Economic Review - February 2005

LESOTHO'S BUDGET SPEECH FOR THE 2005/06 FISCAL YEAR: PROGRESS, PROSPECTS AND CHALLENGES FOR THE ECONOMY

On the 16th of February 2005 the Honourable Minister of Finance and Development Planning, Dr Timothy Thahane presented a budget speech for the 2005/06 fiscal year. This speech highlighted the progress made thus far and outlined challenges that loom on the horizon for the mountain kingdom…

Background

In development economics, economic growth is not the only indicator of a nation's development. Development is deemed as a multidimensional process involving major changes in social structures, popular attitudes, and institutions. Hence, it is perceived as a process essentially representing the whole gamut of positive change in social welfare, addressing income distribution, to help a nation to progress from low living standards to high standards of living, with better accessible education for everyone, more jobs, access to basic needs such as food, shelter, health and protection. Important to note also is, how sustainable these high standards of living are. This aspect paints a picture of an economy into the future and provides an outlook of threats and opportunities for the economy.

The central economic problems of all societies include scarcity of resources, which must be allocated to competing needs. The questions of what, where, how, how much, and for whom to produce goods and services confront each country. Hence, allocation should be done on the basis of the characteristic of the demand, whether or not it is a need or a want, as well as its impact on the social well being of the economy. For example, proper allocation to a particular demand can be assessed on the basis of whether it reduces all aspects of inequality, create more employment opportunities, and reduce poverty?

In his key note address in parliament on the national budget, the Honourable Minister of Finance and Development Planning stated that foundations for Lesotho's sustainable development laid two years ago continue to be firm, and they are being extended and strengthened. This article positions this statement in the theory of development economics, and attempts to identify and analyse three of its aspects, namely: the country's progress towards sustainable development, some economic outlook as well as challenges that may threaten this progress.

The Medium Term Expenditure Framework (MTEF) - A new budgeting tool

A new tool, following the incremental budgeting which proved to be ineffective, termed the Medium Term Expenditure Framework (MTEF) was used in the preparation of this year's budget. MTEF is defined as a transparent planning and budget formulation process within which the Cabinet and central government agencies establish contracts for allocating public resources to their strategic priorities. It ensures overall fiscal discipline and facilitates the annual planning and budgeting process. It is seen as more efficient tool in the allocation of public resources to more productive sectors to achieve economic growth. Moreover, it is seen as a channel that provides the necessary link between the budget and the Poverty Reduction Strategy (PRS). This is much different from the way Government of Lesotho (GoL) has been allocating resources, implementing the budget and monitoring progress. The overall budget seeks to ensure that, first, aggregate public expenditure grows by less than nominal growth in GDP; second, sustainable budget deficit in the medium term is maintained; and third, additional external finance on concessional terms is mobilised.

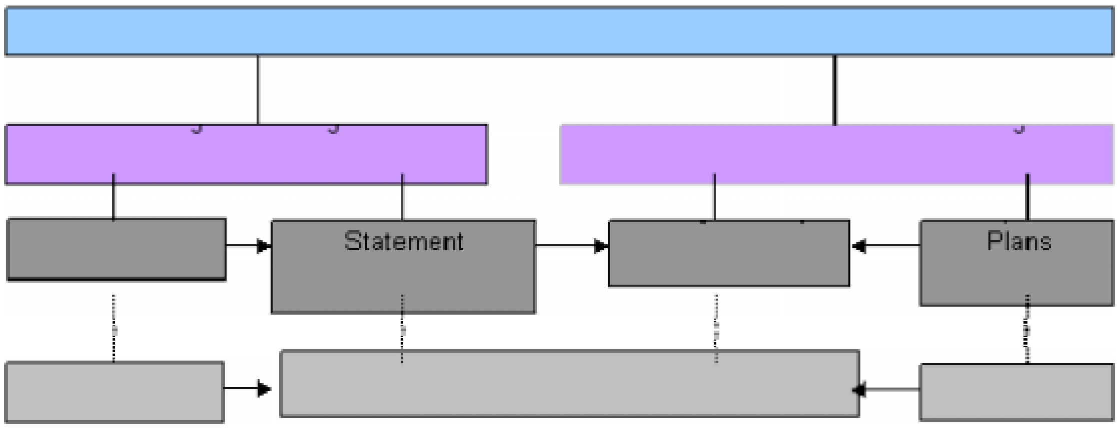

Figure 1

Progress

The Government has made strides in certain areas which indicate its resolution to achieve sustainable development. First, the budget preparation process is transparent, because it requires that the priorities of the Cabinet be explained in a Budget Policy Statement, whereas the priorities of individual ministries are explained in their Corporate Plans. Second, as outlined in the 2004/05 budget, the achievements include upgrading sovereign rating of our currency by Fitch Rating Agency from B+ to BB-, which was driven by improvement in policies, external debt management and sound macroeconomic management. Third, the National Vision 2020 was adopted in May 2004 as well as the Poverty Reduction Strategy (PRS), which was approved in December 2004. The fourth is the reported increase in the enrolment in schools to cover class six of Free Primary Education in 2005. Another important task towards income re-distribution was the introduction of old age pensions in November 2004. Furthermore, efforts were also expended towards the ABC campaign against HIV/AIDS, voluntary counselling and testing and the creation of an infrastructure for training, treatment and care of the infected and affected.

In addition, convictions are gaining momentum for public servants charged with trickster, fraud and corruption, and the backlog of cases is dealt with accordingly. Needless to say, the local government elections have been organised, and local governance is seen as a positive move towards the attainment of accelerated service delivery. Also, the Ministry of Agriculture and Food Security has intensified awareness to commercialise vegetables production and improvement in livestock rearing in areas that proved unproductive for crops.

It, nevertheless, goes without stating that despite these achievements, many challenges still loom on the horizon.

Challenges

The Honourable Minister acknowledged that there are challenges that remain ahead. In order to achieve the commitments contained in the Budget Speech, the government faces a mammoth task in terms of allocation of its scarce resources, even the implementation of strategies that align funds with needs. As indicated in the speech, private sector development was very important to realise job creation and poverty reduction. This underscored the need for expansion of existing industrial clusters and attraction of new investors. However, a major structural bottle-neck hindering new investment is that it takes a total of 92 calendar days to complete required procedures for legally running a business entity in Lesotho, compared to only 38 calendar days in South Africa.

The problems are further compounded by the fact that GoL has to effectively monitor and evaluate the use of public funds. The rate at which funds are disbursed has always been higher than physical development, it being of recurrent or capital nature. The Ministry of Finance and Development Planning should, therefore, position itself to better coordinate and effectively monitor other government programmes. Grants have been flowing in and out of the country underutilised or unutilised, while in some instances, Loans have taken precedence over Grants. Other challenges hinge on all the tripartite role of infrastructural development, be it physical, human, or even institutional, e.g strengthening private sector organisations. Development of infrastructure is essential for creation of a supportive trade and investment environment. Among other things that attract foreign investors and private sector development is an enabling environment. Thus government should more importantly:-

- Improve business, legal and regulatory environment and streamline registration and licensing as well as access to property ownership by foreign investors.
- Improve the quality and delivery of education, as well as enhance provision of tertiary education in the country.
- Strengthening of the extension services to farmers and help them to adopt appropriate proven technology to improve productivity.
- Financing of the estimated deficit for this fiscal year could be through issuing Fiscal Treasury Bills, though this may crowd out the sluggish private sector. Thus this poses a challenge for an accelerated move towards development of domestic capital markets, and hence provide platform for financial sector development.
- Encouragement of Basotho to save, and the entrenching of financial deepening.
- Gaining of victory in the continued fight against HIV/AIDS which not only erodes government funds, but also destroys a young, able-bodied labour force. It thus perpetuates and permeates the venom of poverty.

There is still some ray of hope for the Mountain Kingdom and its inhabitants.

Prospects

The first prospect relates to real sector developments which include, inter alia, the extension of AGOA I under AGOA III which will run until 2015, the reopening of the Cannery at Masianokeng, as well as the renewed mining activity in sandstone and diamonds. Second, the country was selected by the United States to negotiate a five-year Millennium Challenge Account Compact to provide assistance. It is important to mention that upgrading by Fitch Rating Agency from B+ to BB- has a potential for attracting investors to this economy. Again, decentralisation will facilitate monitoring of some activities through community/local government structures. For example, the Ugandan experience has shown that some social services are best monitored by communities. Therefore, government is in the right direction to implement MTEF with Local Government in place. Moreover, financial sector development will also go a long way in facilitating investment and economic growth, that is, as soon as the current structural impediments are addressed through the services of a credit bureau and the entry of First National Bank and the Lesotho Postal Bank into the market.

Conclusions and recommendations

The 2005/06 budget seems to be the answer to low absorptive capacity that donor communities have been complaining about, and redirecting resources to their productive uses. It is an initiative that exposed the Government's commitment to implement her priorities and ability to streamline policies. However, the attainment of these targets demands commitment, and efficiency, not only on the side of Government, but even the private sector, as well as the non-governmental organisations, and indeed the ordinary Mosotho in the village. The government should therefore encourage the manufacturers to fully utilise the financial services such as forward exchange rate contracts in order to curb foreign exchange risk which erode their profits.

This report was benefited by the Budget Speech for the 2005/2006 fiscal year.

Table 1. Monetary and Financial Indicators *

	Nov	Dec	Jan
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	12.17	12.17	12.17
1.2 Prime Lending rate in RSA	11.00	11.00	11.00
1.3 Savings Deposit Rate	1.35	1.36	1.35
1.4 Interest rate Margin(1.1 – 1.3)	10.82	10.81	10.82
1.5 Treasury Bill Yield (91-day)	7.90	7.86	7.92
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2429.1	2373.1	2234.7
2.2 Net Claims on Government by the Banking System	-875.33	-725.21	-1217.28
2.3 Net Foreign Assets – Banking System	4145.04	3972.42	4222.91
2.4 CBL Net Foreign Assets	3523.59	3357.53	3686.32

2.5 Domestic Credit	-263.76	-137.13	-605.90
2.6 Reserve Money	156.80	176.46	143.15
3. Spot Loti/US$ Exchange Rate (monthly average)	6.0536	5.7587	5.9733
4. Inflation (year-on-year percentage change)	4.7	4.8	4.3
5. External Sector (Million Maloti)	**2004**		
	Q2	**Q3**	**Q4**
5.1 Current Account Balance	-281.2	-275.2	-77.3
5.2 Capital and Financial Account Balance	319.3	155.5	224.6
5.3 Reserves Assets	-0.8	391.7	-1.2

**These indicators refer to the end of period. Prime and deposit (savings) rates are averages of all commercial banks' rates operating in Lesotho. The Statutory Liquidity Ratio in Lesotho is 25 percent of commercial banks' short-term liabilities.*

Table 2. Selected Economic Indicators

	2001	2002	2003	2004*
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	3.2	3.5	3.3	3.4
1.2 Gross Domestic Product Excluding LHWP	3.5	3.3	3.2	3.2
1.3 Gross National Product – GNI	0.2	1.6	6.3	3.9
1.4 Per capita –GNI	-1.9	-0.4	4.1	2.4
2. Sectoral Growth Rates				
2.1 Agriculture	0.5	-4.2	-1.9	-0.4
2.2 Manufacturing	7.8	6.9	5.2	5.0
2.3 Construction	1.4	6.9	4.3	4.0
2.4 Services	2.2	2.2	4.4	3.9
3. External Sector – Percent of GNI Excluding LHWP				
3.1 Imports of Goods	68.2	82.8	74.5	79.2
3.2 Current Account	-17.4	-24.5	-21.1	-25.8
3.3 Official Reserves (Months of Imports)	11.7	6.4	5.5	5.5
4. Government Budget Balance (Percent of GDP)	-1.0	-2.7	-2.5	2.5