2	Public Management	52.9	...	59.8	61.0	63.0	64.2	70.5	+10.7
1	Business Environment	74.2	...	88.7	89.5	88.6	88.9	90.4	+1.7
2	Infrastructure	74.5	...	77.7	78.3	79.0	80.3	77.9	+0.2
2	Rural Sector	54.2	...	80.7	81.1	80.4	80.4	80.0	-0.7
1	**Human Development**	76.8	...	84.0	84.1	85.9	85.7	85.6	+1.6
1	Welfare	78.2	...	81.8	80.8	83.1	82.1	81.1	-0.7
1	Education	70.1	...	83.1	84.6	85.0	85.1	85.9	+2.8
6	Health	82.2	...	87.1	87.1	89.5	89.8	89.8	+2.7

Graph 7 and 8: Mauritius also scores high on a number of other governance categories and sub-categories



Trade, investment and industrial policy: "Mauritius' impressive economic achievements [over the past three decades] are a testimony of forward-looking industrial policies on diversification, combined with flexible export strategies." – Investment Policy Review for Mauritius, WTO. Initially a mono-crop economy, Mauritius sought to diversify its economy, attract investment and create employment at the wake of independence by creating an Export Processing Zone (EPZ)

which came to be following the enactment of the Export Processing Zone Act of 1970. Export processing Zones are defined by the World Bank (1992;7) as; "Fenced-in industrial estates specializing in manufacturing for exports that offer firms free trade conditions and a liberal regulatory environment". The main purpose of EPZs are to a) Provide foreign exchange earnings, b) provide jobs and alleviate unemployment problems and assist in income creation, and c) attract foreign direct investment (FDI) and engender technology transfer, knowledge spillovers and demonstration effect so as to encourage domestic entrepreneurs to engage in non-traditional exporting activities (World bank, 1999). The EPZ in Mauritius offered export oriented investors incentives such as 1) Tax holidays for up to 10 years, 2) No tariffs on imported inputs for industrial use 3) Favorable long-term loans (Zafar, 2011 and Frankel, 2010). Labor was relatively cheap compared to the sugar sector and it attracted most women who where outside the labor force at the time. About 80% of workers in the EPZs in 1980 were woman (Zafar 22; 2011). The unemployment rate in Mauritius sits at 8% well below most SSA countries.

Graph 9: Inward FDI Stock (1980-1990)

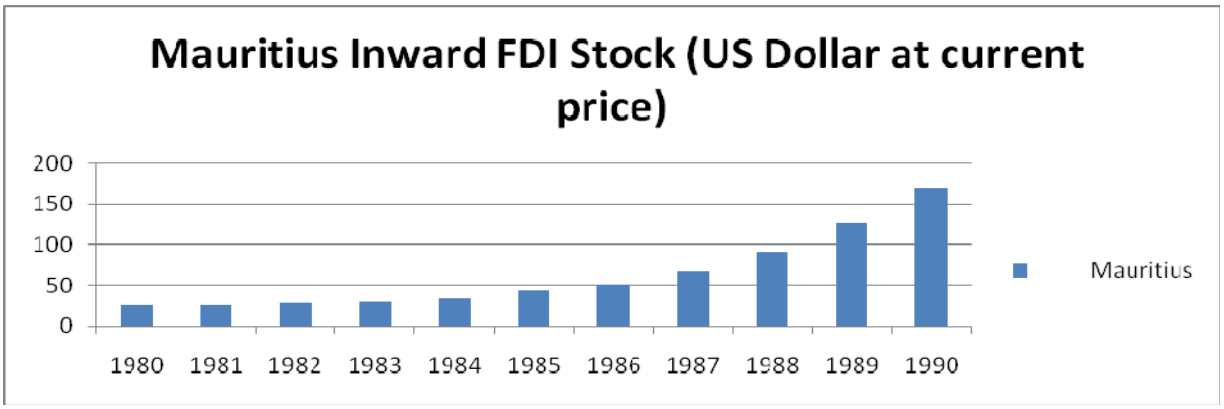
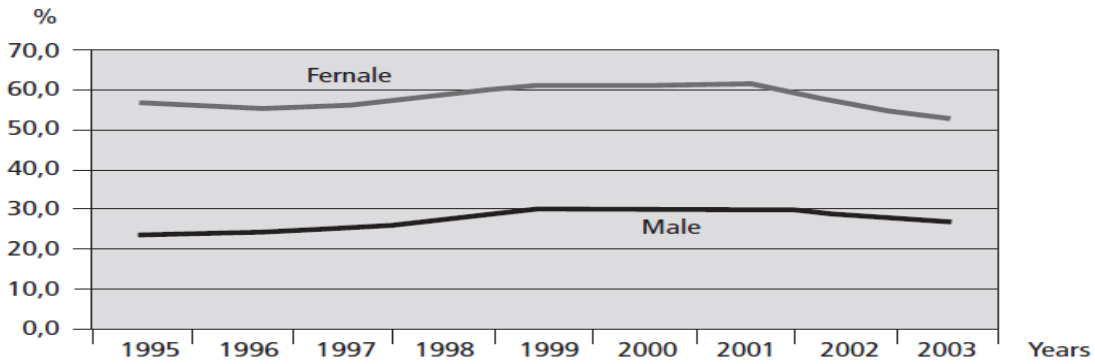


Table 4: Indicators of international competitiveness in mauritius EPZs (World Bank, 1994)

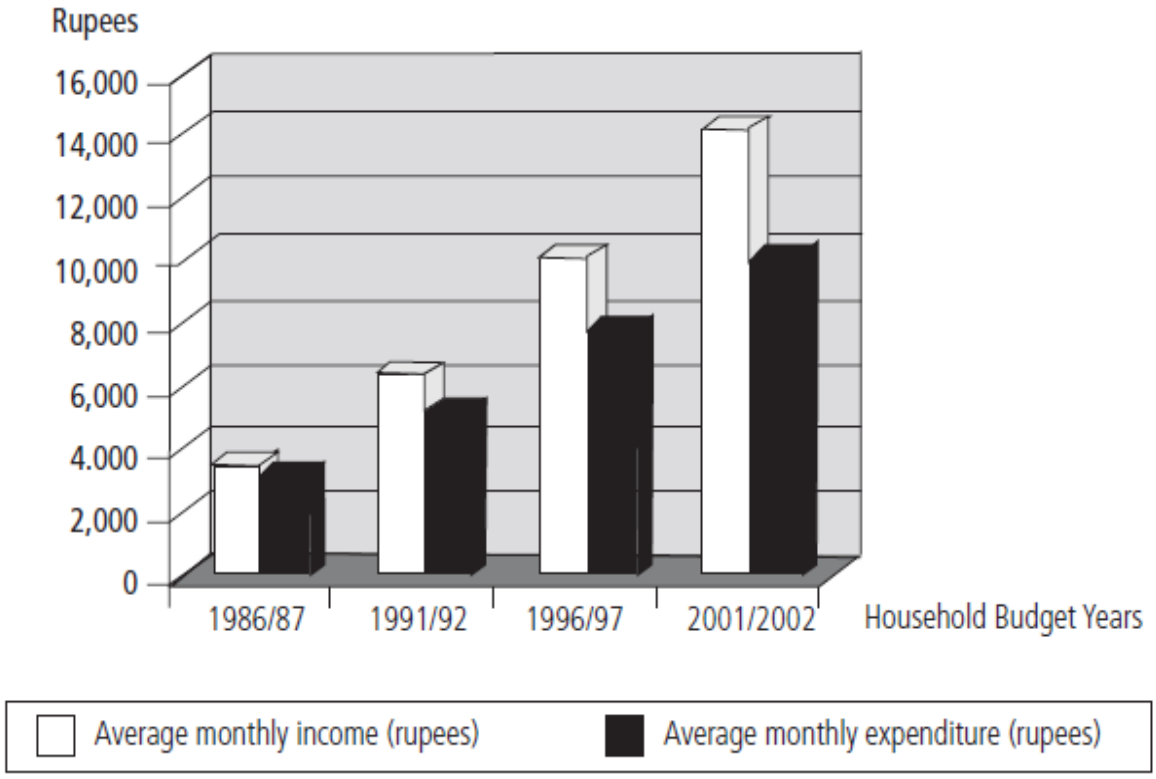
	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Value-added/Exports (%)	41.9	40.2	40.6	37.6	39.4	38.2	38.1	34.6	36.3	36.6
Wages/Valued added (%)	48.0	47.1	49.6	52.4	49.3	49.9	51.2	52.2	53.4	n.a.
Wages/Exports (%)	20.1	18.9	20.1	19.7	19.4	19.1	19.5	18.1	19.4	n.a.
Value-added/Worker ($)[1]	1,834	1,671	1,600	1,913	2,415	2,536	2,595	3,087	3,273	3,248
Labor Costs/Worker ($)[1]	880	786	793	1,003	1,191	1,266	1,328	1,611	1,748	n.a.
Productivity (Index)[2]	100	93	88	90	103	101	104	117	122	116
Labor Cost (Index)[3]	100	91	91	98	106	105	111	127	135	n.a.
Competitiveness (Index)[4]	100	102	97	92	97	96	94	92	90	n.a.
Investment in embodied technology ($ million)[5]	5	12	16	33	41	60	64	55	48	40

1 Data for value-added and labor costs per worker are in current dollar terms.
2 Productivity Index (base 1983): variation in value-added per worker, constant 1992 US dollars.
3 Labor Cost Index (base 1983): variation in labor costs, constant 1992 US dollars.
4 Competitiveness Index: Productivity Index/Labor Cost Index (reciprocal of unit labor cost index).
5 Purchases of equipment are a proxy for investment in embodied technology.

Graph 10: Employment by sex in EPZs



Graph 11: Average Household income and Expenditure (Friedrick, Ebert, Stigtung, 2006)



Learning and innovation infrastructure: Earlier on the government of Mauritius recognized the importance of learning, innovation and technology to increase competitiveness. Workers, most of which were coming from the sugar sector had enough literary and numeric skills required for the low- skilled work that was to be undertaken in the low- technology, entry level, textile and Apparel industry located in the EPZ. Employment rose in the EPZs and due to a high rate of labor turnover, firms in the EPZ were reluctant to invest in training staff (World Bank, 1994). Aware of this, the government, with the input of the private sector enacted the Industrial and Vocational Act of 1988 which then established the Industrial and Vocational Training Board (IVTB) in 1989. The mandate of the board was to:

- Advise the Prime Minister on matters related to training;
- Monitor the needs for training in consultation with the relevant authorities;
- administer, control and operate training schemes; and
- Provide for, promote, assist in and regulate the training or apprenticeship of persons who are, or will be, employed in the commercial, technical and vocational fields.

(The industrial & Vocational Training Act, 1998: Act no. 8 of 1988 dated April 15, 1988)

Amongst the initiatives the IVTB put in place for Industrial training was the levy/grant scheme which was aimed at encouraging on-the-job training and easing the financial burden on firms. Employers are refunded a certain percentage of the cost incurred in training their employees. Between 1989 and 1990 over 100 000 workers had been trained under this scheme (UNESCO 2010)

Table 5: Number of Levy/Grant scheme trainees 1988/89 to 2006/7

TABLE 1: The levy collected and grants refunded over the years together with the number of trainees benefiting

	Levy collected	Grant refund	Grant refund as % of levy collected	No of trainees
1988/89	14.8	0.0	0.0%	0
1989/90	39.7	0.0	0.0%	0
1990/91	49.3	2.4	4.9%	8,507
1991/92	60.9	7.2	11.8%	5,510
1992/93	66.5	12.9	19.4%	6,020
1993/94	71.6	14.0	19.6%	13,903
1994/95	76.9	16.6	21.6%	15,006
1995/96	89.3	18.8	21.1%	17,515
1996/97	101.5	23.0	22.7%	12,525
1997/98	108.2	35.3	32.6%	12,500
1998/99	117.8	42.1	35.7%	18,001
1999/00	133.0	108.7	81.7%	26,020
2000/01	145.2	103.2	71.1%	30,182
2001/02	155.9	90.6	58.1%	25,506
2002/03	160.5	103.5	64.5%	31,424
2003/04	186.3	201.3	108.1%	52,700
2004/05	193.1	92.9	48.1%	26,217
2005/06	211.6	125.0	59.1%	40,740
2006/07	232.9	159.0	68.3%	44,855
Total	2,215	1,157		387,131

The success of this initiative was attributed mainly to the fact that the Act and all that followed was draw up and initiated jointly by the public and private sector (UNESCO, 2010).

A number of institutes that offer training in the textile and clothing have been registered with the IVTB. Programs are also available for training for middle-management positions in design and production (Sawkut, 2008). Other institutions that offer learning and training to the textile and clothing industry are:

- The Clothing Technology Center; the technical arm of the Export processing Zone Development Authority (EPZDA).
- The textile technology department of the University of Mauritius offers B.Sc degrees in textile technology and textile fashion and Design
- The Manchester Metropolitan University in the United Kingdom offers higher national diploma and B.Sc in clothing production management in collaboration with Professor Basdeo Bissoondoyal College

(Sawkut, 2008)

- A favorable environment for investment:

The Export Processing Zone Act provided incentives for investors looking to cater to foreign markets. Incentives provided included: “protective import duties and quotas for infant industries, suspension of import duties on other raw materials and components for specific industries, duty drawback schemes, and favorable long-term loans.” (Zafar, 22:2001)

The institutional support for FDI promotion and trade facilitation has been strong since the establishment of the EPZs. The Ministry of Industry, Commerce and International Trade develops the national strategy for trade and industry. Supporting the ministry are 3 Para - statals; The Mauritius Industrial Development Authority (MIDA), the Export Processing Zone

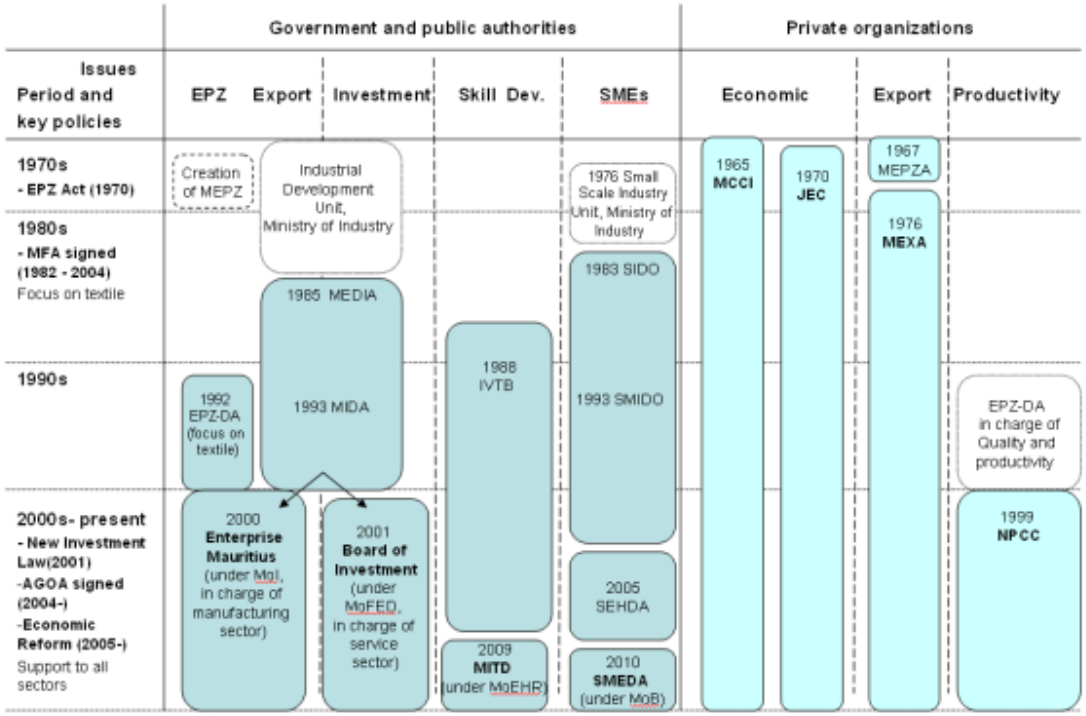
Development Agency (EPZDA) and the Small and Medium Industry Development Organization (SMIDO).

MIDA is responsible for promoting the export of goods and services. It advices government on matters related to export development policies. It also consults with exporters to better understand industrial needs. It has network offices in Africa, Europe and the U.S. Through these linkages important information on international markets is provided to local operators.

One of the biggest achievements of the EPZDA is the creation of Clothing Technology Center. The center assists manufacturers to improve the design and quality of their garments and also to acquire new technologies. The EPZDA also provides consultancy services, performance assessment and supply chain management in order to create a competitive edge in export – oriented activities.

SMIDO assists SMEs in setting up businesses by offering training and advisory services. Other support institutions include: The Development Bank of Mauritius (DBM), The Mauritius Chamber of commerce and Industry (MCCI), The Board of Investment (BOI), and The Mauritius Export processing Zone Association. Table 5 depicts the evolution on major institutions since 1970 (GRIPS, 2012)

Table 6:



Source: GRIPS Development Forum

The labor force was also fairly educated and suitable for low-skilled, labor intensive work with low wages.

Having been overvalued for some time, the Mauritian Rupee was devalued in 1979 by 30% and later in 1981 by 20% and thus made exports internationally competitive (World bank, 2008; IMF 2008).

- The existence of preferential trade agreements

Mauritius, together with other African countries, has enjoyed preferential access to markets of Europe, the U.S and other developed countries. Starting from 1972, Mauritius was linking itself with the European markets by becoming the first ex- British colony to be a member of the Association of African and Malagasy States, thereby, connecting to the European Economic

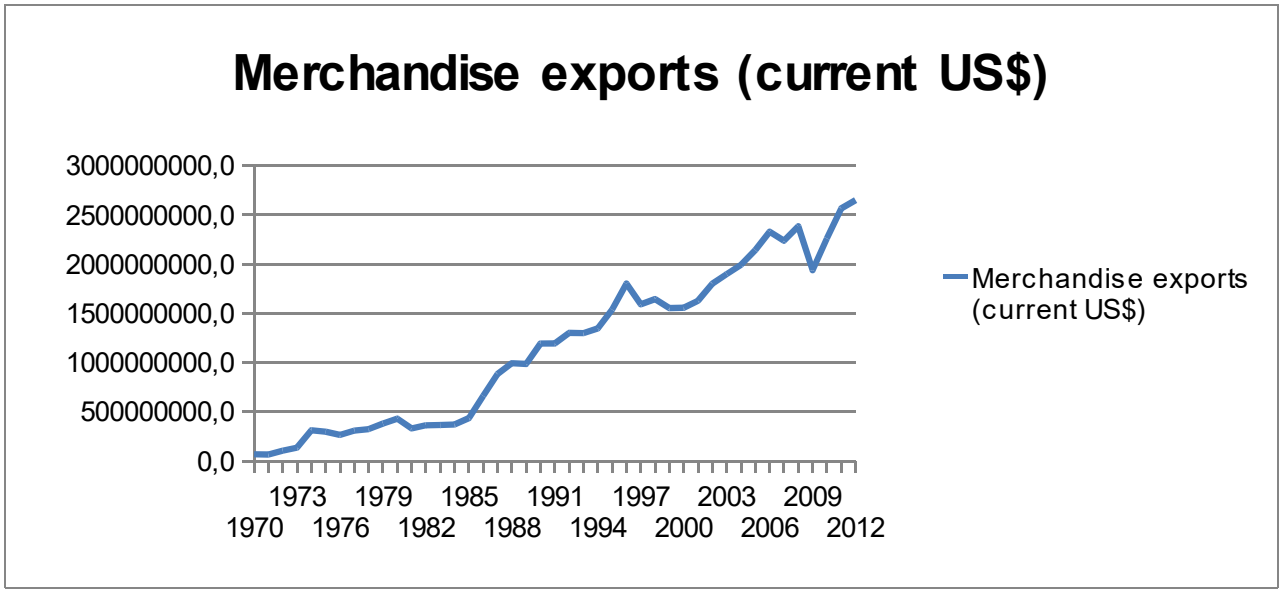
Community (ECC) under the Yaoundé II convention. Mauritius then became a beneficiary of the subsequent Lome conventions (Lome I to IV) which offered non-reciprocal trade preferences to African, Caribbean and Pacific countries (ACP); duty and quota free access for their products exported to the European Markets. The Lome Convention was replaced by the Cotonou Convention which continued until 2008. The EU has since become Mauritius' largest trade partner, with the UK, France, Germany and Italy being the largest importers of products from the island state.

Mauritius also falls under the list of countries that benefited from the Multi Fiber Agreement (MFA) which put restrictions on the products of low-cost exporting countries, especially those in Asia, and therefore did not have to compete with textile products from these countries. Investors from countries such as Hong Kong relocated to Mauritius and other African countries to escape these restrictions and to take advantage of preferential access to E.U and U.S markets.

With the dismantling of the MFA in the early 2000s and the world market becoming open to all exporters including those in low-wage china, Mauritius saw a drop in exports and employment, 30% and 25% respectively (Frankel, 2010).

The African Growth and Opportunity Act (AGOA), a US law, passed in 2000 offers duty and quota free access to the US market of a vast number of products from certain SSA countries which include Mauritius and therefore became the lifeline its textile and Apparel industry.

Graph 12: Mauritius merchandise exports (1973 -2012)



Under the General System of Preferences (GSP) by the WTO, Mauritius is also benefit from non-reciprocal entry into Canadian, Australian, New Zealand and a range of other markets. These non-reciprocal benefits have aided Mauritius in that they have helped attract investors into the country particularly those jumping tariffs that are applicable to non-benefiting countries. They have also aided in expanding the EPZ and creating numerous jobs for Mauritians.

Table 7: List of Preferential Trade Agreements

List of PTAs

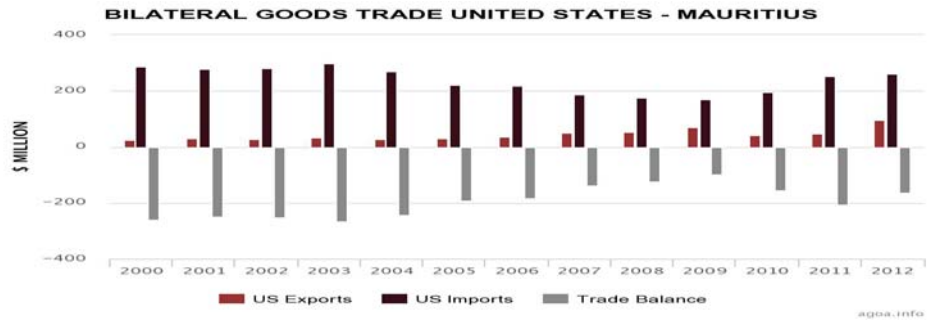
Name	Type	Sub-schemes	Provider(s)	Initial Entry Into Force
African Growth and Opportunity Act	Other PTAs	1	United States	18-May-2000
Duty-Free Tariff Preference Scheme for LDCs	LDC-specific	0	India	13-Aug-2008
Duty-free treatment for African LDCs - Morocco	LDC-specific	0	Morocco	01-Jan-2001
Duty-free treatment for LDCs - China	LDC-specific	0	China	01-Jul-2010
Duty-free treatment for LDCs - Chinese Taipei	LDC-specific	0	Taipei, Chinese	17-Dec-2003
Generalized System of Preferences - Australia	GSP	1	Australia	01-Jan-1974
Generalized System of Preferences - Canada	GSP	1	Canada	01-Jul-1974
Generalized System of Preferences - European Union	GSP	2	European Union	01-Jul-1971
Generalized System of Preferences - Iceland	GSP	0	Iceland	29-Jan-2002
Generalized System of Preferences - Japan	GSP	1	Japan	01-Aug-1971
Generalized System of Preferences - New Zealand	GSP	1	New Zealand	01-Jan-1972
Generalized System of Preferences - Norway	GSP	2	Norway	01-Oct-1971
Generalized System of Preferences - Russian Federation, Belarus, Kazakhstan	GSP	1	Belarus; Kazakhstan; Russian Federation	01-Jan-2010
Generalized System of Preferences - Turkey	GSP	2	Turkey	01-Jan-2002
Generalized System of Preferences - United States	GSP	1	United States	01-Jan-1976
Preferential Tariff for LDCs - Republic of Korea	LDC-specific	0	Korea, Republic of	01-Jan-2000

Table 8: Mauritius' Major trading partners (2014)

Country	2014	Country	2014
1)France	13.9%	6)Italy	6.5%
2)United kingdom	13.6%	7)Madagascar	6.5%
3)United Arab Emirates	10.7%	8)Spain	5.2%
4)United States	10.5%	9)Vietnam	3.0%
5)South Africa	7.1%	10)Belgium	2.8%

Source: Comtrade

Graph 13: Bilateral Goods trade between Mauritius and the U.S under AGOA



4.3 The case of Lesotho

Lesotho is a small land locked country with a population of 2.074mil (2013) and a per capita GDP of 1125, 56 USD (2013). The economy is based on subsistence farming, livestock, remittances from workers in South African mines and a garment assembly industry (ODI, 2009) Lesotho is a leading exporter of clothing from Sub Saharan African to the U.S. Exporting textile firms are wholly owned by foreign investors. The industry is the largest private employer, having created at peak 53,087 jobs in 2004. Despite succeeding in attracting FDI and becoming a lead textile and Apparel exporter, Lesotho still remains one of the poorest countries in Africa. The country is faced with great challenges which include; lack of economic diversification, low domestic saving leading to over dependence on foreign capital flows, extensive unemployment (25.3% in 2008, suspected to be higher than that), widening inequality and poverty as well as widespread cases of HIV/AIDS particularly amongst the youth (Africa economic outlook).

Table 9: GDP - composition, by sector of origin (CIA, 2014 est.)

Agriculture	7.5%
Industry	35.7%
Services	56.9%

Source: CIA, 2014

A brief political history[3]

Lesotho gained its independence from the British on 4 October 1966. However, prior to its independence the political struggle of who would lead Lesotho into independence had already began. The Basutoland Congress Party (BCP) formed in 1952, led by Ntsu Mokhehle, had succeeded in uniting a broad following among educated Basotho who had accrued the confidence to have a more prominent role in Lesotho's tribal chief led society. Splits however soon began to happen within its ranks with the formation of the Marematlou Party (later; Marematlou Freedom Party, MFP) which feared that the "commoners" would take the lead in the government. The MFP was led by Constantine Bereng who was soon to become Moshoeshoe II[4]. Another spilt happened with the establishment of Basutoland National Party (BNP) led by Leabua Jonathan. Religious divides were also present with the majority of Roman Catholics following the more conservative BNP and the educated Protestant elite following the BCP.

In 1961 a commission was appointed to draft a constitution under which Lesotho would gain independence. In 1964 a Westminster-style, two chamber parliament which left the king without any real powers, was approved by Britain. The elections that ensued thereafter saw the BNP with the majority of parliament seats and thus becoming the party to lead Lesotho into its independence.

Post independence, Lesotho saw no rest with regards to political power squabbles. The ruling BNP came into constant conflicts with the BCP, the king, and his supporters. The BNP government began to depend on South African administrative, financial and commercial support. This strengthened the BNP's hold on power but lost the confidence of Basotho who harbored a

[3] Political history derived from Institute of Security Studies'website: http://www.issafrica.org/AF/profiles/Lesotho/Politics.html

[4] Chief Paramount Moshoeshoe I (1789-1870) is proclaimed the founding father of the Basotho Nation.

strong feeling against South African Afrikaners. The elections that took place in 1970 resulted in the BCP winning the majority of parliament seats. Leabua Jonathan of the BNP, however, encouraged by the South African government, refused to accept defeat and suspended the constitution, there after declaring a state of emergency. The king was placed under house arrest and later driven into temporary exile in the Netherlands. The BNP under Jonathan ruled with repressive force until 1986

The BCP, supported by the South African government, formed the Lesotho Liberation Army to oppose the BNP. In 1986 Lebua Jonathan was replaced by Major –General Lekhanya in a coup de tat which saw Lesotho's new rule by a Military Council, which was itself deeply divided by internal tensions and personal ambitions and was therefore incapable of running national affairs. Lesotho was under military rule until 1993.

Lesotho held its first Multi-party election in 1993 which were won by the BCP. The BCP however failed to effectively rule as it was unable to control security forces which were still loyal to the BNP (EISA, 2003). In 1994 fighting amongst rival military factions that resulted in intervention from the Southern African Development Corporation (SADC) took place.

In 1998 an election which produced results similar to those of 1993 was held and SADC had to once again intervene as protests and riots took place. An Interim Political Authority (IPA) which comprised of all members of the opposing parties was established. The IPA through the political parties reformed the previous First Past the Post (FPTP) electoral system to the Proportional Representation system (PR), despite little popular support[5].

[5] Survey institute of South African studies 2000

Elections that followed in 2002 were declared free and fair by both national and international observers. The election was won by the LCD. The 2007 election were again won by the LCD but protested by the newly formed All Basotho Convention (ABC). In 2012 election were won by the Democratic Congress, an off shoot of the LCD lead by its previous leader; Pakalitha Mosisili. It (DC) however couldnt form a government due to lack of parliamentary seats. The ABC together with the LCD and the BNP form a coalition government which was characterized by conflicts between coalition members and eventually lost power before the end of its term, this resulted in yet another intervention by SADC and a snap election. The election in 2015 was won by the DC in coalition with the LCD and 5 other smaller parties.

Foreign Direct Investment and the Textile and Apparel sector

As noted in the case of Mauritius, the factors that hypothetically contributed to the success of its textile and Apparel industry and therefore contributed to its economic development were: 1) An enabling institutional framework, 2) A favorable environment for investment, and 3) the existence of preferential trading agreement. (Subramainian and Roy, 2001; World Bank, 2008, Investment Policy Review (WTO), 2001). In a similar manner as we observed in Mauritius we will look at these factors and their contribution or lack thereof to Lesotho's performance.

- Institutional Framework

Governance: A brief history of politics in Lesotho upon indepedance has been stated in the "Brief political history" section above. Lesotho is a constitutional monarchy with a Prime Minister as head of Government, holding executive power. Legislative power is vested in the government and as well as the Senate (33 members) and National Assembly (120 member). The king serves a ceremonial function. Lesotho ranks 10th out of 52 African countries on the Mo-

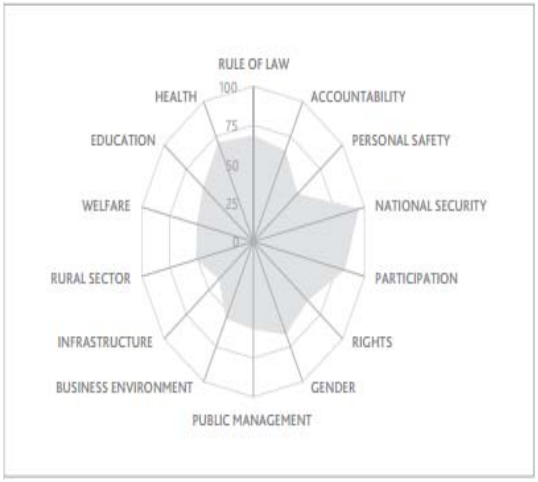
Ibrabim Index of African Governance (IIAG). It ranks 7th, 21st, and 24th out of 52 countries on indicators of Safety and rule of law; Sustainable Economic Opportunity; and Human Development respectively.

Table 10: Lesotho Ranked 10th in 2013 on the overall score of the Mo Ibrahim index on African Governance

Country Results

RANK 2013	CATEGORY & SUB-CATEGORY	SCORE /100							CHANGE '09-'13
		2000	...	2009	2010	2011	2012	2013	
10	Overall Governance	53.8	...	58.4	58.3	58.9	61.0	62.3	+3.8
7	Safety & Rule of Law	65.9	...	66.7	65.0	66.0	68.4	69.5	+2.8
10	Rule of Law	63.7	...	62.3	61.4	60.2	67.2	68.5	+6.2
6	Accountability	56.5	...	66.3	60.5	59.2	59.2	65.0	-1.3
22	Personal Safety	53.3	...	48.3	48.2	49.6	52.1	49.7	+1.4
5	National Security	90.0	...	90.0	90.0	95.0	95.0	95.0	+5.0
9	Participation & Human Rights	56.1	...	61.1	60.8	60.0	66.1	69.9	+8.8
3	Participation	53.6	...	61.3	62.1	62.1	77.9	82.4	+21.0
17	Rights	52.2	...	51.3	52.4	52.3	54.1	60.9	+9.5
13	Gender	62.5	...	70.5	68.0	65.6	66.3	66.3	-4.1
21	Sustainable Economic Opportunity	43.6	...	48.2	49.2	49.8	50.3	50.4	+2.2
13	Public Management	53.2	...	58.0	57.5	54.7	56.3	56.4	-1.6
14	Business Environment	48.8	...	51.3	54.2	56.6	57.1	55.2	+3.9
21	Infrastructure	31.5	...	36.6	38.0	38.9	39.4	38.4	+1.9
34	Rural Sector	41.0	...	46.9	47.0	49.0	48.5	51.5	+4.6
24	Human Development	49.7	...	57.8	58.3	59.8	59.0	59.3	+1.5
29	Welfare	46.8	...	49.4	49.4	51.1	50.6	50.6	+1.3
20	Education	48.2	...	56.5	57.2	56.6	55.5	56.2	-0.3
27	Health	54.1	...	67.6	68.3	71.6	70.9	71.0	+3.4

Graph 14 and 15: Lesotho's score on indicators of sustainable economic opportunity and human development are relatively low



Trade Investment and Industrial Policy: Lesotho's formal garment exporting industry started in the late 1980s with Taiwanese investors who came to Lesotho to a) take advantage of cheap labor for export to South Africa, b) avoid sanction on overseas exports that was placed on South Africa in 1986 c) take advantage of Lesotho's duty-free access to the European market under the Lome Convention (Gibbon, 2003). Lesotho's then government also had strategies underway to promoting the country as a stable and attractive investment destination (1986-1991) (Manoeli, 2012). However incentives offered by the Lesotho government were not exactly generous according to internationals standards.

The first Taiwanese textile firm was established in 1986. By 1991 four (4) firms, still owned by Taiwanese, had opened shop. Amongst them was also a firm from Hong Kong and another South African owned. Foreign owned firms continued to sprout in Lesotho and by the year 2000, 19 firms were operating with the number reaching its peak in 2004 with 49 firms (Stariz and Morris, 2011)

Table 11: Number of Workers and firms in the Lesotho's Apparel industry

	1994	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2008**	**2014**
workers	8600	9847	16417	23518	3314	44345	53087	40364	45886	45310	40800
firms	6	21	19	32	38	-	49	42	47	44	39

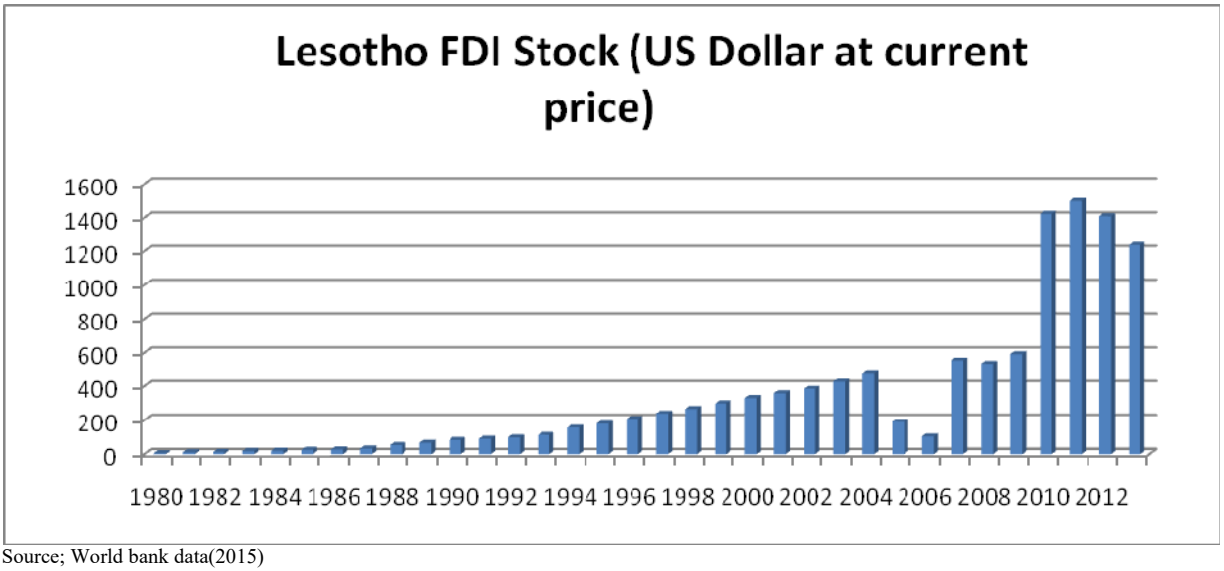
Source: Staritz and Morris (2011) Better works Lesotho (2015)

Despite the textile firm activities that took place in the 1980s, the textile industry in Lesotho only started to take off with the advent of AGOA, which from 2000 onward provided quota and duty free access to the U.S market as well as non-restrictive Rules of Origin laws allowed for lesser developed countries.

The bulk of manufacturing FDI in Lesotho is in the Appear and textile industry. All firms in this sector are foreign owned (mainly Taiwanese); no local firms have joined this sector. Some have tried but have closed down within a short period of time. Under AGOA, Lesotho has been number one textile exporter to the United States. This was a great achievement for a land locked country with few natural resources.

Lesotho has benefited greatly from FDI in terms of employment and export earnings, but the textile industry is very shallow and some would even call it "footloose"; some exporters are only in Lesotho because of the benefits the country receives as a least developed economy from large developed markets such as that of the United States. Without this preferential access, they would not still be in the country (Lall, 2005).

Graph 16: Inward FDI Stock (1980-2012)



Source; World bank data(2015)

Operations in the industry rely mainly on expatriates (Taiwanese and Chinese) most of which are not fluent in Sesotho or English. In 2001, 1076 expatriates worked in the clothing industry (Lall, 2005). There are hardly any Basotho at the managerial and supervisory levels. Skills transfer,

one of the main benefits of FDI is minimal; it is limited to basic production, handling sewing machines, cutting, pressing and so on. 80 ~ 85% of industry workers are female. Vocational training institutions in the country also do not offer technical and managerial skills needed for the garment industry.

- Favorable Investment Environment

Lesotho has no law that governs foreign direct investment however the country maintains a liberal and non discriminatory policy for foreign investors (TPR). The Lesotho National Development Corporation (LNDC) is the government agency responsible for implementing export and investment promotion activities. The LNDC was established by the parliament act no. 20 of 1967. It is part of the Ministry of Trade and Industry, Cooperatives and Marketing which is responsible for the overall national industrialization policy.

The LNDC functions as a real estate developer, facilitator, and service provider. It also acts as a one-stop shop dealing with issues ranging from business inquiries, site selection, firm registrations as well as regulation and facilitation of production and sales together with managing government incentive schemes and tax procedures.

LNDC Industry support and incentives

Company support

- Business registration procedures
- Acquisition of permits and manufacturing licenses
- License and residency paperwork for foreign workers, managers, and owners
- Arrangement of site visits and assistance in selection of suitable sites
- Key focal point for contact with relevant ministries on business regulations
- Facilitation of contact with business companies supplying services
- Facilitation of skill and technology development programs
- Industrial relations if disputes arise with workers

Management of incentive schemes

- Unimpeded access to foreign exchange
- Export finance facility
- Short- and long-term loans
- Import value added tax (VAT) credit facility for local purchase of raw materials and capital goods

Tax management oversight

- No tax on income generated from exports outside the Southern African Customs Union
- Permanent maximum manufacturing tax rate of 10 percent on profits
- No tax on dividends to local or foreign shareholders
- Free repatriation of profits
- Double taxation agreements with Germany, Mauritius, South Africa, and the United Kingdom

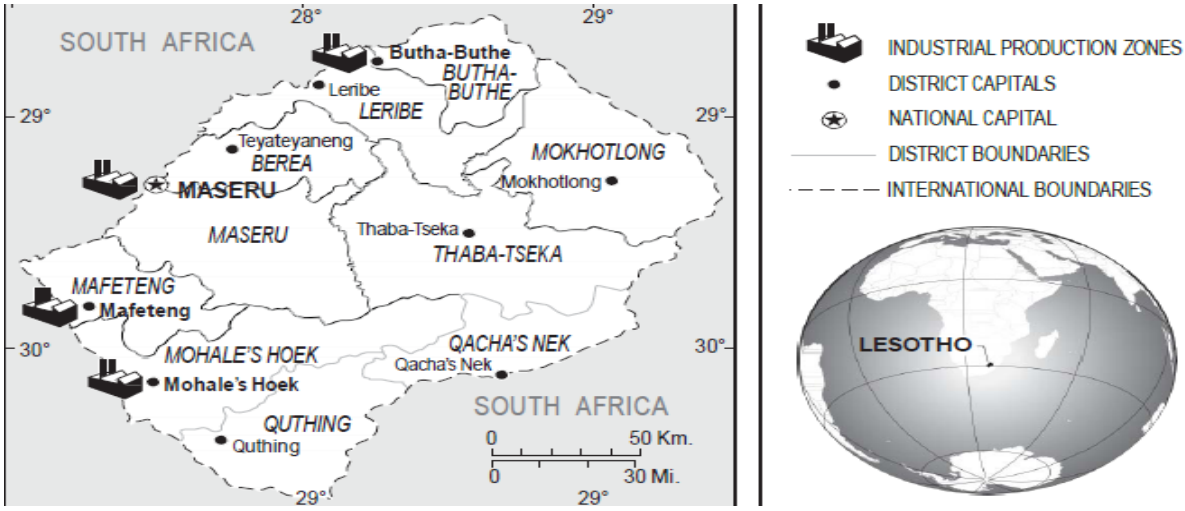
Investment attraction

- Information dissemination to targeted investor pools
- Trade missions to targeted markets and investor pools

Source: Consultations with LNDC officials.

Lesotho has a number of industrial Zones located in various national capital towns close to the boarders with South Africa. Although the country has no export processing zone, initially textile investors tended to cluster in the industrial site in Maseru (Staritz and Morris, 2011). Lesotho is a small country with limited industrial land. Also the cost of renting out factory space can be very costly. To circumvent this problem, the government has, through the LNDC constructed a number of industrial zones with serviced factory shells; the shells come ready with electricity, water and waste mamagement facilities.

Graph17: Industrial Zones in Lesotho



- Trade preferences

Lesotho has always enjoyed preferential access to markets of developed economies. Lesotho, like Mauritius, has had links to the European market since the 1970s under various conventions which offered preferential access to the European Community.

Under the Multi Fiber Agreement (MFA) Lesotho also saw East Asian investors set up shop in the country to take advantage of duty-free and quota-free access to Europe and the United States.

The expiration of the MFA in 2005 hit the textile industry in Lesotho hard as foreign investors left the country and more than 5000 jobs were lost (ODI, 2009).

The textile and Apparel industry could however, still rely of the preferences offered by the African Growth and Opportunity Act (AGOA). It has thus been what has kept the dwindling industry on its feet.

Table 12: Export from Lesotho to the U.S and the E.U (1990- 2001) (US dollar million)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
to US	24.5	27.0 321.1	50.8	55.1	62.4	61.7	64.9	86.5	100.2	110.7	140.1	216.7	
to EU	25.6	18.2 a	18.3	14.7	13.5	12.6	12.7	4.5	0.8	0.2	1.6	3.2	n/

Sources: US Department of Commerce, Otexa; Eurostat; ECU/Euro: US$ exchange rates based on rates for 31 December in relevant year.

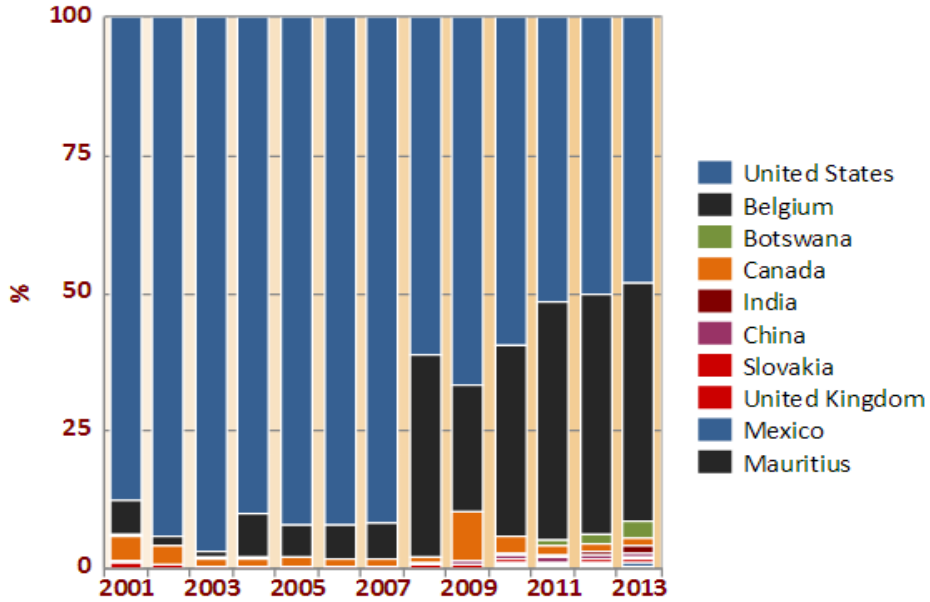
Table 13: Exports to the U.S from AGOA beneficiaries (2001-2010)

Country	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD*
Botswana	0	3708	6344	20118	30043	27687	31333	15802	12361	4778
Burkina Faso	0	0	0	0	0	6	0	0	0	1
Cameroon	0	0	0	0	0	0	0	0	35	33
Cape Verde	0	0	2.452	2.902	2.115	85	0	0	0	0
Ethiopia	163	1297	1684	3327	3509	4872	4560	9357	6619	3312
Ghana	0	324	4.254	7.099	4.986	8.807	7.517	766	275	596
Kenya	51 684	121 312	176 224	271 480	266 615	258 905	244 778	246 154	194 834	79 447
Lesotho	129.242	317.660	372.614	446.494	388.344	384.452	379.464	338.686	276.885	106.109
Madagascar	92.048	75.415	186.253	314.185	272.962	229.499	281.432	277.036	209.943	0
Malawi	4.696	11.402	22.388	25.485	22.450	18.187	19.824	12.671	9.015	3.619
Mali	0	0	0	0	0	0	0	2	0	1
Mauritius	38.874	106.498	134.958	147.798	146.811	145.776	112.346	97.016	98.622	48.251
Mozambique	0	187	2179	1805	2512	658	161	0	0	0
Namibia	0	1539	32131	75906	53058	33010	28576	0	0	0
Nigeria	0	0	0	0	0	18	0	0	0	0
South Africa	30.487	85.261	126.885	114.616	61.621	41.978	21.335	15.955	10.114	2.200
Swaziland	8.195	73.719	126.841	175.641	159.175	134.486	134.533	124.412	94.164	39.280
Tanzania	0	124	851	2520	2811	2994	2810	1501	996	245
Uganda	0	0	1414	4010	4840	1253	1134	403	138	57
Zambia	0	0	0	22	0	7	0	0	0	0
Total	**355.389**	**798.446**	**1.197.472**	**1.613.408**	**1.421.852**	**1.292.680**	**1.269.803**	**1.139.761**	**914.001**	**287.929**

Source: U.S. International Trade Commission (2010)
* Denotes Year-to-Date values from January to June 2010
These figures are that of AGOA *excluding* GSP

Graph 18: Bilateral Good trade U.S –Lesotho under AGOA

Graph 19: Lesotho Key export destinations 2001 -2013



Sources: opendataforlesotho

4.4 Comparative Analysis of Mauritius and Lesotho's FDI spillover gains and promotion and facilitation policies

Development Contributions made by FDI	**Mauritius**	**Lesotho**
Transfer of technology know-how	The textile industry in Mauritius started in the 1970s. To date; Mauritius has the most vertically integrated textile and Apparel sector in SSA Most of the firms in Mauritius are domestically owned (USITC 2009).	The industry first came to Lesotho in the 1980s. To date: Lesotho has only one vertically intergrated textile mill (CGGC, 2011There are no domestically owned textile firms in Lesotho and production in the assembly, cut make trim (CMT) segment of the textile value chain. (see table below)
Human Capital enhancement	Mauritius started off with low skilled labor. However, through further integration in the textile and Apparel industry it has been able grow its skill pool in this industry. Firms in Mauritius are now venturing into higher value added activities such as quality, design and fashion. (see graph on skill requirements and curve of value added stages)	Workers in Lesotho are literate but not technically skilled. In-house skills training are mainly in basic skills. Managers (expats) with shop floor knowledge lack language skills to communicate with Basotho workers (Lall, 2003) and training usually happens informally by floor supervisors (CGGC, 2011)
Economic Integration	The Mauritian textile industry has lead to deep, sustainable integration through exports and the domestic ownership of the industry contributes to sustainability. Textiles are exported to mainly Europe and the U.S	Lesotho's integration into the world market via textile exports is unsustainable as there is no local ownership of the industry and investors are characterized as tariff hopping(GCCG, 2011)
Competition effect	Competition effect: Domestic firms in Mauritius have been able to out compete foreign firms[6]	All initiatives to start domestically owned textile firms have failed.

[6] 30 firms (mostly from Hong Kong) left Mauritius as the industry underwent reconstruction in 2004. Industry in 80% domestically owned (USITC, 2009)

Mediating Factors		
	<u>Spillover Potential</u>	
Foreign firm characteristics: 1. *Degree and structure of ownership* 2. *FDI Motivation* 3. *Global production and sourcing strategy* 4. *Tech-intensity* 5. *FDI Home Country*	1. The industry is composed of large foreign textile and Apparel groups. 2. Initially motivated by loss of competitiveness in home country as well as to take advantage of Preferential trade access to developed markets 3. Mauritius firms source inputs from various countries; however this has not inhibited the sector expanding to other higher value added production activities. Mauritius is also an exporter of yarn 4. Labor intensive, low Tech industry moving towards more tech-intensive, higher value added activities. 5. Chinese, Taiwanese, Hong Kong investors	1. The industry is composed of large foreign textile and Apparel firms. 2. Initially motivated by loss of competitiveness in home country as well as to take advantage of preferential trade access to developed markets 3. Lesotho sources inputs (cotton) from Malawi, Zambia, Mozambique, Tanzania and Benin (USITC, 2009) All high value add value chain activities such as input sourcing, product development, merchandising, marketing, distribution ,etc happen in the the foreign firm home county (GCCG, 2011) 4. Labor intensive low tech industry that has not upgraded. 5. Taiwanese, Hong Kong, South African investors.
	<u>Absorptive Capacity</u>	
Domestic firm characteristics: 1. *Technology Gap* 2. *R&D* 3. *Human Capital* 4. *Scale* 5. *Firm Location* 6. *Exporting* 7. *Sector Dynamics* 8. *Competition*	1. Textile and Apparel industry set up by foreign investors, then integrated and adopted by domestic entrepreneurs. 2. Firms in Mauritius do market research to anticipate consumer behaviors and other factors concerning exports (USITC, 2009) 3. Institutional support for learning and vocational training. 98% literacy rate (world bank) 4. Both big and small firms exist in Mauritius. Only the most adaptable and competitive firms are able to survive	1. Textile and Apparel industry set up by foreign investors. 2. No R&D 3. National Vocational training institutes offer general management and general skills courses but there are no linkages with textile industry and therefore industry specific courses that cater to industrial needs are not offered (CGGC, 2011) 4. Mostly large firms 5. Firms are located in industrial clusters in different districts

	5. Firms are located mostly in the EPZ 6. Some firms produce for the local market but mostly export oriented firms. (USITC,2009) 7. Mauritius has been able to make FDI a success despite perceived difficulties for spillovers in Textile and Apparel value chain 8. Productive domestic entrepreneurs drive out foreign firms. Industry largely domestically owned.	6. Production is for exporting 7. Lesotho has been unable to upgrade and vertical integration is very limited. Factors concerning the Textile and Apparel sector have been ascribed to this failure. 8. No competition between local and foreign firms as local firms is nonexistent.
Institutional Framework		
Institutions: 1. *Labor Market Regulations* 2. *Access to Finance* 3. *Learning and Innovation Infrastructure* 4. *Trade, industrial and investment policy* 5. *Governance*	1. Labor market regulations in Mauritius are substantially rigid (WTO). However, firms in the EPZs benefited from cheap labor drawn from unemployed sugar workers and women who where outside the workforce (Zafar, 2011) 2. Although access to finance is still a hindrance to SMEs entering the export market (Kaseeah et al, 2013). The government has various schemes in place that offer SME financing opportunities (Essays, UK 2013). 3. Mauritius has a literacy rate of 98% (world bank), Higher education and Vocational training institutes are well established and on the job training is also well facilitated (Sawkut,) 4. Openness to trade and foreign investors. Forward looking industrial policies on diversification combines with flexible export strategies (WTO).	1. Labor regulations with regard to the industry have been quite lax (USITC, 2009). However, the ILO through the Better work program has worked with the industry to protect worker's rights. (CGGC, 2011) 2. The government has introduced various funding schemes for entrepreneurs, however a limited number of Basotho have been able to access these funds due to stringent requirement (government official) 3. Lesotho has a literacy rate of 75.8 (UNESCO, 2012) National Vocational training institutes offer general management and general skills courses. On the job training happens informally. 4. Openness to trade and FDI. Reactive industrial policies and not much facilitation of spillovers to domestic economy 5. Ranks 10th in Africa on overall governance (21st on sustainable economic opportunity, 24th on

	5. Ranks 1st in African on Overall governance (1st on Sustainable Economic Opportunity and Human Development. 2nd on Safety &Rule of law and on Participation and Human Rights (IAG, 2013)). Ranks 28/189 on the WBG ease of doing business index (2015)	Human Development, 9th on participation and human rights and 7th on safety and rule of law (IAG, 2013)). Ranks 128/189 on the WBG ease of doing business index (2015)

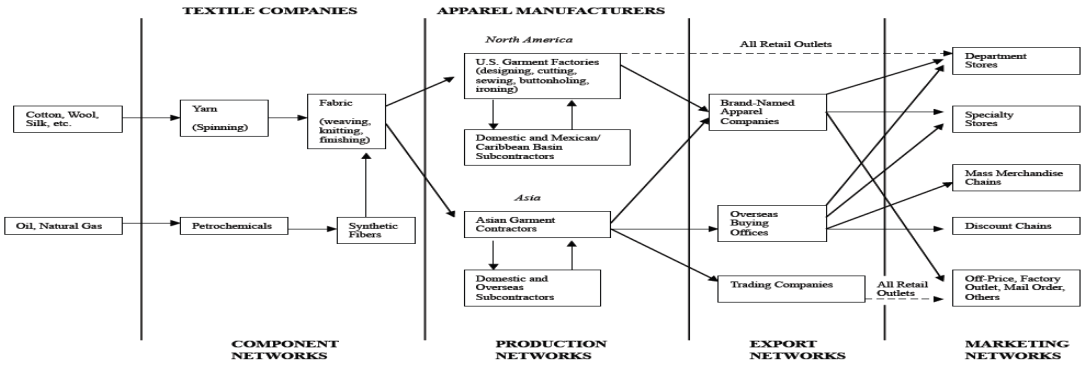
Table 14: Job profiles in the Apparel global value chain

Position	Job Description	Formal Education Requirements	Training/ Experience	Skill Level
CMT/Assembly /Production				
Hand Sewers	Sew, join, reinforce, or finish—usually with needle and thread—a variety of manufactured items. Includes weavers and stitchers.	No formal education required	Required experience	
Sewing Machine Operators	Operate sewing machines to join, reinforce, decorate, or perform related sewing operations in the manufacture of garment or nongarment products.	No formal education required; literacy and numeracy skills	Experience: Need of speed and accuracy skills	
Garment Pressers	Clothing pressers use steam irons and vacuum presses to shape garments and remove creases.	No formal education required	Experience: Need of speed and accuracy skills	
Cutting Machine Operators	In automated facilities, cutters electronically send the layout to a computer-controlled cutting machine.	Technical education	Technical training	
Line Leaders	Supervisory roles; ensure work flows expeditiously along the line.	High school diploma/ technical education	Management skills	
Production Flow Supervisors	Supervisory roles; oversee the pace of the work and ensure stoppages are minimized, monitor production levels, train new workers, and manage constant problem solving.	Technical education/ Bachelor's degree	Management skills	
OEM/ Full Package				
Quality Control	Maintain final quality prior to distribution of product, monitored by buyers	High school diploma/ technical education	Knowledsge of quality systems	
Sourcing, Purchasing, and Supply Chain Management	Capabilities related to OEM production: Workers must have financial skills related to purchasing inputs and coordinating production schedules.	Technical education/ Bachelor's degree in finance/management	Industry experience	
ODM				
Fabric and Apparel Patternmakers	Create the blueprint or pattern pieces for a particular apparel design. This often involves grading, or adjusting the pieces for different sized garments	Technical education in apparel	Experience	
Tailors, Dressmakers, Custom Sewers	Design, make, alter, repair, or fit garments.	Technical education in apparel	Experience	
Designers	Workers must have training in the "aesthetics" of product development, some market and consumer knowledge, and technical skills required to translate ideas into samples.	Technical education/ Bachelor's degree in clothing design	Experience	
Senior Designers	Creative talent within the industry that can develop new design lines for production.	Bachelors/Master's degree in clothing design	Experience	

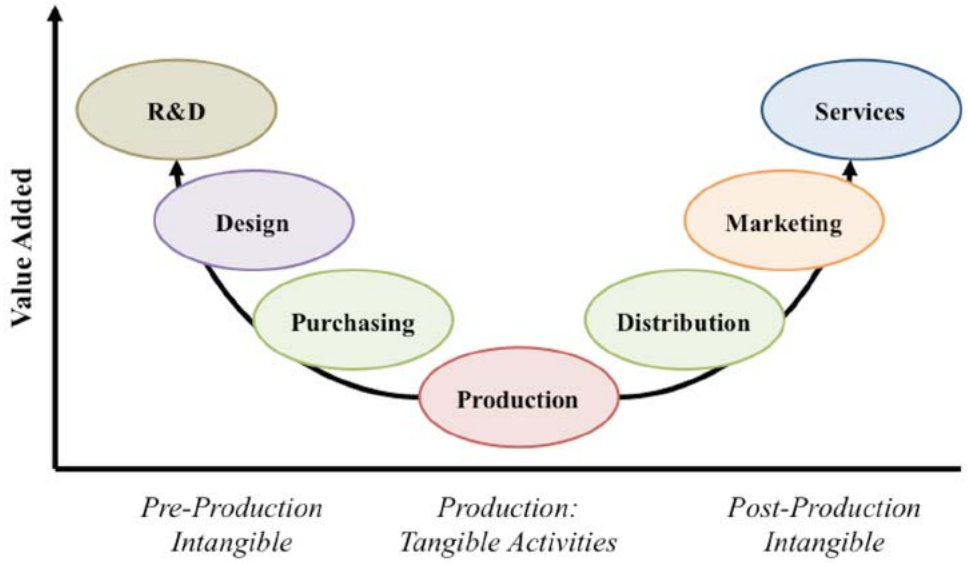
OBM				
General Business Skills	Responsible for financial management supply chain optimization, quality control and/or strategy, and new business development.	Bachelor's/Master's degree in business/engineering	Experience	
Branding and Marketing Capabilities	Responsible for market research, marketing/advertising, networking, and positioning brands in the market.	Bachelor's/Master's degree in business	Marketing specialization and experience	

Skill Level	Low	Low-Medium	Medium	Medium – High	High
	No formal education; experience	Literacy and numeracy skills; experience	Technical education/certification	Technical education /undergraduate degree	University degree and higher

Graph 20: Apparel Global Value Chain



Graph 21: Curve of Value-added stages in the Apparel Global Value Chain



Investigating Institutions

In the above comparison the prescribed institutional framework for promoting the absorptive capacity of domestic is presented. The prevailing policy in both countries is revealed. However, to fully gauge the institutional environment of Lesotho interviews were conducted with individuals from the different organizations that are mandated to execute national development plans especially those concerning the textile industry and also those from international donor organizations and from the textile exporter's association.

As North (1990) states; Institutions are the "rules of the game" while organizations are the "players" in the game. The aim of these individual interviews was to get an in depth understanding on the following issues that can give an indication of the environment in which these organizations themselves operate:

1) Lesotho's performance with regard to substantial FDI spillovers has been lackluster. What is government (or the private partners/ sector) doing to make the necessary gains from FDI?

2) How important does the government and its policy implementing institutions deem the textile industry and ownership thereof by domestic entrepreneurs?

3) How have the 'regular' and 'not-so-smooth' government transitions (as well as political tensions and insecurities) affected the operations of the policy implementing institutes and the foreign investors?

Interviews were conducted with employees (working 5 years +) from Ministry of Trade; department of Industry, Lesotho National Development Corporation (LNDC), Basotho Enterprise Development Corporation (BEDCO), as well as a small business owner (entrepreneur).

Interviewees from government organizations were asked about the role each of their organizations played in facilitating the main elements of the institutional framework that mediate spillovers from foreign direct investment which are: Labor market regulations, Access to finance, Learning and innovation infrastructure, trade and industrial and investment policy as well as governance. In cases where some of the elements where simply non-existent or poorly implemented such as the case of Learning and innovation infrastructure, the interviewees were asked to identify what they felt or observed to be the main hindrances and challenges.

With regard to the Textile Exporters and the Small business owner, they were asked to state the main challenges they faced when doing business in Lesotho.

Interviews: Main findings

Labor market Regulations: One officer mentioned that the Lesotho government lacked the political will to face the hard facts regarding labor regulations in Lesotho. For example; the fact that in order to remain competitive in the textile industry (be able to compete with Asian countries such as Bangladesh) wages had to remain low, whereas wage rates in Lesotho are quite high in comparison. What officials would rather do is pay lip service to workers, saying that they will raise their wages, just so they can vote for them in upcoming elections.

Access to finance: Access to finance has forever been a problem for small business owners in Lesotho.

Learning and innovative infrastructure: “Efforts to build learning infrastructure so that it feeds the job market have not been useful” observes one government officer.

Trade, industrial and investment policy: “We work continuously on industrial policies” exclaims an employee at the Ministry of Trade and Industry. “Every time a new government comes into office I need to review policies but I know that they are just going to end up on someone’s desk untouched.” “Most times our ministers are not knowledgeable. Terms such as Preferential trade access means nothing to them. It’s just an elected person coming from some constituency and he has no interest in this huge monster I keep referring to: AGOA!”

Governance: “Every time there is insecurity in the country, the Lesotho brand takes a knock” exclaimed a foreign investment promotions officer at the LNDC. “We have been very slow with regard to the textile industry” says an employee from BEDCO who has been with the parastatal for more than 10 years. “Even initiatives from international donors to boost participation of our domestic entrepreneurs have failed because they have found us ill prepared.

All the interviewees stated that lack of political will, the reactive nature of policy action, often not to the benefit of the nation and the politicization of crucial development issues were hindrances to the growth.

Chapter 5

Conclusion and Recommendations

5.1 Conclusion

Industrialization through textiles has often times been the formula to economic development for developing countries characterized mainly by cheap labor and in some cases preferential access to markets in developed economies; e.g. South Korea, Taiwan (east Asian tigers) and Mauritius. Lesotho has however, made a shallow gain from this gateway to economic development.

This paper posits that institutions have contributed greatly to Lesotho's lackluster performance as a nation. Lesotho entered independence with institutions that never existed for the benefit of the nation but rather sort to take from the little natural and human resources that exist in the country; extractive institutions. Lesotho, a homogeneous nation was divided to benefit the then elites. The Basotho land was taken from then by the colonizers and the little that was left of it was divided between invisible class and religious lines. These divisions, oblivious to the masses, still exist today and are among the reasons why Lesotho remains an underdeveloped country.

We took a comparative look at Mauritius; the African success story. Even though Nobel Prize laureate James Meade forecasted doom for the small island economy, Mauritius neutralized his underdevelopment curse and performed remarkably. Why did Mauritius succeed?

Instead of fighting for political power in a small country, politicians in Mauritius saw it better to work together to develop the country for the benefit of all who lived in it (Mauritius is a multiethnic country).

They did not hunger for economic and social success and hope for it to fall on their laps with wishful thinking. They set up Exporting Zones and worked at attracting investors into the country. Investors came to them, like in all other African countries, with the aim of skipping restrictions that were in place in their home economies (MFA, loss of competitiveness etc.) and to take advantage of the preferential access to developed markets given to African countries. The government of Mauritius intervened, subsidized and targeted in order for their economy to grow (Subramanian and Roy; 2001). Thus, today most of the textile and Apparel industry in Mauritius in domestically owned. Mauritius is now a middle income country.

In answering the posed research question: "What role have institutions within Lesotho played/or not played with regard to promotion, Facilitating and regulation FDI in the textile and Apparel industry?" We come to the following answer:

Institutions in Lesotho have been extractive and therefore not been able to fully take advantage of the potential benefits provided by Foreign Direct Investment. Investors have entered into the country, not necessarily through the efforts made by Lesotho but because they saw a business advantage for themselves. They were able to bring in minimal foreign earnings and create employment but none of which is sustainable should the trade preferences erode. Minimal skills were transferred and no advances technologies were adopted by local entrepreneurs so that they themselves would be able to carry the industry and export to the world market.

At independence the focus was on power politics; who would take the Prime Ministers seat. The role of opposition parties has not been to challenge questionable policies of the ruling parties that affect social and economic development, but rather, it has been to make it difficult for the ruling party to govern mainly due to interest in personal gains.

The military has played a significant role in the governing of the country not for common gains but for reasons hidden behind unaccountable institutions. Evidence is present in the budget allocations presented each year where in any given year the allocation for defense is more than 4 percentage points[7] larger than that of the Ministry of trade and Industry; a ministry that, aside from its own mandate, houses the foreign and domestic investment promotions agency (LNDC) and the local entrepreneurship promotion agency (BEDCO) set up to drive the economy of the country buy building business and industry. Mauritius, in comparison has no standing army.

5.2 Recommendations

"While economic institutions are critical for determining whether a country is poor or prosperous, it is the political institutions that determine what economic institutions a country has." – Acemoglu and Robinsons (43; 2012)

Although institutions that have been put in place over years are hard to alter, Lesotho needs a strong leadership that can take a long-term view of the situation in the country and thereby make efforts to work together with the citizens of the country to turn Lesotho into a progressive developmental state.

As long as preferential access to developed markets prevail, the textile industry together with other labor intensive industries are well aligned with Lesotho's comparative advantage and are therefore vital areas in which the country can make economic progress. This paper recommends that the government focus its limited resources at facilitating upgrading and diversification in these kinds of industries by means of:

1. Providing access to finance for entrepreneurs

[7] Budget speeches (FY 2010/11 – 2015/15)

2. Invest in Technical and Managerial skills building for development industries and building learning and innovation infrastructure that feed the needs of the market

3. Depoliticizing the public service so that its work of delivering services to the people and is not hindered by political power struggles.

4. Implementing knowledge based policies stemming from international best practices and lessons from the success or failure of developed and developing countries.

5. Assessing the role of the military to see wither it is necessary to have a standing Military. A large portion of the national budget goes towards military activities. These funds can go towards development initiatives.

5.3 Bibliography

- Abraham, Filip, Jozef Konings, and Veerle Slootmaekers. "FDI Spillovers in the Chinese Manufacturing Sector." Economics of Transition: 143-82.
- Acemoglu, Daron, and James A. Robinson. "Why Nations Fail: The Origins of Power, Prosperity and Poverty."Crown Business. New York, .
- Adeoye, Adewale. "Macro-Economic Level Corporate Governance and FDI in Emerging Markets: Is There a Close Relationship?" SSRN Journal SSRN Electronic Journal.
- Aitken, Brian, Gordon Hanson, and Ann Harrison. "Spillovers, Foreign Investment, and Export Behavior." Journal of International Economics, Elsevier, Vol. 43 (1-2), 103-132, 1997
- Athukorala, Prema-Chandra. "Trade Policy Reforms and the Structure of Protection in Vietnam." The World Economy World Economy: 161-87.
- Barrios, Salvador, and Eric Strobl. Foreign Direct Investment and Productivity Spillovers: Evidence from the Spanish Experience. 2002.
- Békés, Gábor, Jörn Kleinert, and Farid Toubal. "Spillovers from Multinationals to Heterogeneous Domestic Firms: Evidence from Hungary." World Economy: 1408-433.
- Blalock, Garrick and Paul J. Gertler. “Welfare Gains from foreign Direct Investment through Technology Transfer to Local Suplpliers.” 2005
- Blalock, Garrick, and Paul J. Gertler. "How Firm Capabilities Affect Who Benefits from Foreign Technology." Journal of Development Economics: 192-99.
- Blomström, Magnus, and Ari Kokko. "How Foreign Investment Affects Host Countries." Policy Research Working Papers, 1999.
- Blomström, Magnus, Steven Globerman and Ari Kokko. “The Determinants of Host Country Spillover from Foreign Direct Investment: Review and Synthesis of the Literature.” EIJS, Working Paper No. 76, 1999
- Bouoiyour, Jamal, and Serge Rey. "Exchange Rate Regime, Real Exchange Rate, Trade Flows and Foreign Direct Investments: The Case of Morocco." African Development Review: 302-34.
- Branstetter, Lee, Raymond Fisman, and C. Fritz Foley. "Do Stronger Intellectual Property Rights Increase International Technology Transfer? Empirical Evidence from U.S. Firm-Level Data."
- Caves, Richard E. "International Corporations: The Industrial Economics of Foreign Investment." Economica, 1971, 1.
- Chen, Tain-Jy, Homin Chen, and Ying-Hua Ku. "Foreign Direct Investment and Local Linkages." J Int Bus Stud Journal of International Business Studies, 2004, 320-33.
- Crespo, Nuno, abd Maria Paula Fontour. “Determinant Factors of FDI Spillovers –What do we really know.” ISEG, 2006.

- Damijan, Joze P., Crt Kostev and Saso Polaneo. “From innovation to exporting or visa versa? Causal link between innovation activity and exporting in Slovenion microdata, 2007
- Dimelis, S and Helen Louri. “Foreign Direct Investment and Productivity Analysis.” DEOS Working Papre, Athens University of Economic and Business, 2001
- Dixit, Avinash. “Governance, Development, and Foreign Direct Investment.” Max Weber Program, Eurpoean University institute 2012
- Du, Luosha, Ann Harrison, and Gary Jefferson. "FDI Spillovers and Industrial Policy: The Role of Tariffs and Tax Holidays."
- Dunning, J.H. “Multinational Enterprises and the Global Economy.” Workingham, Berkshire. Addison Wesley, 1993
- Dutse, AY. Technology Capabilities and FDI-related Spillover: Evidence from manufacturing Industries in Nigeria.” Abubakar Tafawa-balewa University, 2012
- Farkas, Beatrice. "Absorptive Capacities and the Impact of FDI on Economic Growth." SSRN Journal SSRN Electronic Journal.
- Farole, Thomas, and Deborah Winkler. "Foreign Firm Characteristics, Absorptive Capacity and the Institutional Framework: The Role of Mediating Factors for FDI Spillovers in Low- and Middle-Income Countries." Policy Research Working Papers, 2012.
- Farole, Thomas, Cornelia Staritz, and Deborah Winkler. "Conceptual Framework." Making Foreign Direct Investment Work for Sub-Saharan Africa:Local Spillovers and Competitiveness in Global Value Chains, 2014, 23-55.
- Fernandez-Stark, karina, Stacey Frederick and Gary Gereffi. “The Appeal Global Value Chain: Economic Upgrading and Workforce Development.” Center on Global, Governance and Competitiveness; Duke University, 2011
- Ferrantino, Michael J. "Global Value Chains in a Postcrisis World: A Development Perspective Edited by Olivier Cattaneo, Gary Gereffi, and Cornelia Starlitz Washington, DC: World Bank, 2010." World Trade Review: 162-65.
- Foreign Direct Investment for Development; Maximizing Benefits, Minimizing Cost; OECD, 2002
- Fosfuri, Andrea, Massimo Motta, and Thomas Rønde. "Foreign Direct Investment and Spillovers through Workers’ Mobility." Journal of International Economics: 205-22.
- Frankel, Jeffrey A, 2010. Mauritius: African Success Story. HKS Faculty Research Working Paper Series RWP10-036, John F. Kennedy School of Government, Harvard University. http://web.hks.harvard.edu/publications/workingpapers/citation.as px?PubId=7410
- Gerlach, Ann-Christin and Pascal Liu. “Resource-seeking Foreign Direct Investment in African Agriculture. FAO, 2010
- Gibbon, Peter 2003. “AGOA, Lesotho’s ‘clothing miracle’ and the politics of swearshops.” Review of African Political Economy.

- Girma, S., Y. Gong, and H. Gorg. "Foreign Direct Investment, Access to Finance, and Innovation Activity in Chinese Enterprises." The World Bank Economic Review, 2007, 367-82.
- Greif, Avner. “Institutions and International Trade: Lessons from the Commercial Revolutions. American Economic Review, 1992
- Hancock Dawson R and Bob Algozzine. “Doing Case Study Research: A practical guide for beginner researchers.” Teachers College Press, 2006
- Hanushek, Eric A. Economic growth in developing countries: The role of human capital. Standford University, United States, 2013
- Hirschman, Albert O. The Strategy of Economic Development. New Haven: Yale University Press, 1958.
- IMF (2008), Mauritus: Selected Issues, IMF, Washington DC.
- Investment Policy Review, UNCTAD, 2001
- Iršová, Zuzana, and Tomáš Havránek. "Determinants of Horizontal Spillovers from FDI: Evidence from a Large Meta-Analysis." World Development: 1-15.
- Irwin, DA. 2003 “ Historical Aspects of U.S Trade Policy.” The National Bureau of Economic Research. http://www.nber.org/reporter/summer06/irwin.html
- Javorcik, Beata Smarzynska, and Mariana Spatareanu. "To Share or Not to Share: Does Local Participation Matter for Spillovers from Foreign Direct Investment?" Journal of Development Economics: 194-217.
- Kalotay, Kalman and Gabor Hunya. “Privatization and Foreign Direct Investment in Central and Eastern Europe.” Transnational Corporations Vol 9, No. 1, 2000
- Kashcheeva, M. "The Role of Foreign Direct Investment in the Relation between Intellectual Property Rights and Growth." Oxford Economic Papers, 2013, 699-720.
- Lall, Sanjaya, and Rajneesh Narula. "Foreign Direct Investment and Its Role in Economic Development: Do We Need a New Agenda?" The European Journal of Development Research, 2004, 447-64.
- Lall, Sanjaya. FDI, AGOA and Manufacturing Exports by a Landlocked, Least Development African Economy: Lesotho.” The Journal of Development Studies, Volume 41, Issue 6, 2005
- Lesher, Molly, and Sébastien Miroudot. "FDI Spillovers and Their Interrelationships with Trade." OECD Trade Policy Papers, 2008.
- Li, Jing, Dong Chen, and Daniel M. Shapiro. "Product Innovations in Emerging Economies: The Role of Foreign Knowledge Access Channels and Internal Efforts in Chinese Firms." Management and Organization Review, 2009, 243-66.
- M, Magnus, and Ari Kokko. The Economics of Foreign Direct Investment Incentives. Cambridge, Mass.: National Bureau of Economic Research, 2003
- Majeed, Muhammed Tariq and Eatzaz Ahmad. “Human Capital and FDI in Developing Countries.” Journal of Economic Cooperation, 2008.

- Manoeli, Sebabatso, 2012. “Lesotho after AGOA: from textile booms to sustainable development.” The Brenthurst Foundation.
- Markusen, James R., and Anthony Venables. Foreign Direct Investment as a Catalyst for Industrial Development. Cambridge, MA: National Bureau of Economic Research, 1997.
- McBurn, Donald. “Reseach Methods” Wadsworth Thomson learning, 2001
- Méon, Pierre-Guillaume, and Khalid Sekkat. "Institutional Quality And Trade: Which Institutions? Which Trade?" Economic Inquiry: 227-40. 2006
- Michie, Jonathan, and Maura Sheehan. Labour Market Flexibility, Human Resource Management and Corporate Performance. London: School of Management and Organizational Psychology, Birkbeck College, 2000.
- Mo Ibrahim Index of African Governance, 2013
- Mussa, Michael. “Factors Driving Global Economic Integration.” IMF, 2000
- Narula, Rajneesh and Marin Anabel. “FDI spillovers, absorptive capacities and human capital development: evidence from Argentina.” MERIT, 2003
- Ndambuki, Josephine. “Linking Foreign Direct Investment, Access to Finance and Enterprise Innovation in Kenya.” Egerton University, Kenya, 2013
- North D. 1990. “Institutions, Institutional Change and Economic Performance.” Cambridge: Cambridge University Press.
- North, Douglass C. "Institutions, Institutional Change and Economic Performance." 1990
- Nunnenkamp, Peter, and Julius Spatz. "Foreign Direct Investment and Economic Growth in Developing Countries: How Relevant Are Host-Country and Industry Characteristics?" SSRN Journal SSRN Electronic Journal.
- ODI, 2009, “Aid for Trade in Lesotho: ComMark’s Lesotho Textile and Appeal Sector Programme.”
- OECD 2002; ‘Foreign Direct Investment for Development: Maximizing Benefits, Minimizing Cost.”
- Parcon, Hazel. “Labor Market Flexibility as a Determinant of FDI Inflows.” University of Hawai, 2008
- Paus, Eva A., and Kevin P. Gallagher. "Missing Links: Foreign Investment and Industrial Development in Costa Rica and Mexico." Studies in Comparative International Development St Comp Int Dev, 2007, 53-80.
- Pedersen, Poul Ove, and Dorothy Mccormick. "African Business Systems in a Globalising World." The Journal of Modern African Studies J. Mod. Afr. Stud.: 109-35.
- Plank, Leonhard, and Cornelia Staritz. "‘Precarious Upgrading’ in Electronics Global Production Networks in Central and Eastern Europe: The Cases of Hungary and Romania." SSRN Journal SSRN Electronic Journal.

- Rasak Adetunji Adefabi , 2011. Effects of FDI and Human Capital on Economic Growth in Sub-Saharan Africa. *Pakistan Journal of Social Sciences, 8: 32-38.* **DOI:** 10.3923/pjssci.2011.32.38 **URL:** http://medwelljournals.com/abstract/?doi=pjssci.2011.32.38
- Ricardo, David. "On the Principles of Political Economy, and Taxation." Cambridge University Press, 1951
- Rodrick, Dani. "Normalizing Industrial Policy" Harvard Univeristy, 2007
- Rodrik, Dani, and Arvind Subramanian. Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development. Cambridge, MA.: National Bureau of Economic Research, 2002.
- Rodrik, Dani. Institutions for High-quality Growth: What They Are and How to Acquire Them. Cambridge, MA: National Bureau of Economic Research, 2000.
- Rothwell, Roy, and Mark Dodgson. External Linkages and Innovation in Small and Medium-sized Enterprises. S.l.: [s.n.], 1991.
- Sanjaya Lall. "FDI, AGOA and Manufactured Exports by a Landlocked, Least Developed African Economy: Lesotho." Journal of Development Studies: 998-1022.
- Smith, Adam. "The Wealth of Nations." 1986.
- Sriskandarajah, Dhanajayan. "Migration and Developent: a new research and policy agenda." Global Commission on International Migration, 2005
- Staritz, Cornelia, and Mike Morris. "Local Embeddedness, Upgrading and Skill Development: Global Value Chains and Foreign Direct Investment in Lesotho's Apparel Industry." SSRN Journal SSRN Electronic Journal.
- Subasat, Turan, and Sotirios Bellos. "Governance and Foreign Direct Investment in Latin America: A Panel Gravity Model Approach." Latin American Journal of Economics LAJE, 2013, 107-31.
- Subramanian, Arvind, and Devesh Roy. "Who Can Explain the Mauritian Miracle: Meade, Romer, Sachs, or Rodrik?" IMF Working Papers: 1.
- Te Velde, Dirk Willem. "Foreign Direct Investment and Development: An historical perspective." Overseas Development Institute, 2006
- Tools for Development: A handbook for those engaged in development activity, DFID, 2003
- United States International Trade Commission, 2009
- Van Den Berg. "Economic Growth and Development." McGraw-Hill, Singapore, 2001
- Vandermoortele, Milo and Kate Bird. "Progress in economic conditions: Sustained success against the odds in Mauritius." Overseas Development Institute, 2011
- World Bank, Knowledge, technology and cluster based growth in Africa, 2008
- World Investment Report. Foreign direct investment and the challenge of development, UNCTAD, 1999.
- Zafar, A. "Mauritius: An Economic Success Story." World Bank, 2006

- "Globalization, Growth and Poverty." The World Bank, 2002.
- "Labour Force, Employment and Unemployment- 4th Qtr 2014." Statistics Mauritius -. Accessed June 9, 2015.
- "LTEA | Lesotho Textile Exporters Association - Lesotho Textile Industry." LTEA | Lesotho Textile Exporters Association - Lesotho Textile Industry. Accessed June 9, 2015.