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### LESOTHO SIGNS A GRANT AGREEMENT WITH THE MILLENNIUM CHALLENGE CORPORATION

***The Government of Lesotho (GoL) and the Millennium Challenge Corporation (MCC) of the United States (US) have signed an agreement to facilitate the development and implementation …***

## Background

Following the establishment of the Millennium Challenge Account (MCA) by the US, the Government of Lesotho and the Millennium Challenge Corporation have entered into an agreement to assist Lesotho to undertake a series of reform measures. These reforms have been identified as crucial for Lesotho to maximise potential benefits from the proposed construction of the Metolong Dam, which is also expected to be funded under the MCA. The latter is the US initiative that is administered by the newly established MCC, intended to assist the less developed countries in their endeavours to achieve sustainable economic growth and reduce poverty.

In broad terms, the key objectives of the MCA include to (a) encourage and support policy reforms; (b) foster sustainable economic growth; and (c) promote partnership between a receiving country and the MCC, on the one hand, and between a government and non-governmental bodies, the private sector, and representatives of civil society, on the other hand. Based on these objectives, coupled with the country's eligibility to apply for funding under the initiative, the GOL prepared a proposal for funding of the Metolong Dam Project. In addition to providing water for industrial use, this project is also envisaged to alleviate domestic water shortage in many areas around the capital city, Maseru.

For purposes of ensuring that Lesotho maximises the benefits of increased water supply from the proposed dam construction, the GOL, with the assistance of the MCC, committed itself to implement a number of reforms. These reforms relate to the improvement of business and investment climate and will be funded to the tune of US$600,000. The agreement also includes financial assistance amounting to US$800,000, to facilitate the completion of the feasibility study and address data issues related to evaluation and monitoring of the proposed dam project.

## Reasons for Policy Reforms

Although the availability of water is necessary for growth, it is nonetheless not a sufficient condition. As a result, the GoL recognises the need to complement infrastructure development with policy reforms. These are intended to improve the business and investment climate in the country by, among others, removing structural rigidities in areas such as judicial procedures and commercial law reforms; border and customs procedures; financial sector and property rights, including access to credit and land ownership; and training and capacity building for entrepreneurs.

The importance of conducive investment climate in boosting growth and poverty reduction has also been reiterated by the World Development Report (2005). In this report's assessment, in

Southern Africa, Lesotho received the worst rating in terms of the three basic indicators, namely, starting a business, enforcing a contract and registering property. Therefore, to complement other Government efforts aimed at accelerating economic development and fighting poverty such as the Metolong Dam Project, it is imperative for Lesotho to address all impediments to sustainable growth.

## Nature of Proposed Reforms

According to the Agreement, the GoL is committed to undertake various policy reforms, to be funded mostly by the MCC. These reforms can be grouped into the financial sector, land tenure and mortgage legislation, the judicial sector, immigration services and border control, and business development and capacity building. As already indicated, the primary purpose of these reforms is to improve the economic climate as a basis for sustainable growth.

The first area of reforms, which relates to the financial sector, is partly intended to lay a foundation for competition for financial intermediation. The latter refers to the process of collecting deposits from the general public, on the one hand, and lending to others, on the other hand. These reforms involve the overall review and development of the legal and regulatory framework in a manner that is expected to promote participation by different institutions in banking business. This would, in turn, improve credit extension to various sectors of the economy such as, agriculture, tourism, industries and small, medium and micro enterprises (SMMEs).

It is also envisaged that reforms would attract foreign direct investment in the sector. Furthermore, coupled with a review of legislation to improve participation of women in the economy, financial sector reforms are expected to enhance balanced access to credit across genders and thus promote economic growth.

In addition to review of the legal and regulatory regime, highlights of the proposed financial sector related reforms include modernisation of Lesotho's payments system. This would facilitate speedy, secure and reliable transfer of funds that is critical to ensure timely settlement of economic transactions, and thus improve the country's investment climate. Payments system's reforms are also expected to facilitate the development of a market for government securities and foreign exchange.

The authorities also intend to establish a leasing industry in order to reduce risk of investing in project related activities. This would be achieved through the promulgation of a leasing act and the development of a rural and micro finance policy. In addition, the Cooperatives Act will be reviewed and amended, where necessary, to ensure that it is not in conflict with the Financial Institutions Act. These measures are intended to boost credit extension and investment; provide guidance to cooperatives; and thus encourage nationals to establish business enterprises.

The second area of reforms involves the establishment and maintenance of a system of land relations that will contribute to poverty alleviation and economic growth in Lesotho. In this regard, the Government plans to enact the Land Bill and complimentary legislation; develop regulations and procedures, and a land reform strategy; and modernise the land information system. By promoting better land use, reforms in this area are expected to promote investment in irrigation and agri-business and thereby increase potential for food security. In particular, the proposed Land Bill will, among others, eliminate gender inequality in relation to access and land use rights; provide for land holding by investors on a leasehold basis; and provide for decentralised land administration.

The authorities also intend to establish an efficient mortgage regime through the enactment of the relevant legislation and review of the Deeds Registrar and Stamp Duties Acts. The aim of reforms in this regard is to reduce transfer costs; and enable property owners to use their property as collateral to borrow funds from the country's financial system. Property owners in this case will also include women married in community of property, as will be provided for under relevant legislative reforms. Furthermore, the envisaged mortgage regime is expected to provide affordable housing to the nation.

Another area of reforms targets improvement in the efficiency of the justice system. This is envisaged to facilitate speedy settlement of trade and commercial disputes, and hence increase confidence in the justice system. In addition, the authorities intend to design and implement legal and judiciary sector reforms aimed at improving credit discipline. Among others, these measures involve capacitation of lawyers and judges on handling commercial cases; and separation of the administrative function of the Commercial Court from the High Court. This would improve the functioning of the Commercial Court and thereby enhance access to credit by facilitating litigation in cases of default. In this manner, the authorities would reinforce other structural measures to promote credit extension such as the establishment of a credit bureau, reforms to allow for use of property as collateral to secure credit, and plans to implement the National Identification System.

The fourth set of reforms is aimed at improving the efficiency of immigration and passport services (IPS) through computerisation, and streamlining of border control procedures. Firstly, these are expected to reduce the administrative burden associated with IPS and thus promote tourism, investment and trade. Secondly, these reforms are aimed at reducing the operational costs associated with the movement of goods. This would be achieved through the establishment of a one-stop shop for clearance of exports and imports, and harmonisation of border control procedures between Lesotho and South Africa. Finally, the Government intends to build capacity in the area of business development. In this regard, efforts will be taken to provide technical assistance in order to capacitate the existing business development service providers. In addition, this area of reforms will include the establishment of a business information centre. These are intended to improve business advisory services.

## Conclusion

In terms of the agreement between Lesotho and the MCC, the GoL is committed to undertake a series of policy reforms. These are expected to form a basis for sustainable economic growth and complement the country's efforts as documented in Vision 2020 and Poverty Reduction Strategy. Successful implementation of the proposed reforms is also expected to lay a foundation for Lesotho to maximise potential benefits from the construction of the Metolong Dam, which forms the GoL's project proposal for funding under the MCA.

### Table 1: Monetary and Financial Indicators†

| | April | May | June |
|---|---|---|---|
| **1. Interest rates (Percent Per Annum)** | | | |
| 1.1 Prime Lending rate | 12.17 | 11.63 | 11.63 |
| 1.2 Prime Lending rate in RSA | 10.50 | 10.50 | 10.50 |
| 1.3 Savings Deposit Rate | 2.00 | 2.00 | 2.00 |
| 1.4 Interest rate Margin( 1.1 – 1.3) | 10.17 | 9.63 | 9.63 |
| 1.5 Treasury Bill Yield (91-day) | 7.70 | 7.16 | 6.93 |
| | | | |
| **2. Monetary Indicators (Million Maloti)** | | | |
| 2.1 Broad Money (M2) | 2451.18 | 2392.26 | 2320.91 |
| 2.2 Net Claims on Government by the Banking System | -1166.25 | -974.11 | -817.22 |
| 2.3 Net Foreign Assets – Banking System | 4577.85 | 4393.46 | 4151.03 |
| 2.4 CBL Net Foreign Assets | 3280.36 | 3156.48 | 3000.88 |
| 2.5 Domestic Credit | -526.71 | -320.55 | -159.89 |
| 2.6 Reserve Money | 415.7 | 327.4 | 358.14 |
| | | | |
| 3. Spot Loti/US$ Exchange Rate (monthly average) | 6.152 | 6.356 | 6.6970 |
| 4. Inflation (year-on-year percentage change) | 3.5 | 3.5 | 3.1 |
| **5. External Sector (Million Maloti)** | **2004** | **2005** | |
| | **QIV** | **QI** | **QII** |
| 5.1 Current Account Balance | -95.93 | 19.74 | -228.23 |
| 5.2 Capital and Financial Account Balance | 223.98 | -11.14 | 312.55 |
| 5.3 Reserves Assets | -1.18 | -119.83 | -94.55 |

**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 | 2.9 | 3.1 | 3.3 |
| 1.3 Gross National Product – GNI | 0.2 | 1.6 | 6.3 | 3.6 |
| 1.4 Per capita –GNI | -2.1 | -0.2 | 4.0 | 2.4 |
| | | | | |
| **2. Sectoral Growth Rates** | | | | |
| 2.1 Agriculture | 0.5 | -4.2 | -1.8 | 0.5 |
| 2.2 Manufacturing | 7.9 | 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 | 75.3 | 93.9 | 79.4 | 73.0 |
| 3.2 Current Account | -2.9 | -11.6 | -5.7 | -0.8 |
| 3.3 Official Reserves (Months of Imports) | 11.7 | 6.2 | 5.8 | 5.8 |
| | | | | |
| **4. Government Budget Balance (Percent of GDP)** | 0.3 | -5.5 | -1.9 | 7.7 |

† 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.

* Preliminary estimates