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LESOTHO'S BUDGET SPEECH FOR FISCALYEAR 2011/2012: ECONOMIC TRANSFORMATION AND DIVERSIFICATION TOWARDS SUSTAINABLE ECONOMIC GROWTH AND EMPLOYMENT

The current budget speech was presented by The Honourable Minister of Finance and Development Planning amid widespread fiscal consolidation. The key message was that the government should focus on high and shared sustainable growth, meaningful job creation and protection of the vulnerable …………..………..

Introduction

Every year in February, the Government of Lesotho, through its ministry of Finance and Development Planning prepares the budget speech for presentation. A budget speech is a central government policy document which serves the following purposes: firstly, it reviews the government's performance on execution of the past year's budget, together with outstanding challenges, and the way forward. Secondly, it acquaints the public with the government's objectives and aspirations for the fiscal year. Lastly, it enables the public to make necessary adjustments so as to benefit from the impact of positive policy decisions or cushion themselves against the possible adverse effects. The budget speech is presented amid various adverse economic developments, and this year's budget speech was not an exception.

The Setting for the 2011/2012 Budget

This year's budget speech was prepared, read and is going to be implemented amid some negative external and domestic economic shocks. In the past three years, the international economic landscape was being hit hard by the food and fuel prices as well as the global financial crisis. The global financial crisis intensified across the globe affecting several economies negatively. Global output and trade declined by 0.6 per cent and 10.7 per cent, respectively in 2009. Nonetheless, in the middle of recovery most parts of the world's, output and world trade rebounded by 5.0 per cent and 12.0 per cent respectively, in 2010. The high recovery speed was mostly observed in the emerging and developing countries while the advanced economies dragged behind.

During the crisis and the economic recession that ensued, world trade plummeted causing countries whose economies depend on imports tariffs for revenue to suffer. In this regard, the Southern African Customs Union (SACU) revenue pool (All customs and excise duties collected in the common customs area) was negatively affected. The main aim of SACU is to promote free trade among member countries.

SACU imposes common custom duties to non members and has common excise duties.

The contraction in the revenue pool affected SACU member countries' shares negatively. This meant a severely constrained budget for the Government of Lesotho's operations in the fiscal year 2011/2012. In order to navigate this storm, the Government has embarked on fiscal consolidation by curtailing expenditure in line with the growth of revenue.

In this regard, the Government has been forced to curtail its expenditure. The main aim was to ensure that, given low government revenue situation, the Government should still operate effectively and efficiently while cognizant of possible risks. In particular, effort has been made to minimize the wage bill increases by freezing some of the Government job positions and leaving real wages constant. The cuts were also made on goods and services expenditure, such as spending on office equipment.

Nonetheless no cuts have been effected on expenditure on social programs. For example, expenditure on old age pension and the grant to Orphans and Vulnerable Children (OVCs) were not affected. This was an attempt to protect the vulnerable groups from the effects of the global financial crisis which severely affected them since more than two years ago.

The Budget Outturn for 2010/2011

For the fiscal year 2010/2011, the government budgetary operations registered a projected deficit of 8.2 per cent of GDP lower than the budgeted 12.6 per cent. The less-than-budgeted for deficit occurred as result of additional revenue emanating from payments of outstanding SACU adjustments for 2006-2008 and dividends from the Central Bank of Lesotho for 2008/09 and 2009/10 years.

Total expenditure rose as a result of an increase in recurrent expenditure that outweighed the fall in capital expenditure. It is projected to register a projected 63.9 per cent of GDP, slightly higher than the 61.8 per cent that was budgeted for. This was mainly due to the 2.5 percentage points increase in recurrent expenditure to 42.8 per cent of GDP whereas capital expenditure slightly edged downwards by 0.4 percentage points to 21.1 per cent of GDP.

Total revenue and grants recorded a projected outturn of 56.0 per cent of GDP, which is higher than the budget by almost 6.6 per cent of GDP. All components of total revenue have outperformed expectations, while grants have fallen below the budget. Tax revenue is expected to be marginally higher mainly due to slight increase in income taxes. It is projected that over three quarters of the budgeted grants would be received by the end of the fiscal year.

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

Budget Items	Approved Budget for 2010/2011		Projected Outturn for 2010/2011		Proposed Budget for 2011/2012	
	Value	%	Value	%	Value	%
Revenue and Grants	**8183.5**	**49.4**	**8906.2**	**56.0**	**10038.3**	**55.6**
Revenue	6374.4	38.5	7407.8	46.6	7623.8	42.2
Tax	3448.0	20.8	3469	21.8	3952.6	21.9
Other	763.7	4.6	1310.9	8.2	918.6	5.1
SACU	2161.9	13.1	2627.9	16.5	2752.6	15.2
Grants	1809.1	10.9	1498.4	9.4	2414.5	13.4
Expenditure	**10244.6**	**61.8**	**10168.8**	**63.9**[1]	**12717.9**	**70.4**
Recurrent	6675.0	40.3	6817.1	42.8	8008.8	44.3
Capital	3569.6	21.5	3351.7	21.1	4709.1	26.1
Surplus/ Deficit after Grants	**-2085.1**	**-12.6**	**-1305.2**	**-8.2**	**-2712.3**	**-15.0**
Financing	**2085.1**	**12.6**	**1305.2**	**8.2**	**2712.3**	**15.0**

[1] The increase in the ratio depicts the fall in GDP that was faster than the decline in expenditure.

Source: Lesotho Government Budget Speech 2011/2012

2011/2012 Budget

Revenue, Expenditure and Financing

The 2011/2012 budget has proposed a budget deficit equivalent to 15.0 per cent of GDP compared with the budged outturn of 8.2 per cent of GDP for 2010/2011. Total revenue and grants are expected to increase by 22.7 per cent in 2011/2012 to M10038.3 million during 2011/2012, which is equivalent to 55.6 per cent of GDP. Total revenue is projected to increase by 22.7 per cent, attributable to the envisaged increase in customs, VAT and other tax revenue. Non-tax revenue is also expected to boost total revenue. Total grants are expected to increase by 33.5 per cent to M12717.9 million. Total expenditure is expected to increase from 61.8 per cent of GDP to 70.4 per cent of GDP in 2011/2012 fiscal year. This is mainly due to both increases in recurrent and capital expenditures. They are expected to grow by 144.3 per cent and 26.1 per cent of GDP, respectively. The budget deficit is expected to narrow down in the next two years to the benchmark of 3.0 per cent. The deficit is expected to be financed by draw down of government deposits at the Central Bank of Lesotho and by funds from sale of government's bonds.

The current budget has highlighted that for sustainable economic growth and employment, economic transformation and diversification is very imperative. It has been noted that effective tax administration and compliance would enable the Government to fund its operations effectively. It has also been noted that the sharp decline in SACU revenue, slow response or poor collection of non-tax revenue, culture of tax evasion, especially at the border crossings and the rampant fraud and corruption in both the public and the private sectors are an antidote to economic transformation and diversification and as such should be dealt with swiftly and decisively.

Budget Allocations for the 2011/2012

The ministerial budget allocations reflect the priorities of the Government towards the attainment of high, shared and sustainable growth with protection of the vulnerable; economic transformation and diversification

The Ministry of Education and Training (MoET) continues to claim the largest share of total budget. The government is working towards preserving the Free Primary Education (FPE) and continues to do so by spending a sizable amount for its smooth running. As outlined in the budget, the FPE policy is in line with the basic tenets of the government's top priority items. The emerging challenge is accommodation of increased FPE graduates into secondary education. However, an allocation is proposed for construction of secondary schools including building of hostels in remote areas, to enable children who live away from school to attend school without taking long journeys. The government, through the MoET, has continued to provide free meals for primary school children while taking over the extra part of the feeding program from the World Food Programme

The second largest recipient of the budget revenue was the Ministry of Finance and Development Planning. This is largely due to the National Manpower Development Secretariat (a government organ responsible for Basotho national students' loan bursaries). The Ministry was allocated M595.0 million solely for Manpower Loan Bursaries for 2011/2012. Nonetheless, it has been clearly indicated that the bursaries are not sustainable at this level, because few of these loans are paid back. The minister, therefore, urged all the stakeholders to repay their respective shares before the government could resort to harsh and serious measures for those who did not pay, while seeking avenues through which sustainable program of scholarship could be achieved.

In order to economically transform and diversify the economy of Lesotho, this year's government budget was dully allocated to different sectors of the economy that were deemed to be the vehicle through which the government could achieve its stated goals. These sectors are expected to provide Minimum Infrastructure Platform (MIP) for economic growth, employment generation and infrastructure development.

Infrastructure Development

The Government of Lesotho continues to put infrastructure development high on its national agenda. Given the mostly purported positive relationship between economic growth and infrastructure development, it is not surprising that the government has allocated a budget to this end. In this regard, the Government continues to construct, repair, rehabilitate and maintain the road networks in both urban and rural areas. Poor road infrastructure has been considered a constraint to economic growth and development because it delays efficient service acquisition, service delivery and hinders access to basic goods and services. The current road maintenance and rehabilitation in selected areas of the main city and the main roads networks between districts are expected to turn around beneficial both in the short run and in the long run.

Nonetheless, the recent heavy rainfalls and accompanying floods, are posing a challenge to our infrastructure development and maintenance. The recent floods and heavy rainfall have washed off bridges and destroyed road networks.

Moreover, water and sanitation infrastructure is being improved. In this regard, the Government continues to support the Lowlands Water Schemes Program which is intended to supply water to most people in the lowlands. The Government has allocated funds for construction of the Metolong dam for this purpose. It has allocated over M160.0 million for urban water supplies while the Development partners have provided about M70.0 million in grants and M480 million in soft loans.

Without the development of communications and energy sectors, the Government would compromise the overall macroeconomic objective of high and sustainable economic growth. There exists a positive relationship between good communications infrastructure and economic development. Poor communications infrastructure impedes the smooth running of trade and hence economic growth. The international trade, for example, between Lesotho and the rest of the world is largely underpinned by the communication sector and efficiency in this sector would prevent delays and hence boost economic activity. Moreover, the allocations of the funds to the energy sector would highly benefit several sectors of the economy such as households and firms in the urban areas, which rely heavily on electricity. Towards this goal, the Government has allocated M373.0 million to electricity infrastructure while still negotiating with the private bodies to take advantage of the strong winds in the mountains of Lesotho for power generation and expansion of infrastructure.

To further broaden the platform on which to generate employment, especially for the youth, the Government in partnership with the private sector is planning to establish diamond cutting academy. Recently, the diamond mining sector has emerged as the mainstay of the economy of Lesotho, especially from 2004, though it experienced setbacks in the wake of the recent global financial crisis. The planned establishment of the bourse and the jewellery hub are expected to benefit the economy in terms of employment and imparting of technical know-how.

Entrepreneurship Initiative and SMMEs

In order to provide for sustainable and productive job creation and social protection, the Government has sensitised the private sector to take initiative in taking advantage of opportunities provided by the Government. The allocation for social protection has been increased by 7.0 per cent from M564.5 million in the previous year to M604.0 million in the current fiscal year, despite financial strains facing the government operations.

The Government is also creating favourable conditions for private-sector led growth and development by reducing the number of days taken to register a company, obtain licences and leasing. This, in a way, would boost private investment, which would, in turn, boost economic growth.

Moreover, the Government is doing everything in its capacity to reduce youth unemployment, especially for graduates, women and self-employed entrepreneurs. To this end, it has established an Entrepreneurship Initiative, which is intended to train the applicants or groups of people on how to start and run a business, by teaching them how to prepare business proposals that would attract funding and how to run businesses successfully. To make the initiate work, Partial Credit Guarantee Fund is established. The fund is a joint initiative between the Government of Lesotho and local commercial banks, which the

Government is intending to capitalise it by M50.0 million.

Public Service Delivery

For efficient and relatively smooth running of government operations, effective service delivery is an imperative. This has even become more paramount given the current deterioration in the government revenue due to the steep decline in SACU revenue. To this effect, the Government has decided to restrict the growth of the recurrent expenditure by reducing the cost of public administration. It has decided not to create new positions in order to contain the wage bill, which is very high in the Southern African Development Community (SADC) region. The Government has also decided to implement severe penalties and dismissals to those who neglect their duties and misuse government property.

The Government has also decided to improve the procurement services after years of mismanagement. In this regard, it has decided to have an independent board and has put in place new measures to deal with fraud and corruption that has ravaged the procurement process in recent years. The Government had previously decentralised procurement, trained personnel and increased thresholds but all were done in vain.

Conclusion

The Government of Lesotho is expected to navigate the storm of macroeconomic imbalances safely due to the prudent fiscal policy pursued prior to the crisis and the build up of foreign exchange reserves that resulted from buoyancy in SACU revenue and good performance of exports. Nonetheless, measures should be taken to ensure that the reserves do not deplete very fast because this could endanger the fixed exchange rate policy, where Loti is pegged at par to the SA Rand. This could further derail economic recovery because it could scare away potential investors.

2. South African Budget for 2011/2012: Implications for the economy of Lesotho.

The South African (SA) Minister of Finance, Honourable Pravin Gordhan presented the 2011/2012 budget before the SA Parliament in February 23, 2011. The budget was presented amid the stronger recovery on the global economy despite its two-pronged nature, where advanced countries are experiencing moderate recovery while many other emerging economies are growing rapidly.

Against this background the 2011/2012 budget speech highlights the SA's budget proposals as outlined below. Given the strong financial and trade interrelations between Lesotho and SA, it is very important to also look at implications of SA economic developments and the proposed economic policy actions on Lesotho's economy.

The SA budget framework estimated a fiscal deficit of 5.3 per cent of GDP in 2010, which is expected to remain unchanged in 2011/12. It is, however, projected to decline to 4.8% of GDP in 2012/13 budget outturn and 3.8 pr cent of GDP in 2013/14. The expected improvement in the budget balance is at the back of fiscal consolidation which will be effected though moderating the rate of expenditure growth. On the other hand, the continuing spending on priority areas and the growth of revenue due to broadening tax base and the expected strength of economic growth in the coming years are expected to improve the budget balance.

SA economic growth is projected at 3.4 per cent for 2011, after registering an estimated 2.7 per cent in 2010. It is projected to increase to 4.4 per cent in 2013. The improving household balance sheets and hence household consumption as well as accelerating investment will bolster economic activity. Moreover, the recent recovery in demand for commodities and their improved prices are expected to add to the commodity-dependent SA economic growth.

The current macroeconomic situation of SA means that low interest rates and inflation rates will boost the private sector demand and thus enhance economic growth. However, there are imminent upside risks to inflation rate, hence interest rates. These include the recent upsurge of international food and fuel prices. Nonetheless, the inflation rate is expected to remain within the target range of 3-6 per cent, edging towards the upper end of the band in the medium-term as the economy strengthens.

In order to accelerate and achieve sustainable economic growth and development, which will provide meaningful employment and poverty reduction, the budget has proposed a Government's New Growth Path (*GNGP)*. The *GNGP* targets infrastructure and construction. Along this line, the government has proposed the transformation of the financial sector into a two-pronged system. It will comprise of regulatory and financial frameworks, where the former will be in the hands of the SA Reserve Bank and the latter will driven by the market and will be the responsibility of the market-driven Financial Services Board.

The budget has also focused on supporting economic development and industrial promotion. Along these lines, a budget amount equivalent to R10 billion has been set aside for Industrial Policy Action Plan, for investment promotion over the Medium-Term Expenditure Framework period. The budget also includes support for small manufacturing and tourism enterprises as well as small business sector.

The SA growth path strategy and economic developments has implications for the economy of Lesotho. First, Since SA is the main destination of Lesotho's exports in Southern Africa and among SA Customs Union (SACU) members, the recovery in economic growth augurs well for Lesotho's exports sector and employment in manufacturing. Second, SA is the largest source of Lesotho's foreign direct investment in the region and the growth bodes well for investment growth in the country as well as improved Balance of Payments position.

Moreover, the low SA inflation rate remains a welcome development for low imported inflation in the low interest rates within the CMA. The rising demand for SA commodities also augurs well for employment of Basotho mineworkers. The rate of decline of Basotho mineworkers slows down when commodity prices rise. SA's proposal to improve economic efficiency and reform the financial sector will have positive spillover effects on Lesotho's banking sector.

2. Selected Monetary and Financial Indicators+`

	2010	2011	
	Dec	**Jan**	**Feb**
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	10.33	10.33	10.33
1.2 Prime Lending rate in RSA	9.00	9.00	9.00
1.3 Savings Deposit Rate	1.09	1.09	1.09
1.4 Interest rate Margin(1.1 – 1.3)	9.24	9.24	9.24
1.5 Treasury Bill Yield (91-day)	5.60	5.53	5.51
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	6574.81	6300.57	6358.34
2.2 Net Claims on Government by the Banking System	-3197.63	-3102.46	-2740.28
2.3 Net Foreign Assets – Banking System	10667.01	10844.62	10377.27
2.4 CBL Net Foreign Assets	6749.51	7191.62	6915.10
2.5 Domestic Credit	-1000.82	-815.47	-82.20
2.6 Reserve Money	875.07	772.48	876.04
3. Spot Loti/US$ Exchange Rate (Monthly Average)	6.827	6.931	7.192
4. Inflation Rate (Annual Percentage Changes)	3.1	3.2	3.3
5. External Sector (Million Maloti)		**2010**	
	QII	**QIII**	**QIV**
5.1 Current Account Balance	-891.37	-680.49	-547.75
5.2 Capital and Financial Account Balance	332.15	328.46	253.29
5.3 Reserves Assets	928.04	342.90	109.75

+These indicators refer to the end of period. Prime and deposit (savings) rates are averages of all commercial banks' rates operating in Lesotho.

3. Selected Economic Indicators

	2007	2008	2009	2010*
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	1.7	5.1	2.4	2.5
1.2 Gross National Product – GNI	1.7	11.4	1.6	-6.3
1.3 Per capita –GNI	1.6	11.3	1.6	-6.5
2. Sectoral Growth Rates				
2.1 Agriculture	-25.2	27.5	-4.2	0.8
2.2 Manufacturing	1.1	3.6	-1.3	0.5
2.3 Construction	5.1	6.5	11.0	8.2
2.4 Services	3.2	3.1	3.6	2.0
3. External Sector – Percent of GNI				
3.1 Imports of Goods	79.6	80.8	74.7	74.0
3.2 Current Account	12.6	10.3	-0.7	14.7
3.3 Capital and Financial Account	1.6	1.1	3.4	6.7
3.4 Official Reserves (Months of Imports)	7.7	8.4	6.8	6.0
4. Government Budget Balance (Percent of GDP)	8.0	5.9	-1.4	-2.7

* Preliminary estimates