

CENTRAL BANK OF LESOTHO

**SOME THOUGHTS ON SOME OPTIONS OPEN TO LESOTHO
IN THE NATIONALISATION OF THE FINANCIAL INFRASTRUCTURE AND ITS FUNCTION**

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1. INTRODUCTION:

The process of socio-economic development involves not only expanded productive capacity and other associated improvements, but also structural transformation in the economy, inter alia. Some re-alignment among various components of the economic system often occurs. This is manifested to some extent by the changes in the nature and relative magnitude of contributions to the Gross Domestic Product (GDP) by different sectors and sub-sectors of the economy. As patterns and weights change in the make-up of the economy, the composition and functioning of the institutions which facilitate the operation of the economic machinery should adapt in order, to at least, maintain the level of effectiveness, let alone to enhance it. Ideally they should take the lead in the adjustment process in order to pave the way for more rapid, sustained and stable development process, preferably in a manner that improves equity and enhances general social welfare. Inability to adjust accordingly can only have some dampening effect on the development process itself.

The financial system of a country is one of the major facilitators of economic activity. Those who subscribe to the keynesian based analysis would consider it to possess the potential to actually initiate economic activity. The desirable situation in this sphere is the one in which there is no mismatch between the financial infrastructure and its modus operandi vis-à-vis its ability to adequately cater for economic needs of the day. The two aspects should ideally be synchronised.

An appropriate system of financial intermediation, including developed securities markets, would tend to contribute towards an effective monetary policy. In the case of developing economies an additional factor is the degree of permeation of money economy through the society.

The paper attempts to examine the nature of Lesotho's financial system and the degree of its resilience with respect to development needs. An overall review of the financial system of Lesotho is preferable to piecemeal approach that has been followed hitherto. Tackling the subject matter in bits and pieces and at different times, which have characterised the practice so far, can easily lead to duplication in some aspects while gaps remain unattended in others.

The issue at hand is: Has the evolution of the financial infrastructure in Lesotho kept abreast with economic development so as to be able to adequately respond to current and near future needs? Has the mode of operation of constituent institutions adapted in a manner that would enable satisfactory dispensation of service under present circumstances? In other words, have the financial institutions in Lesotho been successful in realising full potential over time (a) in the mobilisation of financial resources and (b) in channelling them to areas of the economy where they are required in order to achieve sustained growth rate possible under stable conditions? If not then what are the underlying constraints and what is it that can be done to correct the situation?

II. PURPOSE:

The purpose of this paper is to:

- a) assess (i) the adequacy of Lesotho's financial system, and (ii) the appropriateness of the mode of operation of constituent institutions, when viewed against the current and near future economic needs;
- b) suggest some of the options open to Lesotho which appear prima facie to be feasible and viable.

III. SCOPE, LIMITATIONS AND ASSUMPTIONS:

The period being addressed extends beyond that of the current Structural Adjustment Facility (SAF) programme which is under the joint auspices of the Government of Lesotho (GOL) and the International Monetary Fund (IMF).

Admittedly no survey of users of the services of the financial institutions was conducted in order to elicit views on the receiving end. The Research Department of the Central Bank of Lesotho (CBL) or some other research institutions may wish to undertake such a survey sometime soon in order to gain knowledge about users' perception on the issue at hand. Meanwhile gaps and possible measures will be identified by using economic analysis of macro-data and by relying on other indicative signals.

It is assumed that the reader is already familiar with the structure of the economy of Lesotho and of its functioning. Familiarity is also assumed in the area of Lesotho's economic relationship with her neighbours. Existing ties are in the form of (a) labour movements, (b) economic groupings such as, (i) Southern African Customs Union (SACU), (ii) Southern African Development Co-ordination Conference (SADCC) and (iii) the Preferential Trade Area of Eastern and Southern Africa (PTA), plus (c) monetary arrangements through the Common Monetary Area (CMA). No attempt will be made to address any of these as each is a legitimate subject on its own. Reference will be made to any of them where it is considered appropriate, however.

It is worth noting that while primary functions remain distinct among financial institutions of various type, often peripheral services they render cause some overlap. This is becoming increasingly common. As a result distinction among different types of financial institutions is becoming increasingly blurred.

VI. EVOLUTION OF THE SET OF DEPOSIT ACCEPTING AND LENDING INSTITUTION IN LESOTHO

Historically, rudiments of deposit, borrowing and lending services were manifested in the form of ‘MAFISA’ system in Lesotho. In this system livestock (cattle, horses, sheep, goats, etc) owner lends some or all of his herd/flock to a relative or a friend for use. Under the system any offspring born while under ‘mafisa’ belongs to the owner of the flock/herd. This may explain why the word for interest in Sesotho is ‘tsoala’. Deposits are much like livestock under ‘mafisa’ they can be used by the deposit receiving institutions. Eventually the depositor must be repaid principal plus interest, that is, ‘tsoala’. The ‘mafisa’ system still lingers albeit to a considerably diminished degree.

Even as the economy became increasingly monetised, in addition to ‘mafisa’, other type of lending/borrowing of funds among still are interest free. No collateral was or is normally required. This practice is still rife even today, especially in the rural areas. Perhaps this practice continues because those concerned feel excluded by the formal institutions that offer such services by means of their prohibitive requirements. Another phenomenon that has emerged in the urban areas is that of ‘money lender’. Borrowers are lent funds without tedious formalities or collateral requirements but interest rates charged are usually exorbitant. Collection or recovery methods in cases of default can be harsh, however.

As time went by Lesotho post office network functioned as branches of the South African Post Office Savings Bank (SAPOSB) in Lesotho. On May 2nd, 1966, Lesotho started operating her own Post Office Savings Bank.

Subsequently, commercial banking started in 1902 when Standard Bank commenced its operations in Lesotho. It was followed by Barclays Bank D.C.O in 1957. The former became Standard Chartered Bank in 1985 after Standard and Chartered and Chartered Banks amalgamated in London. Barclays also changed to Barclays Bank International (Lesotho) in 1977 and then to Barclays Bank PLC in 1985. The two commercial banks, joined by the Lesotho Bank in 1972, essentially performed the function of collecting deposits in Lesotho and channelling them to South Africa thus making loanable funds available to the economy of South Africa. This was so far much of their history of operations in Lesotho. The reason often given for this practice was that there were no viable projects in Lesotho worthy of bank credit or loans. Risk aversion was the justification cited. The Lesotho authorities have had to intervene through Section 21 of the Financial Institution Act 1973, which empowered the Minister of Finance to require banks to hold specified amount of assets in Lesotho. This was pursued further only since 1981 by Legal Notice 8, which actually set minimum local assets requirement at 85 per cent. Compliance also took time to be effected.

In as far as local institutions were concerned, besides the Post office Savings Bank there was also the Basutoland Co-operative Banking Union (BCBU) which was registered in 1957. Formation of BCBU marked the culmination of a success of a number of independent marketing co-operative societies. It was to be a bank for member co-operative societies. It was expected in addition to supply agricultural inputs and equipment as well as to market the produce of societies members. Initial success in this endeavour led the government of the day to use BCBU as a conduit to channel public funds to farmers. This move, inter alia, might have “flooded the circuits”. Considering that management were neither trained not experienced in banking, BCBU was spread thin, over burdened and eventually collapsed. Sound and prudent financial practices were not followed. BCBU was liquidated in 1963.

The tasks of BCBU were inherited by the Finance and Marketing Co-operative Union of Basutoland (FMCUB) in 1963. In 1966 it became Finance and Marketing Co-operative Union of Lesotho (FMCUL). In 1970 the functions of FMCUL were taken over by Co-op Lesotho.

On September 14, 1959, Co-operative Savings Society (BCSS) was registered. Its resources were composed of members' capital contributions as well as of time and demand deposits from the public. In 1966, BCSS became Lesotho Co-operative Saving Society (LCSS). Although its portfolio was supposed to be varied, over a period of time it increasingly tilted towards credit for housing. Bias towards poorly secured long term loans, plus lack of adequate know-how in banking, as well as suggestions of malpractices, led to the demise of LCSS. It was liquidated in 1981.

In the rural areas deposit and credit/loans services were, and still are, rendered by the Co-operative Credit Unions. On another front there were Thrift and Credit Societies. The Thrift and Credit Societies were primary co-operatives that extended loans to members in kind and for agricultural purposes only. That is, they loaned agriculture input. They were part owners of FMCUL. FMCUL channelled agricultural inputs to farmers through them. These societies in turn used FMCUL as an intermediary in marketing members' produce. Thrift and Credit Societies were never widespread. There were only 25 of them in 1972. Total membership of individuals stood at only 165 in 1969.

Co-operative Credit Union (CCUs) are a result of the work of the Extension Department of Pius XII College which became the University of Basutoland, Bechuanaland and Swaziland (UBBS) in 1964 and the University of Botswana, Lesotho and Swaziland (UBLS) in 1966. It was in collaboration with CUNA International from the late 1960s to the very early 1970s. CCUs spread more rapidly. By 1969 there were 40 of them with a total membership of 12,116 individuals, assets of M244,202 and shares of M229,703. By 1988 there were 73 CCUs with a total membership of about 30,000 individuals (mostly heads of households), with deposits and shares totalling M2.4 million. Partly political-induced turmoils of the early 1970s affected Co-operative Credit Unions adversely. They brought deeprooted divisions in these organisations that thrive on co-operation. The movement seems to be established, the Lesotho Co-operative Credit Union League (LCCUL). At first

LCCUL belonged to CUNA international directly. Since 1968 it belonged to CUNA International via the Africa Co-operative Savings and Credit Association (ACOSCA).

Most of the borrowing from CCUs has been mainly for provident purposes. Funds are often borrowed by members for meeting medical expenses, school fees, purchase of food supplies and other similar items. The only productive item that features after the most popular provident purposes has been loans for building a family house. In the circumstances the Lesotho Credit Union Scheme for Agriculture (LECUSA) had to be devised in 1968. Funds were provided by OXFAM and the Catholic Relief Services (CRS). CCU machinery was used by LECUSA in order to promote loans for productive purposes in agriculture. LCCUL has been able to mobilise external resources for member CCUs from time to time.

Recovery of loans by CCUs leaves room for improvement. Most members, however, are reliable. The problems seem to be largely as follows: (a) loans are used for consumption and provident purposes and therefore do not generate any income with which to repay; (b) most members are poor with little or no income with which to repay loans; (c) insufficient training and guidance through extension services to support borrowers. Nevertheless, the CCU movement has withstood the test of time. It seems to merely need some stimulation and support.

Up to the close of the 1960s' a vacuum still existed in the structure. There was still no major financial institution to offer lending for the purposes of financing large productive projects. In recognition of this need the Lesotho National Development and Savings Bank was established by Order No. 8 of 1971. It started operations in October, 1972. At that point the Post Office system ceased collecting deposits from the public. Right from the beginning the new financial institution operated as a commercial bank. It did not function as a development bank as originally intended. That seeming diversion was a blessing in disguise. It turned out that the needs were not being fully met in the commercial banking sphere. As a result the new bank expanded rapidly and dropped 'National Development and Savings' from its name later in 1972. This outcome meant that there was still no development bank in the conventional sense in the Lesotho set of financial institutions.

As the population and income grew, especially in the urban areas, demand for financing building or residential houses rose rapidly. Yet LCSS was deteriorating and could not meet the challenge. As a response the Lesotho Building Finance Corporation (LBFC) Act of 1976 was adopted. LBFC started operations in August 1977. The new institution was subjected to abuse by the powerful in the society in its early years. The influential personalities borrowed large amounts with no intention of repaying. Were it not for government subventions, LBFC could have collapsed early. Since 1986, under more professional management, abuse has abated. Problems that remain, which are being tackled, are purely economic in nature. One of them is that of finding a solution to a riddle of lending long term on concessional interest rates while paying competitive interest rates on deposits in order to attract scarce financial resources needed for making loans. Another is the question of identifying an effective manner of mobilising much more financial resources in order to meet the high and rising level of demand for housing loans. Preferably, the bulk of the funds mobilised should be available to LBFC medium to long term as its lending is long term. Consequently appropriate instruments ought to be utilised.

The gap in development banking remained. While LNDC machinery was inter alia used to address finance needs on the industry side, there was no major institution to provide finance to agriculture. Yet agricultural sector was the largest contributor to the Gross Domestic Product (GDP). The reaction to this apparent need was the passage of the Lesotho Agricultural Development Bank Act 1976. It was only in March 1980 that LADB started its operations. In those early years LADB maintained a low profile and operated on a small scale. Since 1978, under new management LADB became more aggressive and has expanded rapidly (some would say perhaps too rapidly) opening branches in a number of high population density rural areas. The challenge for LADB is that of mobilising adequate financial resources to meet a high demand for loans. Noteworthy is the high risk element involved in agricultural credit due to unpredictable climatic conditions.

The scale of projects financed tends to be small on the average. In the circumstances economies of scale cannot be enjoyed. This is another factor that diminishes chances of success. Supportive extension service, efficient delivery and storage services for inputs and outputs as well as effective marketing, are other co-requisites for success. Aggressive and

meticulous follow up action by way of extension services is of utmost importance if recovery rate is to be enhanced. As part of the attempts to mobilise resources LADB is intent on diversifying its operations when it is opportune.

The Lesotho National Development Corporation (LNDC) was instituted in 1967. Its mandate was, and still is, to “... initiate, promote and facilitate the development of manufacturing and processing industries, mining and commerce ...” (Lesotho National Development Corporation Act 1967). In the absence of a development bank LNDC, as one of the means of fulfilling its mandate, has had to extend some loans to enterprises in need of additional finance. Sources of funds so used by LNDC were largely Government of Lesotho subventions and external grants and concessional loans. In 1975 Basotho Enterprises Development Corporation (BEDCO) was formed as a subsidiary of LNDC. BEDCO was to assist aspiring Basotho entrepreneurs only and with loan requirements of M100,000 or less. It was also to provide shelter, provide training and extension service for small Basotho industries. In August 1980 BEDCO was made a separate parastatal institution. In 1986 the line of demarcation between projects financed by BEDCO and those by LNDC was raised to M250,000. BEDCO's sources of funds loans were similar to those of LNDC in nature. The funding roles of BEDCO and LNDC seem to have been a result of a void in development banking in Lesotho. Had there been a development bank, the two institutions would have probably settled for merely guaranteeing loans secured for projects they would have recommended.

With respect to leasing and financing of hire purchase, WMN Investments provide service but only to a limited degree. Caledon, which used to render comparable services, has been phased out. It is noteworthy that Lesotho Bank offers hire purchases services.

Before independence the then British High Commission Territories of Basutoland, Bechuanaland and Swaziland had used, at first the British currency (that is, sterling) and later on South African currency, as legal tender. Proclamations by the British authorities gave legal support to these loose arrangements. Following independence, however, Botswana, Lesotho and Swaziland (BLS) sought more formal and clearly defined arrangements. Discussions on the subject between BLS and South Africa commenced in 1972. Negotiations ended in 1974 together with South Africa, BLS entered into the Rand

Monetary Area Agreement in terms of which the South African rand remained legal tender in the BLS. Swaziland, which has already made arrangements for the issue of her own currency, issued the lilangeni in September, 1974 but opted to remain in the newly formed Rand on a one-to-one basis. Almost two years later, Botswana, with comparatively brighter economic prospects due to availability of plentiful natural resources, followed suit in August, 1976 and issued her own currency, the pula, which was at the same time, delinked from the South African rand. Lesotho was the last of the BLS group to issue her own currency. The Lesotho Monetary Authority Act was passed in 1978 and the loti, which has since remained pegged at par to the South African rand, was issued at the same time as the Monetary Authority became operational in January, 1980. The Lesotho Monetary Authority was elevated to the level of the Central Bank of Lesotho in August, 1982. Both the lilangeni and the loti were to circulate only within the territories of their respective countries, side by side with the rand. In the case of Swaziland the Rand formally ceased to be legal tender in 1986 but in practice continues to circulate freely. Free flow of funds among contracting parties was to be maintained. The Rand Monetary Area Agreement was replaced by the Common Monetary Area (CMA) Agreement in 1986. CMA Agreement gave Lesotho and Swaziland a comparatively higher degree of autonomy. It is noteworthy that CMA itself has evolved. The degree of devolution is very advanced at this point. The Central Bank of Lesotho now performs almost all standard functions of a typical central bank.

The composition of Lesotho's financial institutions has evolved over a period of time to include the following: (a) the Central Bank of Lesotho, (b) three commercial banks (Barclays, Lesotho Bank and Standard Chartered), (c) one specialised development bank, the Lesotho Agricultural Development Bank (LADB) and (d) an institution that plays the role of a building society, the Lesotho Building Finance Corporation (LBFC). (e) LCCUL together with its member Co-operative Credit Unions, also play a role in mobilising deposits and extending credit in Lesotho.

How does Lesotho compare with sister countries in the vicinity in this regard?

V. LESOTHO AND SELECTED SADCC COUNTRIES:

In this section variety, number as well as the form of ownership of financial and closely related institutions are compared to those of selected countries within SADCC. Criteria for selection were (i) proximity to one powerful economy, (ii) comparable stage of economic development and (iii) common colonial experience. Comparisons of this type need to be interpreted with care. Sizes and structures of economies can differ considerably.

Table 1 shows the number of financial and related institutions by type in each of the selected countries. It would have been more revealing if the number of branches and agencies of each institution were reflected. Distribution of branches and agencies of each institution taking population and commercial centres as well as ease of communication into account, would improve comparisons. There are still other points that would need to be considered to make comparisons among countries even more meaningful. As such information is not available at this stage, then one has to make do with what is available.

Subject to limitations catalogued above it is clear from Table 1 that Lesotho has the least number of institutions. Zimbabwe has the largest number and the widest variety. Lesotho is the only country without a multipurpose development bank.

Table 1

NUMBER AND VARIETY OF FINANCIAL AND RELATED INSTITUTIONS

IN SELECTED SADCC COUNTRIES

(1988)

	CB	DB	SDB	BS	MB/AH/DM	0	TOTAL
Botswana	3	1	-	1	-	3	8
Lesotho	3	-	1	1	-	-	5
Malawi	2	1	-	1	1	2	7
Swaziland	5	1	-	1	-	-	7

Zambia	11	2	-	1	-	4	18
Zimbabwe	5	1	-	3	6	5	20

Key:

CB	=	Commercial bank (s)
DB	=	Development bank (s) with broad mandate i.e Multipurpose or multi-sectoral development bank (s)
SDB	=	Specialised (= single sector) development bank (s)
BS	=	Building societies or equivalent
MB/AH/DH	=	Merchant bank (s), Accepting house (s), Discount House (s)
O	=	Other financial and related institutions

Table 2 classifies financial and related institutions by form of ownership. Institutions in Lesotho are either wholly domestic or foreign. There is no joint ownership. Malawi does not seem to have financial institutions that are totally foreign owned. Five of the seven institutions are jointly owned by local and foreign entities in Swaziland. In each case Swaziland holds 40 per cent of the shares. Zimbabwe hardly has any institution that is 100 per cent owned domestically.

Table 2

**FORM OF OWNERSHIP OF FINANCIAL AND RELATED INSTITUTIONS
IN SELECTED SADCC COUNTRIES
(1988)**

	<u>DOMESTIC</u>	<u>JOINT VENTURE</u>	<u>FOREIGN</u>	<u>TOTAL</u>
Botswana	4	2	2	8
Lesotho	3	0	2	5
Malawi	3	4	0	7
Swaziland	1	5	1	7
Zambia	9	2	7	18
Zimbabwe	0	11	9	20

Form of ownership as reflected in Table 2 gives some rough indication of the extent to which national interests may feature in the decision making process.

Table 3 shows the ratio of percentage change in net domestic bank credit to that of Gross Domestic Product (GDP). At 1.3 for Lesotho and 0. For Swaziland it means the two indicators changed at about the same rate on the average. The two ratios are close to one. In the case of Botswana it means that deposits exceeded domestic credit and that deposits in excess of credit accumulated at the rate much higher than the growth rate of GDP. In Zambia net domestic credit grew at a much higher rate than GDP. The ratios for Lesotho and Swaziland would please monetarists who prefer to see the two variables keep pace.

Table 3

RATIO OF PERCENTAGE CHANGE IN NET DOMESTIC BANK CREDIT PERCENTAGE CHANGE IN GDP

SOURCE: IMF, IFS, VOL. XLI, NO. 12, December 1988

NOTE: For all countries average figures covering the period 1983-87 were used; except for Lesotho, Zambia and Zimbabwe whose figures are averages percentage changes for 1983-86.

VI. SIZE AND OPERATION OF THE FINANCIAL SYSTEM IN LESOTHO:

Historical development of the system and its institutions has been traced. The next step is to consider its status at present and in recent past. It will be status from the point of view of capacity and the degree and manner of the utilization of that capacity. This will be done by gauging magnitude of the assets and that of mobilised resources. Attention will also be paid to the pattern of lending among sectors of the economy.

Assets of Lesotho's financial institutions over a six years' period (1983-88) is shown in Table 4. Institutions included are the Central Bank of Lesotho, the three commercial banks, LADB and LBFC. Total assets grew at an average rate of 16 per cent per annum, but with a wide range of about 10-22 per cent. The growth rate for 1986 of about 11 per cent and that for 1987 of about 10 per cent, were below the inflation rate that prevailed during those years. The rate of inflation using Consumer price Indices was 18.1 per cent for 1986 and 12.2 per cent for 1987. That means there was in fact negative real growth in assets during those years. Loans and advances as a ratio to total assets averaged 53 percent ranged between about 43 (in 1984) and about 69 (in 1988). From 1984 to 1988 the ratio grew uninterrupted from 43 per cent to 69 per cent. That indicated a definite shift in the composition of assets in favour of loans and advances. As a proportion of GNP assets averaged 36.5 per cent with a range of 33-40 per cent over 1983-88. Where assets are expressed as a proportion of GDP, the average was 70 per cent and the range 67-74 per cent.

Service point of banks in the country in the form of headoffices, branches and agencies are shown in Table 5. As LADB is poised to diversifying the services offered to customers, it has been included in Table 5. With 22 offices it means that there are 72,727 people per office. If agencies are included then the figure becomes 25,806 people per service point. If household unit is used instead, then the figures are 13,787 households per office and 4,892 households service point.

It would have been more informative if comparable data were readily available for those selected SADCC countries referred to earlier. Indication of the distribution of these bank service points in relation to population and to commercial centres distribution around the country would have been informative. Commercial banks, however would argue strongly that they locate branches and agencies proportionately to demand for their services.

GROWTH OF ASSETS OF THE FINANCIAL SYSTEM*

(Million Maloti)

End of Period	Assets of the Financial System			Loans and Advances		Nominal GNP (M)	Nominal GDP (M)	Assets as proportion of GNP (%)	Assets as Proportion of GDP (%)
	Change Over		As Percentage of Total	Amount (M)	As Percentage of Total				
	Amount (M)	Previous Year (M)							
1983	269.8			132.9	49	817.9	394.8	33	68
1984	327.3	57.5	18	140.3	43	952.7	465.5	34	70
1985	407.6	80.3	20	183.0	45	1063.9	549.6	38	74
1986	460.5	53.0	11	242.7	53	1238.9	654.9	37	70

1987	510.8	50.3	10	312.7	61	1373.9	758.5	37	67
1988	651.7	140.9	22	447.8	69	1635.3	930.3	40	70

SOURCE: Central Bank of Lesotho, quarterly Reports

- Notes:**
1. Included are the assets of the Central Bank, commercial banks, LADB and LBFC
 2. All percentage figures were rounded off
 3. GDP and GNP figures for 1988 are preliminary (therefore subject to change)

TABLE 5**HEADOFFICES, BRANCHES AND AGENCIES OF BANKS IN LESOTHO**
(1989)

	HEADOFFICE + BRANCHES	AGENCEIES
Commercial Banks	14	27
LADB	<u>8</u>	<u>13</u>
	22	40

Another useful indicator of the capacity and performance of the system could be money supply and net domestic credit both expressed in the form of a ration with respect to GDP. Table 6 reflects the picture. Ratio of money supply to GDP averaged about 54 per cent, with a range of 51-56 per cent over 1984 –88. If notes and coin in circulation are excluded from money supply, on the ground that their magnitude is not particularly reflective of the banking activity as such, then the corresponding figures become 49 per cent for the average, and 47-51 per cent as the range. This fairly steady ratio over the years should prove satisfactory to monetarists who essentially recognise only transactions demand for money. Net domestic credit as a ratio of GDP has been rising rapidly from 27 per cent in 1984 to 44 per cent in 1988. Some would argue that the phenomenon is acceptable for a developing country where the process of monetisation of the economy could still be taking place. Others would worry especially in those economies where expansion of net domestic credit leads to external imbalances through a high propensity to import. Lesotho fits this description. Average propensity to import (regarded as equal to the marginal propensity to import) has been estimated at about 0.63 with respect to National Disposable Income.

Table 6**MONEY SUPPLY AND NET DOMESTIC CREDIT AS PERCENTAGE OF
THE GROSS DOMESTIC PRODUCT (GDP)**

(1984-88)

	1984	1985	1986	1987	1988
	%	%	%	%	%
Money Supply ¹ /GDP	54	56	54	51	53
Money Supply ² /GDP	49	51	49	47	48
Net Domestic Credit/GDP	27	30	34	38	44

NOTES: 1. Money supply includes maloti in circulation, demand Deposits, call deposits, savings deposits, fixed time Deposits and Deferred Pay Fund.

4. Money supply¹ minus maloti in circulation = Money Supply²

This is one of the reasons underlying intervention through structural adjustment facility (SAF). Whether to worry about expanding net domestic credit or not should depend largely on the use to which such funds are put. If it is mainly for directly productive purposes, then there is less reason to worry. However, if the funds are used largely for consumption purposes, especially where propensity to import is high, as indicated earlier, then it should be disturbing, unless there are some counter-balancing forces. Table 8 will attempt to reveal, to some degree, how bank credit is distributed amount sectors of the economy.

Before discussing Table 8 it may be worthwhile to have some indication of what fraction of loanable funds with financial institutions actually get loaned out in one form or the other.

Table 7 offers some guidance in this regard.

Table 7

RATIO OF ACTUAL CREDIT TO LOANABLE FUNDS

(1985 – 1988) (M Millions)						
	TOTAL	RESERVE	LOANABLE	ACTUAL		RATIO
	BANK	REQUIREMENT	FUNDS	CREDIT		
	DEPOSIT					
	(1)	(2)	(3)	(4)	(5) = (4)	(3)
1985	M303.37	M14.34	M289.03	M166.90	(76.0)	0.58
1986	346.31	16.71	329.60	223.80	(132.2)	0.68
1987	378.16	18.41	359.75	285.10	(174.2)	0.79
1988	472.11	23.29	448.82	405.70	(245.7)	0.90

SOURCE: Central Bank of Lesotho

Notes:

- (a) Column (3) is actually column (1) minus column (2). Figures in column (3) are estimates in that some of the funds in that column may not be held in such a liquid form as to be readily loanable.
- (b) In column (4) figures in brackets represent net government borrowing from the banking system.

Close examination of columns (4) and (5) reveals that government slice of the total actual credit rose rapidly thus crowding out the private sector. Much of the funds borrowed by the government were used to finance budget deficit. The bulk of it was used to pay recurrent expenses. If the ratio in column (5) had grown that rapidly as a consequence of financing directly productive activities in the private sector, it would have been more economically beneficial, and presumably more rapid economic growth would have been achieved.

Table 8 shows the contribution of major sectors of the economy to GDP in percentage form. At the same time it shows what share of domestic bank credit each of those major economic sectors got over the period 1983 – 87.

Table 8 (a)

CONTRIBUTION OF MAJOR ECONOMIC SECTORS TO GDP THEIR SHARE OF DOMESTIC BANK CREDIT

IN PER CENT

(1983 – 88)

MAJOR SECTORS	1985		1983		1984		1987		1988	
	share of Bank credit	contribution to GDP	share of Bank credit	contribution to GDP	share of Bank credit	contribution to GDP	share of Bank credit	contribution to GDP	share of Bank credit	contribution to GDP
	%	%	%	%	%	%	%	%	%	%
Agriculture	23.0	7.7	24.4	0.8	23.7	7.8	26.1	0.7	24.3	6.3
Mining & Quarrying	0.3	0.1	0.2	1.0	0.3	0.1	-	-	0.3	0.1
Manufacturing	11.0	6.8	9.4	11.6	12.0	8.2	10.8	8.8	10.0	4.9
Electricity & Water	1.2	0.8	0.6	5.6	0.9	1.0	10.6	10.6	1.0	3.0
Construction	11.6	13.2	10.3	8.8	11.6	13.9	10.3	11.2	10.9	12.3
Trade & Catering	17.2	51.1	17.1	58.7	17.5	54.3	17.0	54.7	17.0	56.6
Transport & Communications	2.5	7.9	2.2	5.3	2.5	3.6	2.5	4.2	2.5	4.9
Other	11.9	33.2	35.8	8.2	31.5	11.1	32.3	9.8	34.0	

-----SOURCE: Central Bank of Lesotho (1983 – 87)

Table 8 (a) suggests that the share of bank credit by a given economic sector does not match the contribution made to GDP. To some degree this can be expected. Bank credit requirements, by type and magnitude differs from one type of economic activity to another. Also, some

activities have been beneficiaries of external funding to varying degrees in the form of grants and concessional loans. Still others are financed to some extent by non-bank resources. Even with these qualifications borne in mind the pattern portrayed in Table 8 (a) does tell a tale. Trade and catering sector has traditionally absorbed the bulk of domestic bank credit. The sector accounted for over 50 per cent of the total domestic bank credit for all the years shown. Yet value-added in this sector tends to be very low. So are the forward and backward linkages generated. In addition, in the case of Lesotho where propensity to import is very high, domestic bank credit to trade and catering is tantamount to financing imports of finished products. This puts the strain on the foreign exchange holdings of the country.

The pattern reflected in Table 8 (a) in a way manifests the preference of commercial banks for distributive activities. Credit to trade is quick to recover and bears higher returns. That pattern also reveals the structure of the economy of Lesotho. There is a heavy bias towards distributive as against directly productive activities. Yet, as pointed out earlier, this is the sector with high propensity of import finished products thus leading to external imbalances. The need to restructure the economy resolutely in the direction of activities with higher value added, more forward and backward linkages, and import substitution or export generation, is obvious.

Table 8 (b) compares distribution of domestic credit among major sectors in the cases of Botswana, Lesotho and Swaziland. Clearly Swaziland banks devoted more credit to Agriculture and Manufacturing over 1985-1987. Except for Mining, which is a major activity in Botswana, and which is virtually non-existent in Lesotho, the pattern between these two countries is essentially comparable.

Table 8 (b)

**DOMESTIC BANK CREDIT: SHARES OF MAJOR ECONOMIC SECTORS
IN BOTSWANA, LESOTHO AND SWAZILAND
IN PERCENT (1985-87)**

	1985			1986			1987		
	B	L	S	B	L	S	B	L	S
	%	%	%	%	%	%	%	%	%
Agriculture	6	6	19	6	8	18	7	7	20
Mining & Quarrying	22	0	4	13	0	5	8	0	0
Manufacturing	5	5	48	7	7	32	8	8	37
Electricity & Water	1	3	-	0	1	-	0	1	-
Construction	6	12	5	3	13	6	5	14	5
Trade & Catering	28	57	9	36	51	16	34	54	16
Transport & Communications	3	5	5	1	8	9	3	4	7
Other	<u>29</u>	<u>12</u>	<u>11</u>	<u>34</u>	<u>12</u>	<u>13</u>	<u>35</u>	<u>11</u>	<u>15</u>

SOURCE: Derived from Quarterly Reviews of :

- (a) Bank of Botswana
- (b) Central Bank of Lesotho
- (c) Central Bank of Swaziland

NOTES: 1) Columns may add up to slightly less or more than 100
Due to rounding off.

2) The item OTHER in the case of Botswana is high. That is because it encompasses credit to parastatals. Ideally, credit to parastatals should be distributed among the various sectors depending on the activity of parastatals borrowing from banks.

3) In the case of Swaziland, the sector: Electricity and water could not be isolated. It is lumped with other sectors.

Table 9 compares the average share of bank credit for each major sector for the periods 1969 – 71 and 1983-88. The rationale being that such a presentation would crystallise long-time shifts, if any. Trade and Catering, while it remained predominant with more than 50 per cent of the share, lost ground from 62 per cent (1969 – 71) down to 51 per cent (1983-88). Manufacturing and construction gained significantly. The desirable situation as already mentioned is where the bulk of bank credit would go into directly productive activities such as Manufacturing, Construction as well as Agriculture as there is relatively higher value added.

Table 9

AVARAGE SHARE OF BANK CREDIT BY MAJOR SECTORS

(1969-71 – 1983-88)

IN PER CENT

	<u>AVERAGE FOR 1969 –71</u>	<u>AVERAGE FOR 1983-88</u>
	%	%
Agriculture	10	4
Mining & Quarrying	7	-
Manufacturing	4	8
Electricity, Gas Water	-	5
Construction	6	14
Trade & Catering	62	51
Transport & Communications	3	7
Other	8	11
	-----	-----
	100%	100%

- SOURCES:**
- (1) Table 8 (Average for 1983-88)
 - (2) Macro Onado and Antonio Porter (Average for 1969-71)

At the grassroots level it is co-operative credit unions so far that offer deposit and lending services on a formal basis. Co-operative Credit Unions however operate under rigid norms that restrict rendering of services to members only and only to a set limit per member depending on shares held. Table 10 gives some indication of the capacity of the co-operative credit union movement. In 1988 there about 4.384 households per co-operative credit union. As they serve members then total membership of 30,000 in 1988 formed 9.4 per cent of all households in Lesotho.

Table 10

**CO-OPERATIVE CREDIT UNION UNDER LCCUL, MEMBERSHIP,
LOANABLE FUNDS AND ACTUAL LOANS (1984 – 1988)**

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1988</u>	<u>1987</u>
No. of Co-op Credit Union	64	64	66	70	73
Total Membership (Individuals)	27,160	28,008	29,000	31,000	30,000
Deposits & Shares	1,435,752	1,735,000	1,826,984	2,242,586	2,408,460
Total Loans	1,155,895	1,236,000	1,398,551	1, 715, 695	1,902, 368

SOURCE: LCCUL

So far three major areas have been covered: (a) historical development of the system has been traced; (b) a rough comparison with selected SADCC economics has been made, and (c) an attempt has been made to gauge the capacity of the system and to observe the pattern of lending among major economic sectors. Against this background the next step is to attempt to identify gaps and weak links in the system.

VII. PERCEIVED SYMPTOMS AND DIAGNOSIS IN THE FINANCIAL SYSTEM:

Preceding sections have attempted to lay some groundwork. The next step is to try to interpret the information that has been gathered and to read other signals with the view to deriving a meaningful picture.

It is clear from the information in the earlier sections that in Lesotho there are no institutions that render services normally offered by merchant banks, accepting houses or discount houses.

The question is whether or not there is any or adequate demand for services of such institutions already. If there is then some entrepreneur (s) should recognise the opportunity and take advantage of it in due time.

Leasing is done on a limited basis by WMN Investments. Hire purchase financing is done by Lesotho Bank and to some degree by WMN Investments as well. Peripheral financial services such as factoring and invoice discounting do not seem to be rendered at all. In Botswana, for instance, leasing, factories and invoice discounting are handled by the Financial Services Company of Botswana (Pty) Ltd, which is a joint venture among the commercial banks in that country.

Missing also in the array of financial institutions operating in Lesotho is a 'multipurpose' development bank in the conventional sense. That is to say, there is no bank that lends concessionally for development purposes in all or most of the productive sector. Instead there is a specialised development bank. It is the Lesotho Agriculture Development Bank (LADB) which caters for the agricultural sector. It would appear that lending functions of BEDCO and the LNDC were meant to fill this vacuum. Limited capacity and financial resources of those two institutions has meant that the vacuum remains. New ideas are called for.

There also seem to be no machinery for mobilising non-bank financial resources. Institutions such as unit trusts or investment trust companies or other variants thereof are the ones that normally perform a function of mobilising non-bank finance. In this case also, one must ask whether or not the economic environment in Lesotho is ready to accommodate such institutions. That is, would such institutions be feasible and viable in Lesotho at this stage? That needs to be studied.

There have also been some debate with respect to financial institutions in Lesotho and their respective roles. In 1983 Ph. K. Heinrich Bechtel wrote to propose establishment of a new privately owned bank. It was to be either in the form of a co-operative bank or a company with a broad spectrum of shareholders. It was to be a 'people's bank' which is more prepared to tone down risk aversion which some consider an exaggerated element in the case of commercial banks currently operating in Lesotho. Then at a conference on: "Strategies for Small Business Survival and Growth in the BLS Countries," held at Mazenod among other points raised A.M. Maruping pleaded for the strengthening of the development arm of the Lesotho Bank in order to assist in the involvement of Basotho entrepreneurs in at least small scale industry* (Keynote Address,

February 26th, 1985). This was followed up at a seminar on: "Strategies for Implementing the Recommendations of the Business Training Centre's Conference" in Maseru in April 1986, where Maruping lauded Lesotho Bank for pursuing a policy of bold and progressive moves in the crusade to assist Basotho entrepreneurs. A plea for preferential interest rate charges on loans extended to Basotho entrepreneurs engaged in directly productive activities was also made at the Seminar. The rationale was that such activities, unlike pure trading, usually (a) bear high value added, (b) lead to more forward and backward linkages and (c) contribute to favourable external sector balances by either resulting in increased exports and/or in reduced imports (through import substitution). One of the resolutions adopted by the seminar read:

"(a) That Lesotho Bank be reminded of its full name which is the Lesotho National Development (and Savings) Bank. That it should return to its initial mandate which was to promote national development. To do that effectively its division which deals with small business be strengthened and made more aggressive.

(b) The other commercial banks operating in Lesotho should be urged to do likewise".

* It should be noted that no such division existed within Lesotho Bank at that time. It was taken for granted that such a division ought to be in existence. Projects and Export Finance Division of the Lesotho Bank was introduced in May 1988. Definite decision to form it was made in 1987.

The daring moves by Lesotho Bank, which included de-emphasis of collateral for customers with a good repayment record, had been articulated by the General Manager, Mr P. T. Mafike to the Lesotho Chamber of Commerce and Industry (LCCI) delegates attending the annual conference in April 1986. It had been a reaction to murmurs within LCCI ranks alluding that Lesotho Bank was not addressing the needs of Basotho entrepreneurs. His major complaint was that most Basotho entrepreneurs who secured loans from the Lesotho Bank had a poor repayment record. At the 1987 LCCI annual conference Mr Mafike retorted to suggestions of lending at preferential interest rates. He pointed out that unlike a conventional development bank that receives loanable funds in the form of Government subventions, external grants or concessional loans, Lesotho Bank was mobilising financial resources competitively in the market. He felt that Lesotho Bank was in any case already absorbing a lot in the form of loans that are either repaid far behind schedule or are irrecoverable and therefore written off altogether. Perhaps sentiments about Bechtel's suggestion of another bank still linger despite Lesotho Bank's attempts to bend backwards to accommodate banking needs of Basotho entrepreneurs. LCCI seems to be contemplating teaming up with a new foreign bank to establish another bank in Lesotho along the lines proposed by Bechtel. Yet Trinity Asset Management consultants, in examining the case of LBFC recently, observed that it is "... apparent from the investigations that the financial community of Lesotho is 'over banked' by too many institutions competing for the existing available pool of domestic funds." (Trinity Asset Management 1987).

There are those who perceive the commercial banking market in Lesotho as highly competitive even with only three institutions. Others see the market as typically oligopolistic. Still others consider it as composed of three monopolies. This is based on the argument that each commercial bank caters for a different type of clientele. Thus enabling each bank to charge steep lending rates and to impose heavy service charges without alienating customers. Even though CMA permits free movement of funds

among member countries, in the specific case of Lesotho the flow of private funds, when there is any at all, has tended to be in one direction, which is out of the country. This would mean that serious competition can be posed from outside the country either; so the argument goes.

Another point of debate alluded to earlier is that of risk aversion. Some feel that commercial banks exaggerate risk aversion as a way of maintaining high liquidity instead of making financial resources available to producers and that the Central Bank is encouraging this practice by the generous interest rates paid on commercial banks deposits. Other feel that risk indeed tends to be on the high side on the average, in Lesotho.

At the tenth anniversary celebrations seminar of the Lesotho Institute of Accountants in May 1988, Mr Mafike observed inter alia that there was:

- “1. Lack of organised, well co-ordinated and efficient financial/capital market.
2. Non-availability of adequate medium to long-term finance for industry.

3. Inefficient utilization of available financial resources.” (the Future Economic Development of Lesotho and the Role of the Accountant, May 6th, 1988).

These were legitimate observations. Steps should be taken to address them.

While the debate on the merits and demerits of the Lesotho financial system continued, ad hoc measures were being taken to cope with what was considered to be unmet finance needs. Had there been a conventional ‘multipurpose’ development bank there would have probably been no need for LNDC, and later on BDCO, to have as part of their functions administration of loan to industry out of the funds raised through subventions, external grants and concessional loans. These two institutions could have perhaps operated even without the lending role. That they were put in a situation in which of they had to do so is a symptom of a gap in the financial system. LBFC and the Lesotho Housing Corporation (LHC) have had to resort to external borrowing in order to finance specific projects because of what they cite as lack of medium to long-term finance domestically. The existence of special

funding schemes which are scattered among various institutions is yet another sign of hitches in the system. Even Central Bank of Lesotho has had to host (a) the Export Finance Scheme. (b) the Food Self Sufficiency Programme (Fund), and (c) quite possibly may have to accommodate some element of the Rural Credit Scheme which is still in the pipeline, assuming that it will finally materialise. All these seem to indicate existence of some discrepancy in the financial system of Lesotho.

In the attempt to bridge some of the gaps the Lesotho Bank instituted the "Projects and Export Finance Division" recently (May 1988). M5 million has been allocated to it to start with. It is to extend loans with the terms ranging from 3 to 5 years. Interest charged will still be at the commercial rate. Some analysts have argued forcefully that what really provides relief to the entrepreneur is not mainly the below market rate of interest but largely the length of the term within which the borrower must complete repayment. This is so particularly in developing countries where enterprises tend not to be capital intensive. If this argument is considered valid, then the gesture of the Lesotho Bank through the Projects and Export Financial Division should still be regarded as generous. Analysts with monetarist bent would tend to be prone to this line of thinking. Keynesian inclined analysts would tend to regard interest rate as one of the major variables in determining investment. In addition to relatively longer term loans this Division has broken with tradition in conventional commercial banking by not only appraising and evaluating projects proposed by prospective customers but also by generating bankable project ideas internally. Those ideas are then brought to the attention of promising customers. The bias in financing in this regard is towards directly productive activities. Such activities as mentioned earlier tend to have (a) higher value added, (b) more linkages and (c) tend to generate more employment and (d) result in improved trade balance. There is a close follow up of projects financed. Guidance is given to the borrowers in order to minimise failure rates of projects. In an environment of a developing economy, such as that of Lesotho, this Division seems to be a step in the right direction. If this pioneering effort succeeds, then would there still be a need to establish a conventional development bank if duplication is to be avoided? Can the Lesotho Bank handle commercial and development banking operations pari passu without one suffering? Is the capacity of the Division adequate to fill the vacuum in the medium to long term credit market? These are the questions that need accurate answers.

It should be pointed out that just because a particular type of financial or related institution is not operating in Lesotho it studies to determine

feasibility and viability of each should be undertaken as the first step. Their absence in the economy may well be an indication that services which such institutions render are not yet in high demand in the market. Reference can be made, in this context, to merchant banks, accepting houses, discounting houses, unit trusts, and investment trust companies. In the case of leasing MB Consulting concluded that there is a viable market in Lesotho; and that there was unrealised potential. (MB Consulting, A survey of Leasing operations in Lesotho, October 1984).

After all the foregoing point-counter-point, what seems to be the gist of the matter in Lesotho? Where lies the challenge? The challenge seems to largely involve:

(a) finding a way of using a much higher percentage of loanable funds to finance directly productive activities by devising an efficient mechanism of channelling such already mobilised financial resources to areas where they are needed in order to achieve that end; that is finding a way of putting to use in the directly productive sectors currently unused liquidity held by the banks;

(b) initiating some machinery for mobilising untapped non-bank financial resources and making them available for the financing of productive activities; or if (a) is unsuccessful, resort to devising a mode of actually competing in the mobilisation of financial resources in the market for the purpose of directing such resources to directly productive activities.

(c) discovering a way of harnessing and using productively funds which are currently flowing out of the country in the form of premium paid to insurance and assurance companies operating abroad plus pension and provident funds administered by companies abroad, for instance. This paper addresses (a) and (b) above. (c) could be a topic for separate investigation.

What then are the options open to Lesotho in order to meet this challenge? That is the subject of the following section.

VIII. SOME OPTIONS OPEN TO LESOTHO

This section will suggest some of the options aimed at attempting to improve the situation. It is suggest that each be studied more closely as a

separate exercise since the scope of this paper does not permit an in-depth analysis on any of them.

1. Lesotho Building Finance Corporation (LBFC). The central problem seems to be that of mobilising financial resources competitively in a tight market by offering attractive interest rates on the deposits while lending concessionally. Interest rates on mortgages are sub-market and the loans are long-term. Unless subventions, grants or concessional cannot be sustained. One option, as a lasting solution, which could be considered is for LBFC to charge higher interest rate elasticity of demand for building loans is likely to be on the low side at this juncture in Lesotho. The main attraction is the long-term nature of the loans. In this a variety of instruments can be used to mobilise resources competitively in the market. Because of the long term nature of LBFC loans it is advisable that financial resources mobilised for lending purposes should also be available on fairly long term basis. Therefore, for this to materialise LBFC has to use appropriate instruments.
2. Lesotho Agriculture Development Bank (LADB) is operating in a difficult area. Given highly limited range for pastoral farming and small holdings for arable farming, and considering that climatic conditions are highly unpredictable, the element of risk is very high. Failure rate of projects tends to be on the high side. If concessional finance is to be continued, resources used for that purpose must be of low cost. That means subventions, grants or concessional borrowing abroad. As profit margin tends to be low even for successful operations, higher interest rates might exclude many. LADB may consider expanding very cautiously henceforth lest it becomes overstretched. Consideration could be given to consolidation of the scale of operation already attained. Some even argue that LADB is thin on experienced professional management. Strong and efficient extension work support is necessary to minimise failure rate of projects financed. Once consolidated in all these areas, LADB could undertake even non-agricultural projects in the rural areas. It could become Lesotho Agricultural and Rural Development Bank (LARDB). This could fill to some degree the vacuum left by BEDCO if it is to cease extending loans as a matter of policy or due to lack of loanable funds.
3. LNDC and BEDCO are short of financial resources needed to enable them to fulfil their mandate.

- (a) BEDCO, as already mentioned, because of less than satisfactory track record and difficulty in mobilising funds for loans purposes and in loan recovery, could cease performing the lending function. It could expand and consolidate the rest of its functions. Then lending to small Basotho entrepreneurs can be handled by LADB in the rural areas (LARDB) and by the Projects and Export Finance Division of Lesotho Bank in the urban areas. Or if the idea of LADB taking over rural financing of non-agricultural projects is considered untenable on close scrutiny, then Lesotho Bank can extend its service even to the rural areas. Another option would be that of a separate multipurpose development financing institution that would serve directly productive activities of the type currently qualifying for BEDCO and LNDC assistance.
- (b) The idea of broadening LNDC's equity base by allowing participation of international institutions should be pursued. Swaziland counterpart of LNDC, has already implemented this approach with some measure of success. Some would insist on Lesotho retaining at least 51 per cent of equity shares in order to retain control. It may not be that necessary for Lesotho to retain the majority shares. There could be other ways of achieving that same goal of safeguarding national interests. Those other methods should not limit raising of financial resources via equity.
- (c) LNDC could continue to mobilise external concessional funding; perhaps from countries whose institutions will have become share participants in LNDC.
- (d) The idea of LNDC being allowed to issue securities in order to raise non-bank funds could be closely studied. Requiring closer study in particular is the demand side of the securities market. First, in a crowded market such as that of Lesotho in order to attract buyers of securities, yields will have to be competitive and therefore on the high side. This would mean that LNDC would be mobilising high cost financial resources which may as well be obtained from the commercial banks where excess liquidity is already in existence. LNDC and BDCO could negotiate special arrangement with one or all commercial banks (especially Lesotho Bank). A formula could be found that would enable channelling of funds to viable LNDC-BEDCO supported projects that need finance.

4. Establishment of unit trust or investment trust companies has been suggested by some. Financial resources thus raised would then be channelled to directly productive activities as commercial banks are inclined to lend to the distributive activities. Feasibility and viability of such undertakings need to be studied carefully. Is the economic climate ripe for such institutions? Is it advisable to start in a small way? Again yields will have to be high in order to attract broad participation. In the end resources will still have been raised at high cost in a tight market. All the same considering reportedly exorbitant lending rates currently being charged in the banking system, unit trust or investment trust could still prove to be a comparatively less costly source of funding if a reasonable spread is maintained.

5. As earlier observed, some analysts believe that productive activities (projects) are highly sensitive to interest rates charged on loans. Others believe that viable projects tend not to be that sensitive to interest. It is a staple in the Keynesians versus monetarists debates. What if the case for multipurpose concessional funding (i.e. lower than market rate interest charges and longer term loans) were to be pursued? In that case some of the options open to Lesotho would be as follows:
 - (a) One way would be to augment the project's division of the Lesotho Bank, perhaps even to the point of elevating it to a status of a separate subsidiary of Lesotho Bank. That is, have some autonomy vis-à-vis Lesotho Bank. Then Lesotho Bank can provide initial funding to set such an operation in motion. That would probably mean the Lesotho Government, the sole shareholder in Lesotho Bank, may have to forego some dividends for a couple of years. This would be an attempt to channel financial resources already mobilised to directly productive activities. That could be supplemented by some form of donor funding. The know-how of the banking operations already exists. Familiarity with the market is also already there. In considering this option it should be noted, however, that the perspective and mode of operation normally expected from a development (therefore concessional) lending differs greatly from that of the commercial banks. Therefore, keeping such an augmented operation under the shadow of a commercial bank may not be a successful endeavour. In addition, manpower in the field of banking is in short supply in Lesotho.

(b) Another option is to adjust the mandate of LADB so as to cover other developmental activities that are outside the realm of agriculture. That is, turn LADB into multipurpose development bank. Again, some banking experience already exists albeit to a less extent compared to Lesotho Bank. Experience in dealing with concessional funding has been gained even though limited to one sector. Some would argue that agriculture is of such importance and is so sensitive in Lesotho that its prominence should not be compromised by lumping it with other sectors when it comes to finance. In any case, LADB is still in the process of consolidating its management and operations. It may take a while for LADB to reach the capacity necessary to carry such a mantle.

© Yet another option that has been mentioned is that of establishing an industrial development bank. In this case the problems would be that of (i) raising capital by mobilising local funds in an already crowded market. Again attractive interest rates on deposits would be required in order to be competitive. So the idea of concessional funding would be frustrated. (ii) Development projects outside agriculture (LADB) and industry would still be left unattended. (iii) Lack of know-how, in contrast to options (a) and (b), would be another constraint.

(c) There is still an option of establishing an entirely new institution, a multipurpose development bank. In addition to problems similar to those already mentioned in options (a), (b) and (c) above, experience in other countries has not been encouraging. This type of bank has not been a success. On the other hand mistakes made elsewhere could be avoided in Lesotho. The advantage of a new and separate institution is that it will have an undivided attention and therefore is likely to gain depth in its area of assignment. Ipsa facto it could also relieve non-financial institutions of the burden of having to lend without financial resources. That way those other institutions can be left to concentrate on their more important functions. This option is worthy of serious consideration.

In the rural areas, LADB is already operating to some degree. Service costs tend to be high as loans processed are many but involve small amounts. Profit margins are narrow, even where there is success in funded projects. That means interest rate charges have to be subsidised. Credit in rural areas, given present circumstances would call for some

element of mobilisation of cheap financial resources in the form of subventions, grants and concessional borrowing from abroad. Borrowers tend to be honest, but failure rate tends to be high more often than not. Due to rampant poverty in the rural areas back-up income is not available to cover repayments. Neither are there assets to talk about, which could be used as collateral. The idea of setting up Rural Credit Fund is a good one, assuming that the bulk of the funds will come from grants and concessional borrowing from abroad; at least to start with. It should not be an isolated exercise. It should be a well co-ordinated package consisting of:

- (i) Credit, (ii) effective extension work, (iii) timely provision of inputs, secure storage, prompt transport and satisfactory marketing of output. If one of these elements is missing, success is unlikely. Then LADB and co-operative credit unions can be used as outlets to reach rural population. Co-operative credit unions, however, operate under their rigid rules and procedures that confine lending to members only. Perhaps if they could adjust so as to be able to accommodate the general public in their operations their capacity would have to be augmented. Their current capacity is on the low side. They easily get overburdened.

These are only some of the options open to Lesotho.

XI. CONCLUSION:

The purpose of the paper was to examine the adequacy of Lesotho's financial system, to determine appropriateness of the mode of operation given economic needs; and to suggest some options which are open to Lesotho if there should be need for improvement.

The findings are that Lesotho's financial system is fairly sound. What is needed is improved operations of various institutions and deepening of the financial markets. There is also need to gain greater depth in the management cadres. Some of the institutions have to adjust their way of mobilising financial resources. By and large it is a redeemable situation. What is needed is a thorough study of all aspects. Macro-analysis rather than piece meal micro-analysis is preferred.

Monetary sector supports the real sector. The two are complementary. Unless resolute efforts are made to restructure the real sector so as to be more productive and thus result in more import substitution or generation

of exports, then the impact of corrective endeavours in the monetary sector will be limited and imbalances in the economy will persist.

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