



Economic Review

January 2011

The Process of Preparing the National Strategic Development Plan is Launched

Lesotho sets its eyes on Social and Economic Transformation: The Role of National Strategic Development Plan

Background

Lesotho is one of the most undeveloped of the world's developing countries. Notwithstanding the positive developments that have taken place in the country, including, *inter alia*, implementation of the highlands water project and expansion of the manufacturing and mining sectors, Lesotho has experienced low economic growth, poor agricultural productivity, sluggish infrastructure development and increased unemployment, particularly for the youth, to name but a few. This has raised the need and urgency for radical transformation of the economy of Lesotho to foster broad based and sustainable economic growth and employment generation that will be translated into poverty reduction.

It is in this spirit that the Government of Lesotho (GoL) launched the process of preparing the National Strategic Development Plan (NSDP) for the period 2012/13 to 2016/17. The outcome of this process will be a document that outlines the strategy that will be followed to attain an accelerated and sustainable economic and social transformation.

The main objectives of the NSDP include outlining the strategies for transforming the economy, improving intellectual and skills profiles and defining a future that is characterised by the capacity to produce goods and services for the global markets.

The National Vision 2020, which defines how Basotho would like to see their nation in the first 20 years of this century in terms of economic growth and socio economic development, was launched in 2003. Medium term development frameworks are used to coordinate and guide policy formulation and resources allocation in the implementation of the National Vision 2020. Since its launch, Vision 2020 has been implemented through the Poverty Reduction Strategy Programme from 2004 to 2008 and currently the Medium Term Macroeconomic Framework (MTEF) is being used. The NSDP, once developed, will take over from and/or complement the MTEF in the implementation of the National Vision 2020.

Social, Political and Economic Challenges Facing Lesotho

Lesotho is faced with a number of macroeconomic and socio-economic challenges, which need to be addressed to attain the national vision that “by the year 2020, Lesotho shall be a stable democracy, a united and prosperous nation at peace with itself and its neighbours. It shall have a healthy and well developed human resource base. Its economy will be strong; its environment well managed and its technology well established.”

Economic growth has been fluctuating over the years, indicating that Lesotho has not been able to sustain its economic growth rates at high levels. Growth rates as high as 6.0 per cent per year were registered in the 1990s. In the early 2000, growth slowed down to about 3.0 per cent, on average. This slowdown resulted from several shocks including the removal of textiles quotas, the real appreciation of the exchange rate and persistent drought that crippled agricultural productivity. Lesotho experienced strong macroeconomic performance during 2006-08, supported mainly by favourable external conditions. During this period, real gross domestic product grew at an average rate of 4.5 per cent. Economic performance deteriorated in 2009 as a result of, amongst other things, reduced demand for Lesotho’s main exports of textiles and diamonds as well as the decline in migrant mineworkers’ remittances.

The unemployment rate for Lesotho, estimated at 31.0 per cent, is also high. In recent years, unemployment has worsened among the youth, including university and other tertiary institutions’ graduates. Employment creation, which is vital for reducing poverty, could be attained through high rates of economic

growth that are sustained over many years. In addition, agricultural production has deteriorated significantly over the years, resulting in increased food insecurity. This could be addressed, by amongst others, increasing formal and informal work opportunities, improving agricultural productivity, as well as by increasing utilisation of land by availing to those who have the means to utilise it for production.

Development of infrastructure is important for the creation of an attractive environment for investment. While it is true that some milestones have been achieved in the development of the road network, village water supply systems, communications network, major dams, hydroelectric plant and other infrastructure, a lot still remains to be done. Access to roads needs to be increased. More water resources are being developed to support further growth of the wet industries while rural water supply systems need to be expanded.

Pre-requisites for high Broad Based and Sustainable Economic Growth

On the one hand, rapid and sustainable economic growth is a necessary condition for employment generation and poverty reduction. On the other hand, rapid economic growth requires high and sustained levels of investment across all sectors of the economy. Investment also thrives and becomes sustainable in an investment friendly environment, otherwise it stagnates. The strategic plan will have to be clear and precise on what should be done to improve the investment climate in Lesotho. The literature identifies a number of factors that are necessary conditions for the growth of both foreign and domestic investment.

Political and social instability create an uncertain environment, which discourages investment. A number of studies on growth find that politically unstable regimes generally grow slower than stable ones. This is because the incentives to invest or disinvest depend largely on the likelihood that the policies of the prevailing political regime and the regime itself will remain stable in the foreseeable future. Foreign investors are less likely to commit their capital into unstable political environments. Therefore peace and stability are important for economic and social prosperity.

The rule of law is not only essential for the protection and defence of human and political rights but efficient law enforcement is also essential for economic and social development. It encourages investment, both domestic and foreign, along with entrepreneurship and business development. While many aspects of the rule of law are important for generating broad-based economic growth, certain areas, namely the administration of justice, the regulatory framework for business and investment, the use and enforcement of contracts and the protection of property rights and intellectual property rights emerge as some of the most fundamental challenges to be addressed if countries are to promote and facilitate small business development and attract direct domestic and foreign investment.

Another prerequisite for high and sustainable economic growth and employment creation is the availability of good physical infrastructure. Infrastructure can positively impact on economic growth in various ways. Some types of infrastructure are used as direct inputs in the production processes. For example, electricity generation infrastructure is a necessary input in the

production processes of many goods and services. Infrastructure also acts as a complement to other production inputs. Good infrastructure generally increases the productivity of other inputs in the production process. Reliable power supplies enhance productivity of machinery and other equipment just like good education and health care enhance labour productivity. Availability of infrastructure also stimulates accumulation of other factors of production and also increases aggregate demand, particularly during construction and maintenance operations.

High quality formal education that meets the skills demands of the economy is necessary for improving the production capacity of a nation. Availability of technical skills that meet the requirements of the modern economy is a critical ingredient for economic growth and employment generation, not only because it increases productivity but also because it makes an economy more competitive and provides increased incentives for investors to provide capital and to engage in economic activities that could propel growth.

Economic reforms cannot be implemented properly without institutions that are functioning well. Strong and efficient institutions will formulate good policies and will execute and monitor such policies effectively. This will in turn result in an investor friendly environment and improve business competitiveness.

Preparation of the Strategic Plan

The strategic plan will identify key constraints that must be addressed to transform Lesotho from a subsistence economy to a modern industrial and service economy. In addition, it will

suggest policies, actions, strategies and investments that should be implemented to put the economy of Lesotho on a rapid growth path that is necessary for sustainable job creation.

Building on Vision 2020, the preparation of the plan will be based on a consultative process. The consultations will be grouped into five clusters, namely; i) Investment climate, financial services, trade and manufacturing; ii) Infrastructure, including roads, water, information and communications technology (ICT), power and institutions; iii) Skills development, focusing on technical, scientific, medical, managerial and ICT skills; iv) Economic sectors including tourism, agriculture, mining and environment and natural resources; and v) health, HIV and AIDS and vulnerability.

The planning team, comprising of a secretariat and a few local and international consultants will be responsible for undertaking consultations and producing the plan. This team will report to the Steering Committee, which will be chaired by the Honourable Minister for Finance and Development Planning. After being reviewed by the Steering Committee, the reports will be submitted to Cabinet before being released for discussion by the National Planning Board. Thereafter the plan will be shared with the key stakeholder groups and the general public through districts consultations.

The strategic plan is envisaged to have two major components. The first part will focus more on analysing the existing or current socio-economic status of Lesotho, that is, the situation as it prevails now. This will lay the basis for defining policies, strategies, actions and investments that could be implemented to move the economy of Lesotho to a

position of high and sustainable economic growth.

This section will include an elaboration of policies, strategies, actions and investments that will be implemented to promote peace, democracy and good governance; generate employment, reduce poverty and social vulnerability; protect the environment and promote climate friendly technologies and practices; promote HIV/AIDS prevention, care and treatment; and radically transform technical, vocational and higher education to produce world class skills and expand access to technology, applications, innovation and networks. Lastly, an analysis of the fiscal budgetary implications of the implementation of the plan, particularly in relation to the role of government as facilitator, regulator and promoter of fair market competition will be provided.

The second part will comprise of a comprehensive investment programme that will identify areas for investment that will maximise the chances of attaining the overarching objective of high, sustainable and job creating growth.

It is expected that the first draft of the strategic plan will be completed by July/August 2011. If this timeline is met, the draft plan will be used to inform the preparation of the national budget for 2012/13 fiscal year. If all goes according to plan, the plan will be finalised in December 2011 and its implementation will commence in April 2012.

Conclusion

Economic transformation is achievable, as demonstrated by the success of countries like Singapore and Ireland.

These countries have revived their economies to reduce unemployment and achieve high standards of living. Having recognised and accepted the failure of past policies, major policy changes were implemented and new strategies were adopted over several decades to achieve economic transformation.

Attraction of foreign direct investment, mainly into manufacturing industries, (FDI) played a major role in reducing unemployment in these countries. A number of incentives that reduced the costs of setting up business and of production were put in place. Administrative barriers to investment were also dealt with. The political stability that prevailed in these economies also encouraged foreign investment. Nonetheless, the role of domestic investment in development was not disregarded as programmes for assisting the development of small and medium enterprises were developed. With time, these economies shifted from basic manufacturing to production of high value added commodities and services industries.

The transformation was facilitated by massive investment in human capital development to produce highly skilled workforce, particularly in information

technology. In Singapore, government also cultivated the culture of IT use and application among businesses and invested heavily in IT infrastructure development. High technology institutions were also developed and government also deepened the level of technological research through global cooperation programs with highly established tertiary institutions in the United States (US), Australia and in Europe. Throughout the years, government increased investment in the establishment of technical institutes and also increased sponsorship for overseas training.

In addition, to facilitate the transfer of skills and technology to the local people, government provided incentives for foreign firms to establish local training centres. Many such centres, mainly geared towards high skilled industries such as electronics, were opened. The education system in Singapore has also gone through a number of reforms to make it highly selective. It is such that, through tough competition, it categorises students into the best who can go to university and who will be part of the higher skilled workforce as well as those who go to the practical training schools to become semi-skilled manufacturing workforce.

Implication of Rising Food Prices on Lesotho's Economy

The upsurge in the prices of various international agricultural commodities has put an upward pressure on prices of basic food items.....

Background

Food prices went on an upward trajectory at the end of the second quarter of 2010 and increased through January 2011. According to the United Nations Food and Agriculture Organization, the Food Price Index (a benchmark basket that tracks the wholesale basket of 55

agricultural food commodities) rose by 56.2 points since January 2010 to 231 points in January 2011, the highest level since 1990. The hike in international food prices and their pass-through into basic foodstuff prices are threatening the advent of another food crisis.

While the hike in food prices will benefit agricultural food commodity exporting countries, it will lead to deterioration in the terms-of-trade in agricultural food commodity importing economies. Thus this article provides an analysis of the

current trends in food prices and the factors behind the recent price hikes, The implications of the surge in food prices for the economy of Lesotho are also discussed.

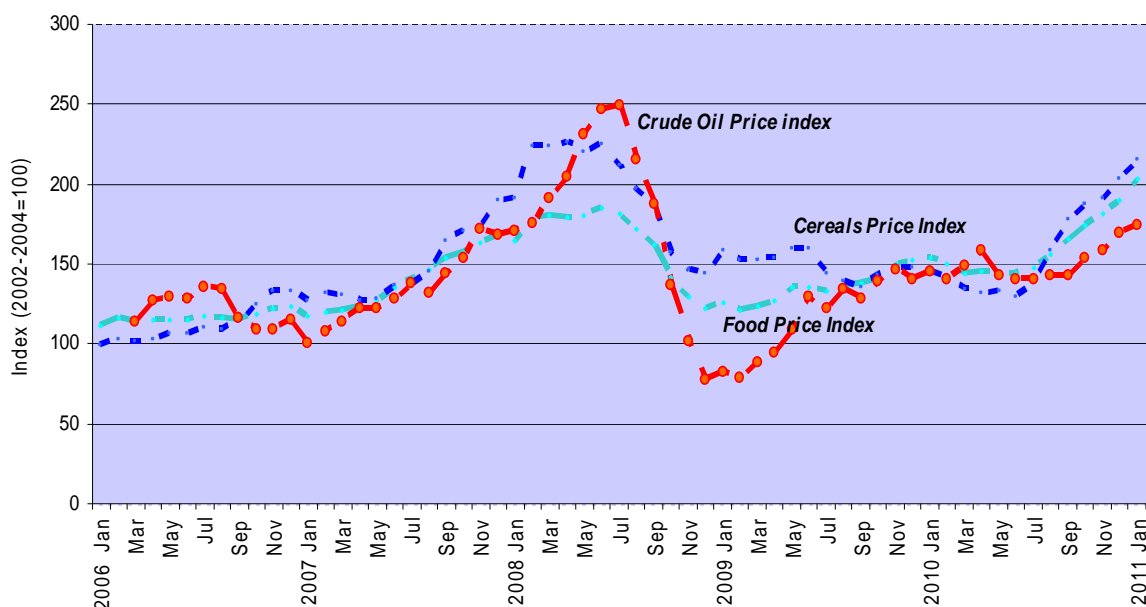
The Recent Trends In International Agricultural Food Prices

The international price index for the basic foodstuffs rose sharply in the latter half of 2010 as indicated in *Figure 1* below. The FAO Food Price Index (FFPI) rose for the eighth consecutive month to 230.9 points in January 2011, up 59.5 points from the lowest level in June 2010. In addition, the FAO Cereal price Index (FCPI) averaged 215.4 points in January 2011, up by 116.2 points from January 2006. The

FCPI has increased by 48.1 per cent in January 2011 from a year ago.

The spike in food prices is led by cereals (e.g. maize, wheat and rice) which are important staple food in many developing countries. The monthly average price for wheat increased by 23.8 per cent in January 2011 from March 2010. The benchmark wheat price (United States (US) No.2 Hard Red Winter) averaged USD326.6 per tonne, 62.1 per cent higher than in the previous year.

Figure 1: Monthly Food and Cereals Price Indices (2004=100) and Crude oil Price Index (2005=100)

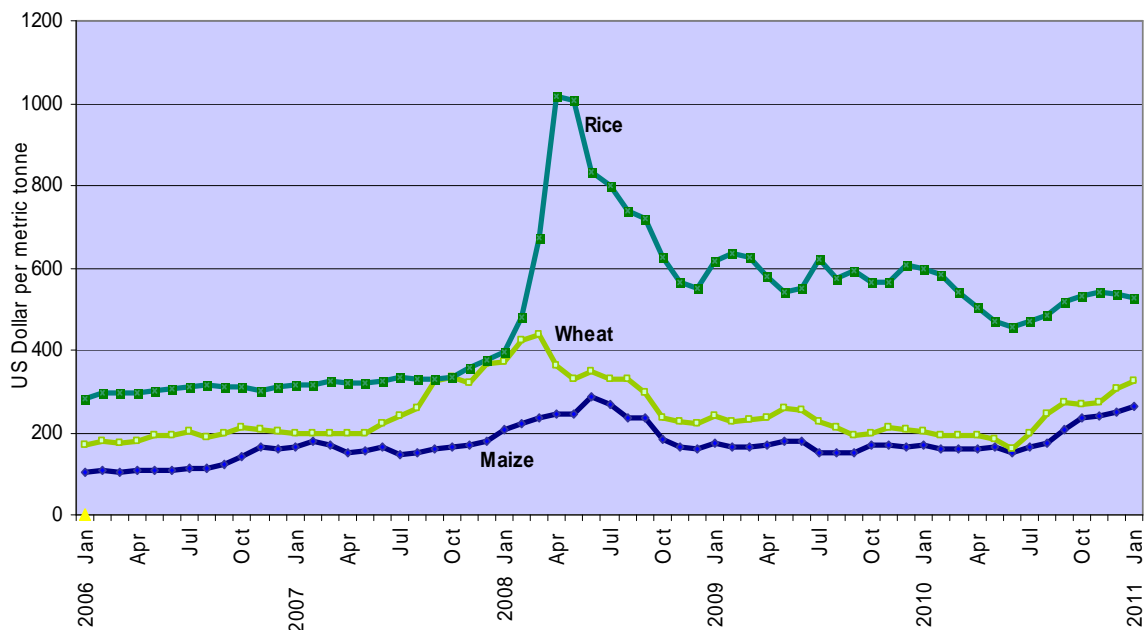


Source: United Nations Food and Agriculture Organisation and International Monetary Fund

Export prices of cereals also increased as depicted in figure 2 below. The export prices of Maize averaged USD265.3 per tonne in January 2011, 73.5 per cent

higher than in June 2010. In addition, the export price of rice averaged USD528.2 per tonne in January 2011, up 12.3 per cent from July 2010.

Figure 2: Monthly Maize, Rice and Wheat Prices per metric tonne in US Dollars



Source: International Monetary Fund

Causes and Factors Underlying the Current Hike in International Food Prices

A variety of new and ongoing forces are driving the world food situation and, in turn, the prices of international food commodities. These factors include:

Global Food Imbalance: Perhaps one of the most important forces behind the recent food price increase is the structural imbalance between the food supply and demand. The imbalance is largely driven by the growing population and high economic growth dynamics in many countries. Rapid population and economic growth in emerging-market economies such as China and India have shifted demand for grains into high protein foods. The consequence of this is that more land is being used for animal grazing and to produce animal feed at the detriment of food production for human consumption.

Volatile Weather Shocks and Patterns: The second factor is the adverse weather conditions caused largely by rapid climate change. Catastrophic storms and

drastic droughts in Eastern Europe, Argentina, wildfires in Russian Federation, and heavy rains in North America and Australia - the leading agriculture commodity producers - have led to the curtailment of production in cereals. For example, early in the latter half of 2010, Russian Federation announced a ban on the country's exports of grains (wheat) due to low grain stocks caused by ravaging fire and a severe draught that had devastated crops. Concurrently, the bad weather in several key exporting countries around the globe sent the European wheat futures prices up by more than 12.0 per cent in a day. This saw the price of wheat soaring by nearly 90.0 per cent between June and December 2010¹.

High Energy Prices and Increased Biofuel Production: High energy prices, especially the oil (petroleum) prices have contributed to the upward spiral of food prices. This is because oil is used as an input in the production of fertilizer. Petroleum oil is also used in agricultural

¹ Financial Times – August 5, 2010 “Russia Grain Export Ban Sparks Price Fears”

production cycle, that is, it is used from sowing to harvesting and to distribution processes. Moreover, the increased demand and use of ethanol fuel produced from crops have also contributed to the food price boost. Biofuel is used as a supplement in transportation, especially in advanced economies and also some emerging market economies. The high demand for this type of fuel has contributed to the absorption of corn-based ethanol of 15.0 per cent of global corn crop. This has by the way contributed to the recent price spikes.

Exchange Rate Volatility: Since the second half of 2010, the USD has depreciated against trading partners' currencies. When the USD depreciates, prices of commodities fall and, vice versa.

Government Trade Policies: Restrictive trade policies like export restrictions are also part of the equation for rising food prices because they aggravate global supply shortages. In addition, export bans and restrictions reduce the confidence in international grain markets, concurrently signalling to others to hoard or build up strategic reserves. Given the expectation that consumers will buy at any price, these restrictions have led to sharp price spikes currently.

In response to the rising food price and its repercussion, many governments have adopted several policies. In this regard, the European Union paid out 39 billion euros on direct agriculture subsidies while the US spent USD21.3 billion to subsidise mainly large-scale farmers.

Implication of Rising Food Prices on Lesotho's Economy

The recent rise in the international food prices is likely to impact negatively on the economy of Lesotho. Given that Lesotho is a net importer of cereals and given the recent adverse and heavy rain falls in Southern Africa, the food price in Lesotho is expected to continue to increase. Between March 2010 and December 2010, average food price index in Lesotho has increased by 29.0 per cent. The continued rise in food prices is expected to further exacerbate the food price inflation and the overall inflation in Lesotho. This is because food basket carries around 39.0 per cent of the total in Lesotho's overall consumer basket of goods and services.

At the household level, food price hikes are likely to worsen food insecurity. Thousands mouths of unfed and ill-fed infants are likely to increase given the continued rise in food prices. This will have serious implications on the achievement of the Millennium Development Goals (MDGs). In addition, the rise in food prices is likely to increase Lesotho's import bill, especially given the current strengthening of the loti against the USD.

Food price hikes like this one increase the urgency for Lesotho to implement long term strategies to resuscitate food production. The subsistence nature of farming in Lesotho has not served this economy well and needs to be done away with in favour of commercialization. This is necessary for Lesotho to be able to build its own food reserves as insurance against recurring food crisis.