



Lesotho Budget Speech for Fiscal Year 2008/2009: The Race for Jobs, Better Life, High and Sustainable Growth Must be Won.

The Honourable Minister of Finance and Development Planning presented a budget speech for the 2008/2009 fiscal year on the 13th February 2008. His key message was that Lesotho cannot afford to lose to other countries the race for jobs; the race for better life for all its people; and the race for high, sustainable and shared economic growth.....

Introduction

Every year the Minister of Finance is expected to present before parliament the review of the performance of the preceding budget and provide the outlook for the current year. Thus the budget speech serves three purposes; firstly, it is used as an accountability and report back tool on how the government has used the public finances. Secondly, it indicates the policy direction that the government intends to take in the next fiscal year. This is through the allocation of anticipated revenue collection to various government expenditure programmes. A number of stakeholders like development partners, investors, labour unions, business community and ordinary citizens look up to the budget speech. Lastly, the budget is a reliable indicator of the government financial position. It shows the position of revenue relative to expenditure and how the shortfall will be financed and in the case of the surplus how is it going to be invested.

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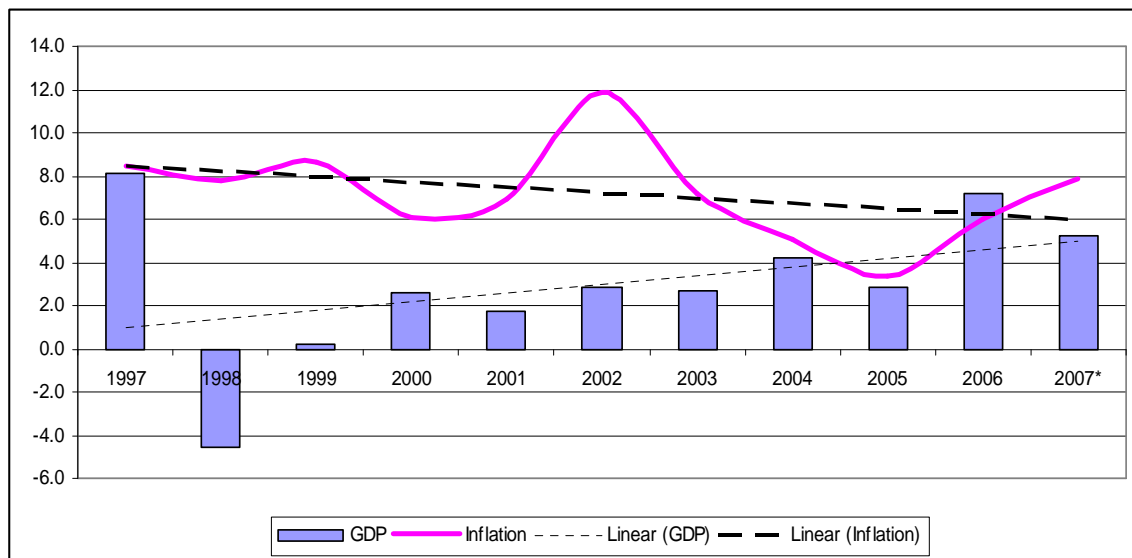
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The 2008 budget speech was prepared against the background of commendable macroeconomic performance in recent years and major challenges and risks that lie ahead. During the last ten years, the economy of Lesotho has managed to grow by an average of 2.5 per cent per annum. The significant part of this growth has been driven by the expansion of the manufacturing sector, particularly the production of textiles and garments for the US market under the African Growth and Opportunities Act (AGOA). In the

last three years, mining activities have contributed to the growth performance particularly from the re-opening of Letseng Diamond mine and subsequent opening of new mines in Liqhobong and Kao. The economy is estimated to have grown by 5.1 per cent in 2007. Price developments in the country have also been favourable as inflation during the

last ten years has averaged 7.0 per cent reaching a maximum of 11.9 per cent in 2002. Southern African Development Community (SADC) macroeconomic convergence target on prices is single digit inflation. Figure 1 presents the evolution of inflation and GDP growth in the period 1997-2007.

Figure 1: GDP Growth and Inflation 1997-2007 (Per Cent)



However, the economy is faced with a number of challenges. The continued liberalisation of the textile and clothing market is likely to expose Lesotho exporters to strong competition from the low cost producers from Asia. It is important that local producers are able to adapt to the new and complex environment. In addition, the SACU revenue pool is under threat from the tariff reductions due to trade liberalisation. SACU is negotiating a number of free trade agreements with other regions in the world and has also made some commitments in World Trade Organisation (WTO). The coming into operation of the SADC customs union in 2010 may have implications on the revenue sharing formula. Customs revenue account for more than half of

total revenue of Lesotho budget. The mushrooming of unlicensed schemes is also a major risk. These schemes exploit the loopholes in the financial regulations and disappear with the savings from the poor.

Significant progress was achieved in the last budget towards building a conducive investment climate. These include

- Establishment of one stop shop for registration of companies
- Streamlining the procedures to obtain import and export permits
- Reduced number of pages in manufacturing application forms

Budget Outturn for 2007/2008

The projected outturn for the fiscal year 2007/2008 showed an overall surplus after grants of 5.9 per cent of GDP compared to the budgeted deficit of 2.9 per cent of GDP. The surplus was mainly due to the more than expected revenue. The major tax revenue items are projected higher than budgeted. This is driven by the robust economic growth coupled with the good performance by the Lesotho Revenue Authority (LRA). However, there is still a long way for both income tax and Value Added Tax (VAT) to compensate for the possible decline in customs revenue. On the expenditure side, total expenditure

and net lending is projected lower than the budgeted. The situation is similar in both capital and recurrent expenditures. The under-performance in expenditure, particularly capital expenditure may indicate the presence of slow implementation capacity by some implementing agencies of government.

The projected overall surplus is expected to build government deposits with the banking system and to reduce the foreign borrowings. Cognisant of the eminent decline in the customs revenue, and the recurring drought conditions in the country, it is crucial that the government keep some reserves that can be used during difficult times.

Table 1: Government Budgetary Operations (Million Maloti; Per Cent of GDP)

Budget Item	Approved 2007/2008 Budget		Projected Outturn for 2007/2008		Proposed 2008/2009 Budget	
	Amt	%	Amt	%	Amt	%
Revenue and Grants	6883.1	58.5	7352.6	62.4	8696.5	64.4
Revenue	6393.1	54.3	6975.6	59.2	8006.0	59.3
Grants	490.0	4.2	377.0	3.2	690.5	5.1
Expenditure and Net Lending	7229.7	61.4	6660.4	56.6	9095.9	67.4
Recurrent Expenditure	5315.5	45.1	4964.7	42.2	6956.7	51.5
Capital Expenditure	1924.2	16.3	1701.4	14.4	2157.1	16.0
Net Lending	-10.0	-0.1	-5.7	0.0	-17.9	-0.1
Surplus/Deficit after Grants	-346.7	-2.9	692.3	5.9	-399.4	-3.0
Financing	346.7	2.9	-692.3	-5.9	399.4	3.0
Foreign Financing	61.8	0.5	-54.9	-0.5	135.2	1.0
Domestic Financing	284.9	2.4	-637.4	-5.4	264.2	2.0

Source: Lesotho Government Budget Speech for 2008/2009

2008/2009 Budget

Revenue and Expenditure and Financing

The 2008/09 budget proposes a budget deficit equivalent to 3.0 per cent of GDP compared to the estimated 5.9 per cent of GDP for 2007/08. Total revenue is

expected to grow by 26.3 per cent to M8.6 billion. All major tax revenue components, customs, VAT and income tax are budgeted to register some growth. Grants are budgeted to grow by 40.9 per cent to M690 million due to inclusion of Millennium Challenge Account funds. Expenditure and net lending is budgeted to grow by 25.8 per

cent to M9.0 billion. Both recurrent and capital expenditure are expected to rise by 30.9 per cent and 12.1 per cent respectively.

Allocation of Spending in the 2008/2009 Budget

The analysis of spending is usually a good indicator of the priorities of Government policies and programmes. The social services continue to claim the largest share of the allocations. Education sector alone accounts for 22.0 per cent of the total budget. The Government is continuing to implement the free primary education (FPE). The first FPE graduates are in the second year of secondary education. A number of challenges are being addressed in the sector. The government continues to expand the number of classrooms in both primary and secondary schools. It should be noted that the concept of combined primary and secondary is being used throughout the country. In addition, training of teachers remains a priority. As relates to tertiary education, the Government is continuing to provide loan bursaries to Basotho students in both local and international institutions particularly South Africa. This year a provision has been made to support students who would enrol at the newly opened Limkokwing University of Creative Technology. It is believed that this new university will contribute in the expansion of skill development in the country. The loan bursary scheme will be restructured in order to ensure transparency and predictability.

The health sector is allocated 10.3 per cent of the total budget. Lesotho is one of the countries that are worst affected by HIV/AIDS with a prevalence rate of 24 per cent. The allocation presents evidence that the scourge is beginning to affect resource allocation. The Government is implementing the free access to health services and drugs.

This includes all government and Christian Health Association of Lesotho (CHAL) health centres. In addition, the construction of the replacement of Queen Elizabeth II hospital under the private public partnership (PPP) is about to commence. Further, the construction and upgrade of health facilities across the country is being implemented under the Millennium Challenge Account.

Significant resources have also been allocated towards infrastructure development. In the 2008/09 budget, this includes construction of urban and rural roads and Metolong dam. Also the construction of industrial development infrastructure has been provided for. The budget speech reiterated the need for a minimum infrastructure platform to facilitate sustained economic growth.

Personal Income Tax (PAYE) Adjustment

The budget proposed a number of tax relief measures to individuals. The tax credit was increased by 28.6 per cent to M4 500 and the tax threshold was increased by 6.6 per cent to M37 378. In addition, the lower tax rate is reduced from 25 per cent to 22 per cent. These measures imply an injection of about M100 million back to the economy. This is equivalent to 0.7 per cent of GDP. The injection is likely to support consumption expenditure and the performance of sub-sectors such as retail wholesale and repair, communications, transport and storage and catering.

Public Financial Reforms

As part of the on-going public financial management reform, the budget also announced the introduction of the Integrated Financial Management Information System (IFMIS) on the first of September 2008. IFMIS is expected to replace the current Government of

Lesotho Financial Information System (GOLFIS) which has been very problematic in recent years. The new system will harmonise with the newly implemented procurement procedures and would enhance auditing of the Government accounts. These reforms are expected to improve public accountability which is one of the tenets of good governance.

Pension Reform

The budget announced the introduction of the defined contribution scheme for all public servants aged 40 years and below. Under this scheme, staff will contribute 5 per cent of their annual salary while Government will contribute 11.2 per cent. The scheme would be managed by the Independent Board of Trustees. The benefits of the conversion

need not be spelt out as it would benefit the employees at their time of retirement and the government may have some funds released from the recurrent expenditure towards capital projects. The Government intends to convert all its employees in future when resources allow.

Conclusion and Recommendation

The Honourable Minister of Finance emphasised the importance of peace and stability for achievement of sustained economic growth and reduction in poverty. It is accepted that developing countries cannot achieve sustained economic growth if the flow of trade continue to be disrupted. This creates negative investor perception about the whole country and affects future business decisions.

This report has benefited from the Lesotho Budget Speech 2008/2009

South African Budget Speech for 2008/09: Some Implications for Lesotho

In the face of global economic slowdown, high inflation, trade liberalisation and power shortages the South African Budget 2008 poses implications for Lesotho.....

The Honourable Minister of Finance in South Africa (SA) presented the 2008/09 budget before parliament on the 20th February 2008. The budget is expected to register a larger surplus equivalent to 0.8 per cent of GDP compared to 0.6 per cent of GDP projected for the 2007/08 budget outturn. The surplus is mainly due to the good revenue performance that has been witnessed in recent years. The continuing over performance of the tax revenue has been due to the robust economic growth realised in the last few years coupled with the favourable terms of trade. To isolate the transit positive revenue shock the budget introduced the cyclically adjusted budget balance. Fiscal surpluses are always important in emerging and developing countries

because they can be used to cushion against external shocks which are very common. The positive tax revenue shocks have been traced in Lesotho budget, part of these gains has been used to pay off commercial debt while the other is being saved.

The budget projects an economic slow down from 5.0 per cent in 2007 to 4.0 per cent in 2008. The slow down reflects the negative impact of the global economic slow down, higher domestic interest rates and electricity power shortages. It is important to note that economic growth is expected to recover in the medium term. The economic growth performance in SA has implications for Lesotho economy. About 27.1 per cent of Lesotho exports

are destined to SA. Also the bulk of the foreign direct investment in Lesotho originates from South Africa. The budget projects the inflation measure of CPIX to average at 7.1 in 2008 compared with 6.5 per cent in the previous year. Thus, CPIX will remain above the South African Reserve Bank (SARB) target band of 3 to 6 per cent. It is expected to average at 4.9 per cent in 2009. Inflationary developments in SA are always transmitted into the Lesotho economy as Lesotho imports the bulk of its consumables from SA.

In line with the gradual approach on liberalisation of exchange controls that has been under taken since 1996, the budget announced the removal of exchange controls on institutional investors. The exchange controls are to be replaced by a system of prudential regulation involving quarterly reporting and monitoring of foreign exposure by the SARB. The announced relaxations entail a major shift in the functions and responsibilities of the SARB Exchange Control Department to Financial Surveillance Department. Other areas that are affected are

- Limits on foreign diversification by institutional investors
- Prudential limits on foreign diversification by banks
- Foreign diversification by banks

This report has benefited from the South African Budget Speech 2008

3. Monetary Policy Operations Report of February 2008

The CBL's objective of maintaining price stability in the present policy framework is attained through the maintenance of an adequate level of foreign reserves and fighting domestically generated inflation.

Table 2 below shows amounts auctioned and discount rates that prevailed for each of the auctions. The

- Streamlining administration of controls on individuals

Exchange control regime in SA has implications for Lesotho due to the membership of Common Monetary Area (CMA) by both countries. Lesotho is not obliged to relax to the same extent as SA given the nature of the economy.

The budget provided for financial support to Eskom to facilitate investment in electricity generation in light of the current demand pressures. Eskom has capital expansion plans of about M343 billion over five years but given low levels of the current tariffs, Eskom would require cashflow support. On the management of electricity demand, a new levy is introduced of 2 cents per Kwh on the sale of electricity generated from non renewable sources. This would encourage efficient use of electricity and focus generation towards renewable resources like solar, wind and water. The bulk of Lesotho electricity needs are served from domestic production at Muela Hydro station but Lesotho economy cannot be immune from the impact of electricity power shortages prevailing in SA. If the problem persist, overall trade in the region would be negatively affected and the jobs of about 50 000 Basotho employed in the SA mining industry remain at stake.

against 10 bids that were successful in the previous auction.

Table 2: Treasury Bill Auctions

Type of Security	Auction Date	Maturity Date	Auction Amount (Million Maluti)	Amount Issued (Million Maluti)	Discount Rate (%)
91-day TBs	31-Oct-07	01-Feb-08	160.0	160.0	8.90
182-day TBs	07-Nov-07	07-Mar-07	30.0	30.0	8.72
91-day TBs	28-Nov-07	29-Feb-07	150.0	150.0	8.82
91-day TBs	02-Jan-08	04-Apr-08	150.0	150.0	9.10
182-day TBs	09-Jan-08	11-Jun-08	30.0	24.8	10.45
91-day TBs	30-Jan-08	02-May-08	150.0	150.0	9.17

The Lesotho 91-day treasury bill rate still remained below its SA counterpart rate despite the fact that it continued to follow an upward trend in January. The Lesotho 91-day treasury bill rate rose by seven basis points to 9.17 per cent. The

counterpart SA rate decreased from its previous level of 10.52 per cent in January 2008 to 10.37 per cent in February 2008. Consequently, the gap between the two rates narrowed from 142 basis points to 120 basis points at the end of the review period, as depicted in figure 2 below.

Figure 2: Measuring the Success of Monetary Policy Objectives: Performance of Lesotho 91-Day T-Bills vs RSA T-Bills

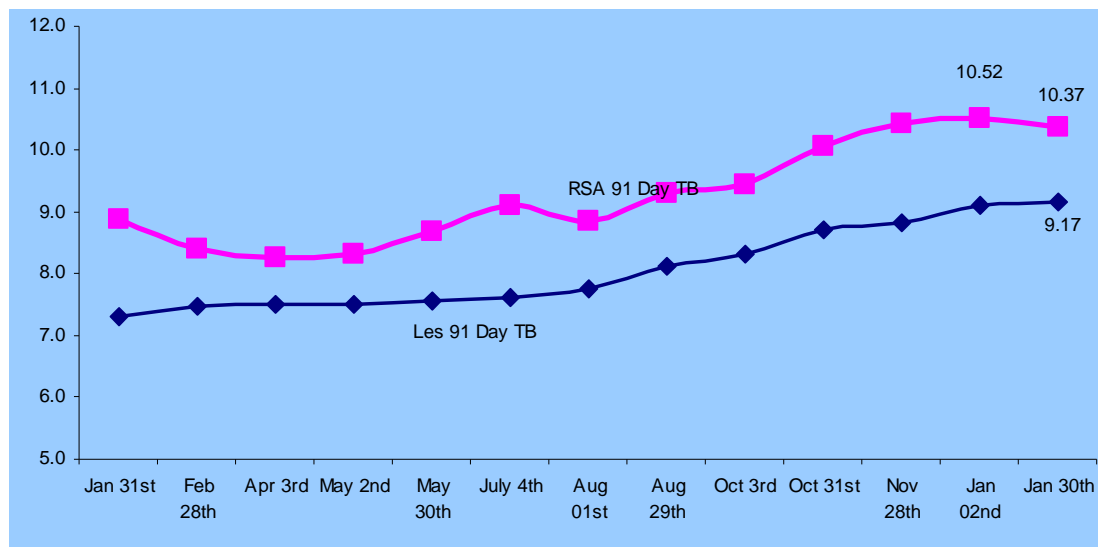


Table 3: Selected Monetary and Financial Indicators

	2007		2008
	Nov	Dec	Jan
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	14.50	15.42	15.42
1.2 Prime Lending rate in RSA	14.00	14.50	14.50
1.3 Savings Deposit Rate	4.08	4.67	4.67
1.4 Interest rate Margin(1.1 – 1.3)	10.42	10.75	10.75
1.5 Treasury Bill Yield (91-day)	8.74	8.82	9.10
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	4104.13	4154.15	4025.04
2.2 Net Claims on Government by the Banking System	-3281.40	-3324.32	-4068.94
2.3 Net Foreign Assets – Banking System	8157.91	8377.64	9240.21
2.4 CBL Net Foreign Assets	7033.41	6786.26	7869.92
2.5 Domestic Credit	-1992.05	-2071.06	-2768.51
2.6 Reserve Money	716.06	535.05	540.27
3. Spot Loti/US\$ Exchange Rate (Monthly Average)	6.7229	6.8385	6.9976
4. Inflation Rate (Annual Percentage Changes)	9.3	10.5	10.5
5. External Sector (Million Maloti)	2007		
	QII	QIII	QIV
5.1 Current Account Balance	62.68	465.67	374.39
5.2 Capital and Financial Account Balance	390.49	245.40	-103.11
5.3 Reserves Assets	143.38	-870.86	-116.19

+ 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 4: Selected Economic Indicators

	2004	2005	2006	2007+
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	4.2	2.9	7.2	5.1
1.2 Gross National Product – GNI	7.9	5.5	3.1	4.9
1.3 Per capita –GNI	7.9	5.5	3.1	4.0
2. Sectoral Growth Rates				
2.1 Agriculture	-1.9	-1.7	1.7	-39.3
2.2 Manufacturing	2.1	-8.6	10.5	11.0
2.3 Construction	-4.4	-3.4	0.6	3.5
2.4 Services	2.1	4.1	6.6	6.3
3. External Sector – Percent of GNI				
3.1 Imports of Goods	86.3	83.1	80.1	86.5
3.2 Current Account	-4.7	-5.7	3.5	9.5
3.3 Capital and Financial Account	5.8	3.6	0.7	8.2
3.4 Official Reserves (Months of Imports)	5.2	5.5	6.7	7.6
4. Government Budget Balance (Percent of GDP)	5.7	4.8	11.8	5.3

* Preliminary estimates

+CBL Projections