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DOING BUSINESS 2010: REFORMING THROUGH DIFFICULT TIMES

Lesotho is battling to keep up with the pace of doing business reforms and continues to slide down the IFC's Doing Business Ranks……………

Background

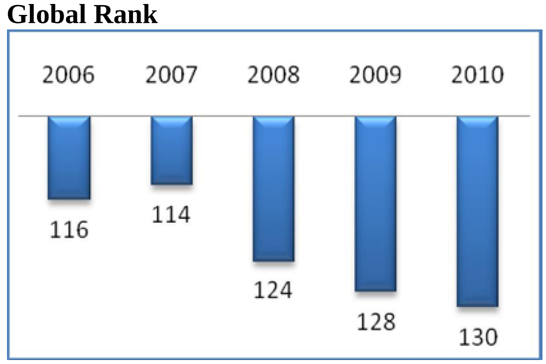
Doing Business 2010 is the seventh IFC's report in a series of annual reports investigating regulations that enhance business activity and those that constrain it. It presents quantitative indicators on business regulations and the protection of property rights that can be compared across 183 economies, over time. A set of regulations affecting 10 stages of a business's life are measured: starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business.

This paper, therefore, presents the summary of Doing Business indicators for Lesotho with a comparison of economies in the region and best practice economies globally for each indicator. It highlights the extent of obstacles to doing business, and also helps identify the source of those obstacles, supporting policymakers in designing reform.

Overview of Doing Business 2010

This round of doing business was a tough one where countries around the world had to cope with the effects of the financial crisis and the global economic downturn. Despite the many challenges, more governments implemented regulatory reforms aimed at making it easier to do business. Reformers focused on making it easier to start and operate a business, strengthening property rights and improving the efficiency of commercial dispute resolution and bankruptcy procedures. Reforming business regulation on its own is not a recipe for recovery from financial or economic distress, but a good regulatory environment can influence how well firms cope with the crisis and are able to seize opportunities when recovery begins.

Figure 1: Ease of Doing Business in Lesotho, Global Rank

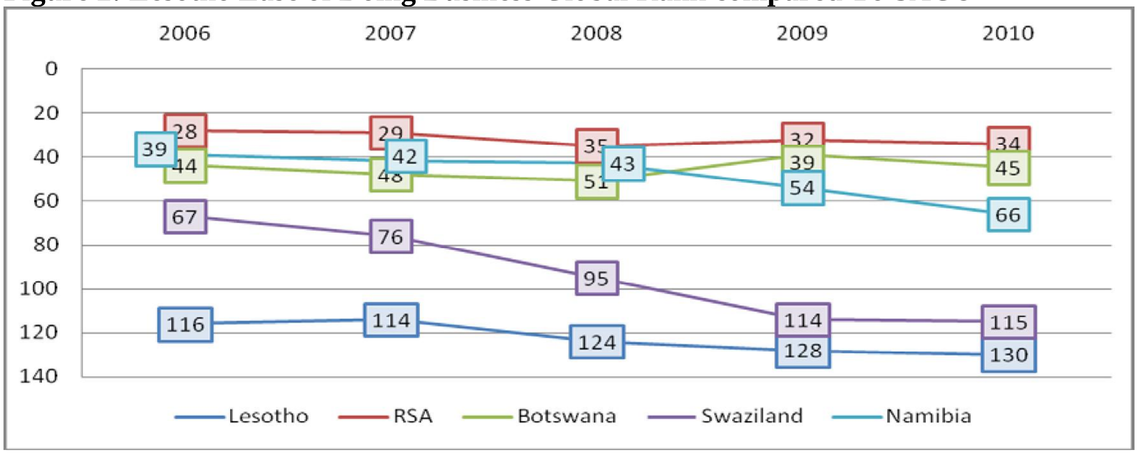


Data Source: Doing Business Indicator

Lesotho is globally ranked at position 130 out of 183 countries and is the last country amongst SACU countries in 2010. She has lost 2 positions as compared to 2009 and has maintained a smooth downward trend since 2007 as shown on Figure 1 above. There were no reforms in any of the doing business indicators recorded from Lesotho in this round.

In SACU, Lesotho has always ranked the last, slightly below Swaziland. Lesotho is ranked 96 positions lower than South Africa and 85 positions lower than Botswana. It shows that there are very big disparities in terms of how business is done in these countries yet they are all situated in the same region.

Figure 2: Lesotho Ease of Doing Business Global Rank compared To SACU



Data Source: Doing Business Indicator

Singapore remained the highest ranked country in the world followed by New Zealand, China, United States of America and the United Kingdom. In Africa, Mauritius (globally ranked 17) is leading the pact followed by South Africa (globally ranked 34), Botswana (Globally ranked 45), Namibia (globally ranked 66) and Rwanda (globally ranked 67). Sub-Saharan Africa remains the most difficult region to do business in with an average rank of 139, followed by South Asia and Latin America and Caribbean with average ranks of 118 and 95 respectively.

Low and lower-middle income economies accounted for two-thirds of reforms recorded in this round. Rwanda led the world doing business reforms, reforming on 7 out of ten areas. As a result, Rwanda has been promoted from position 143 to 67 globally becoming number 5 in Africa.

Starting a Business Indicator in Lesotho

The first step in doing business, for entrepreneurs, is to legally incorporate and register the business entity before it can operate. Entry of new businesses is often regulated by a set of rules and regulations which involve a number of procedures, time delays and other financial costs. In some economies, the process is straight forward and affordable and in others, the procedures are so burdensome that entrepreneurs may have to bribe officials to speed up the process or may decide to run their business informally. Analysis shows that burdensome entry regulation constrain private investment, push more people into the informal economy and fuel corruption.

Starting a business indicator is based on four sub-indicators, these are: the number of procedures; time in days; costs; and the minimum capital requirement. In this indicator, Lesotho is ranked 131 in 2010 which represents a loss of three positions compared to 2009.

There are generally seven procedures involved and it takes about forty days to complete the whole process. The costs and minimum payment requirement measured as a percentage share of income per capita are equivalent to 27.0 per cent and 11.9 per cent respectively. Procedures 1 and 3, which are, hiring a legal practitioner to register the company in the Deeds Office and public health inspection by Maseru City Council, are the longest with 21 and 14 days respectively. In terms of cost, the most expensive procedures are: applying for a manufacturing or trading license and registering for taxes; and hiring a legal practitioner.

Dealing with Construction Permits in Lesotho

Once entrepreneurs have registered a business, they are often constraint by costs and regulations before they can start operations. Processing of construction permits is used to measure the dealing with construction permits indicator. This indicator involves the number of procedures to be followed, time in days and the average costs to be incurred. In dealing with construction permits indicator, Lesotho is ranked number 155 out of 183 countries and this is the worst performance compared to other indicators.

To build a warehouse, it takes 15 procedures which cost 601 days and cost 670.4 percent of GNI per capita. The most expensive procedures in terms of the time each procedure takes are connection to water and electrical power services, obtaining a land lease, building permit and telecommunications connection.

Denmark, Singapore and Qatar are respectively good practice economies on the number of procedures, the time it takes and costs to be incurred. In Denmark, it takes only 6 steps, in Singapore it takes only 25 days and in Qatar it costs only 0.6 percent of GNI per capita in dealing with construction permits.

Employing Workers

Each county has its own system of laws and institutions intended to protect workers. Analysis across economies shows that while employment generally increases the tenure and wages of incumbent workers, overly rigid regulations may have undesirable side effects like less job creation. Therefore, there is need for governments to strike a right balance between worker protection and labour market flexibility.

Doing Business 2010 uses two indices to measure this indicator: a rigidity of employment index and redundancy cost measure. The first one is the average of three sub-indices: difficulty of hiring, rigidity of hours and difficulty of redundancy. The second one measures the flexibility of contracts and the ratio of the minimum wage to the value added per worker. Lesotho is ranked 14 on the former and 44 on the latter and overall is ranked 67. This is the second best performance by Lesotho as compared to all 10 indicators. In SACU, Lesotho is ranked number 3 ahead of Botswana and South Africa which are ranked 71 and 102, respectively.

Registering Property

Formal property titles help promote the transfer of land, encourage investment and give entrepreneurs access to formal credit markets. However, a large share of property in Lesotho is not formally registered and this limits financing opportunities for businesses. Currently, Lesotho is embarking on reforms aimed at formal registration of land through the Land Act.

On this doing business indicator, Lesotho is ranked 142 in 2010 which represent a deterioration of 3 positions compared to 2009. There are 6 procedures involved and it takes 101 days which cost 8 per cent of the total property value. In terms of time, the costliest procedures are land transfer application filed for government approval at the Ministry of Local Government and inspection and surveying of the property with 75 and 14 days respectively. With respect to financial costs, submitting the deed of transfer and application to a lawyer or legal practitioner costs M2,500.00 and lodging the deed with the Registrar of Deeds costs a minimum of M7, 000.00.

Lesotho is ranked fourth in SACU ahead of Swaziland and as compared to the best practice economies, it takes only 1 procedure in Norway, 2 days in New Zealand.

Getting Credit

Access to credit is one of the greatest barriers to business in Lesotho. Commercial banks are highly liquid and much of that liquidity goes to South Africa where there are fewer barriers to credit extension. To measure this indicator, Doing Business constructs two sets of indicators of how well credit markets function: one on credit registers and the other on legal rights of borrowers and lender.

In 2010, Lesotho went down 4 positions compared to 2009 and is ranked number 113. Compared to the region, Lesotho is the last country in SACU and is 70 positions lower than Swaziland which is the second last ranked country.

Protecting Investors

When making investment decisions, investors look for laws or legal and regulatory frameworks that protect their investments. Doing Business 2010 constructs the strength of investor protection index which is an average of the three sub-indices: extend of disclosure, extend of director liability and ease of shareholder suits index. Lesotho is globally ranked at number 147 and the strength of investor protection index is 3.7 out of 10. This is the second lowest in SACU ahead of Swaziland which registered only 2 out of 10. South Africa is the highest in the region on 8 out of 10 and the best practice economy is New Zealand at 9.7 out of 10.

Paying Taxes

Taxes are essential and crucial for an economy to function properly and also to provide public amenities. One way to enhance tax collections and compliance is to ease and simplify the process of paying taxes for businesses. This indicator records effective tax that a company must pay and the administrative costs of doing so. It does so by constructing three sub-indicators: the time it takes to prepare, file returns and pay taxes, number of tax payments per year and the total tax rate.

Lesotho is ranked 63rd in 2010, going down 5 positions as compared to 2009. Paying taxes in Lesotho involves 21 payments per annum and takes 324 hour per year which is rated at 18.5 percent of earning before taxes. This is the best indicator in which Lesotho is ranked but it is very low judging by world’s standard and also in SACU. In Maldives, it takes only one payment per year and costs less than an hour and in Timor-Leste, the total tax rate is just 0.2 percent of earnings before taxes.

Trading Across Borders

Barriers to trade (tariffs, quotas and distance from large markets) greatly increase the cost of goods or prevent trading altogether. Doing Business 2010 compiles procedural requirements for trading a standard shipment of goods by ocean transport. This is based on all documents required by customs and other agencies to import and export, costs to export and import and the time to export and import.

On this indicator, Lesotho is ranked number 143 in the global rankings and number one in SACU. This is by far low compared to the best practice economies. It takes only 2 documents to export and import in France and about 5 days to export to Denmark and 3 days to import from Singapore. In Malaysia, the container cost only US$ 459 and US$ 439 to import from Singapore. In

Lesotho, it costs over three times these costs and it takes more than 40 days to import and export.

Enforcing Contracts

This indicator tracks the efficiency of the judicial system in resolving a commercial dispute, following the step-by-step evolution of a commercial sale dispute before local courts. Rankings are based on the three sub-indicators: procedures, time costs and financial cost of filing the claim, obtain judgment and enforce it.

It involves about 41 steps and 695 days and cost almost 20 per cent of the claim itself to enforce a contract in Lesotho. Lesotho is ranked at position 105 in doing business 2010 which is a 2 positions drop compared to 2009. In the region, Lesotho is ranked 4th ahead of Swaziland.

Closing Business

Businesses often face the reality of having to close down mainly as a result of insolvency or bankruptcy. In countries where administrative bottlenecks and bankruptcy laws are inefficient, unviable businesses linger for years leading to non-recovery of overdue loans and other assets of creditors. The closing business indicator is made up of three measures: the time and costs of the insolvency process, and the recovery rate.

In this indicator, Lesotho is globally ranked at number 72. It takes about 2 and half years for the process to come to an end, costing 8 percent of the total estate and creditors are said to recover only 34 cents on the dollar invested in the business. Regionally, Lesotho is fourth ahead of Swaziland. In Japan, creditors are able to recover approximately 93 cents from a dollar invested and in Ireland, it takes only 4 months for the process to be concluded, and it costs only 1 percent of the estate under dispute in Singapore.

Current Investment Climate Reforms in Lesotho

Although no reforms from Lesotho were recorded in this round of doing business, there are several reforms underway aimed at improving the business cycle in general. To address problems in starting a business, the one-stop shop business facilitation centre has been launched being led by the Ministry of Trade, Cooperatives and Marketing, the companies bill is being reviewed and the manual registration of companies is being transformed to be electronic.

The Land Act that has recently been passed by Parliament will also help address several doing business indicators. They include, starting a business, dealing with construction permits and registering property. To address issues relating to getting credit, the establishment of the credit bureau supported by the Millennium Challenge Compact will improve credit extension by commercial banks. The initiative of introducing new VAT filing period for SMMEs may earn Lesotho approximately 5 positions on the paying taxes indicator and establishment of a commercial court will also improve the rankings of Lesotho on the enforcing contracts indicator.

Conclusion

Lesotho's laws and regulations make it time consuming and expensive for businesses to comply. There are a lot of cumbersome procedures coupled with unnecessary bottlenecks which make it comparably difficult for investors to do business in Lesotho. Despite several reforms underway, the country is slipping in regional and international rankings because other countries reform faster and because other reforms are taking a long time to implement. According to the Ministry of Finance and Development Planning through the Department of Private Sector Development and Financial Affairs, Lesotho could gain approximately 25 positions on the global rankings if the current reforms are implemented now assuming other countries do not reform.

Doing Business report is one of the key references for investors when making investment decisions. Ranking way above 100 and maintaining a declining trend mean that Lesotho is losing the competitiveness and as a result may be forfeiting potential investment opportunities which are required for sustainable economic growth and employment which are key in poverty alleviation.

2. LESOTHO SOVEREIGN RATING FOR 2010

Lesotho's long term foreign currency credit rating by Fitch Rating Agency remains unchanged at BB- while local currency rating is BB..……….

Background

Fitch sovereign credit ratings refer to the capacity and willingness of a sovereign government to service its debt within the maturity dates and in accordance with the conditions agreed upon with the creditors at the time the loans were contracted. The main aim of Fitch is to assess the sovereign government's ability and willingness to generate foreign exchange necessary to meet the external financial obligations of the concerned government as well as other private entities. The rating of the currency in which the debt is denominated refers to financial obligations in terms of either the domestic or foreign currency that a sovereign government is willing and capable of repaying.

Furthermore, as for the maturity terms involved, the ratings reflect long-term and short-term obligations. A short-term rating refers to obligations maturing in less than 12 months and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

Credit ratings are used largely by investors as indicators of the likelihood of regaining their funds in accordance with the terms on which they invested. The ratings vary from A, B, C or D. Fitch uses the scaling in which the top rating is 'AAA' and the bottom is 'D'. The rating at the bottom of the scale implies the greater probability of default, and vice versa. Governments rated above 'BBB' are known as 'investment grade' while those rated below fall into the 'speculative grade' category.

In the "speculative grade", category, governments have to pay higher costs for obtaining finance in international markets than "investment grade" governments. This has far reaching implications on the external financing costs of the private sector of such countries since the sovereign rating is a key parameter for determining the costs involved in external borrowing by residents of a given country. In determining the payment capacity and willingness to repay debt, Fitch considers macroeconomic indicators such as the available stock of foreign currency reserves, balance of payments flows, economic growth prospects and capacity to generate revenue and a variety of political and social factors.

Lesotho's Current Credit Rating

For eight consecutive years, Lesotho's Long Term Foreign Currency (LTFC) rating has been left unchanged at BB-. Other countries in the scale with Lesotho include Armenia, Gabon, Nigeria, Serbia, Uruguay as well as Vietnam. Nigeria and Vietnam have been rated along with Lesotho in this scale as far back as 2006, while other countries are new in the scale. This rating is on the lower end of the 'BB' rating, thus implying that there is a possibility of credit risk developing.

However, this ‘speculative’ credit rating shows that capacity for continued payment is dependent on a sustained, favourable business and economic environment.

Lesotho’s ability to pay off its short-term foreign currency loans is rated ‘speculative (B)’ and had been sustained for some time. This means that the country has ‘minimal capacity for timely payment of financial commitments, plus vulnerability to near-term adverse changes in financial and economic conditions’. Meanwhile, Fitch has continued to rate the local currency at BB due to concerns about the Government’s ability to cope with the steep declines in SACU revenues.

The Fitch rating process identified strengths as well as weaknesses in rating Lesotho’s creditworthiness in the international financial markets. The strengths comprise: enhanced credibility of the monetary and exchange rate policy regime in the CMA region, low inflation rate, strong economic integration with South Africa, balance of payments position, net external creditor position. Nonetheless, slower economic growth, and low per capita income especially among the peers, poor business environment, low levels of financial intermediation and concentrated export basket and export direction have been touted as the main weaknesses in the rating of Lesotho.

Strengths

Enhanced credibility of monetary and exchange rate regime

Lesotho has adopted a fixed exchange rate regime, which has been in operation since 1974 when the loti was first pegged to the South African rand. This has led to the domestic monetary policy closely tracking that of the bigger neighbour and this has afforded Lesotho considerable monetary policy stability and policy credibility. The price developments, as a result, have been largely anchored to those in South Africa. About 90.0 per cent of Lesotho’s imports come from SA, therefore, approximately 70.0 per cent of Lesotho’s inflation is explained by economic factors in SA. This has kept Lesotho’s inflation relatively stable and contained. The inflation rate averaged 7.1 per cent in Lesotho in 2005-2009 compared with 7.4 per cent in other countries in the ‘BB-’ range. It increased to 10.7 in 2008, and retreated to 7.2 per cent in 2009 compared to 7.3 per cent realised in South Africa in 2009.

Balance of Payments Position

In the period 2005-2009, Lesotho registered an average current account surplus of 6.0 per cent of GDP as a result of SACU receipts and miners’ remittances from South Africa. SACU receipts and miners’ remittances jointly averaged 50.0 per cent of GDP during the same period. Moreover, capital and financial account inflows remained robust during the last five years averaging 8.5 per cent of GDP mainly due to sustained Foreign Direct Investment in export-oriented manufacturing. FDI stocks amounted to 58.0 per cent of GDP in 2008 against 40.0 per cent on average in Southern Africa.

Strong International Liquidity

A trail of BOP surpluses has increased Lesotho’s stock of foreign exchange reserves to 77.0 per cent of GDP in 2009, an equivalent of 6.8 months of imports cover. In conjunction with banking sectors’ external assets amounting to 18.0 per cent of GDP, they make Lesotho a significant net external creditor. As a result of the huge build-up of official reserves, Lesotho’s debt service ratio is much below those of peers in the BB- range. Coupled with strong high foreign exchange reserves, the international liquidity position of Lesotho has significantly increased.

Weaknesses

Low Economic Growth and per capita income

Lesotho's low economic growth and low per capita income, especially among the peers were cited as major rating weaknesses, particularly in view of the need to alleviate high unemployment and poverty and therefore to improve the country's economic performance. Fitch expects growth to uptick to 2.5 per cent after declining by 1.9 per cent in 2009 from 4.4 per cent realised in 2008 mainly as a result of the second round effects of the global financial and economic meltdown. The positive growth prospects are expected at the back of the expected recovery in the mining sector.

Meanwhile, the Kao mine is expected to resume production this year. In addition, Mothae has already started operating on a trial basis in May 2010, and possibly, it may contribute to massive production over the next two years. Textile exports are also expected to pick up along with growth recovery in the US and recovery in other markets into which the textile producers are attempting to diversify, mainly the European Union and South Africa.

Poor Business Environment

The Kingdom of Lesotho ranks 130 out of 183 countries according to the 2010 World Bank's *Ease of Doing Business Report*, a clear indication of a poor business environment. It is the lowest in the 'BB' range after Gabon and Philippines. It compares poorly with all other SACU economies but favourably in Sub-Saharan Africa. Difficulties with contract enforcement is also having a toll on the business environment, making private sector credit significantly low compared to the peers. As of 2009, private sector credit as per cent of GDP stood at 13.1 per cent compared with over 25.0 per cent of GDP among the 'BB' range.

Nonetheless, Millennium Challenge Account (MCA) funding is being utilised to improve the business environment. Land reform bill, the establishment of credit bureau and a commercial court are some measures in the pipeline to address the poor business environment that is crippling the economic growth of the country.

Narrow Export Base

The export base of Lesotho is very narrow and the direction of exports is very concentrated. Garments accounted for 75.0 per cent of goods exports over the period 2005-2008. In addition, over 50.0 per cent of these merchandise exports were destined for the US in 2002-2007. Together with its high levels of trade openness, these rendered Lesotho most vulnerable to external shocks. For example, the global financial crisis had a negative impact on exports and consequently on employment by the manufacturing sector.

Conclusion

Lesotho's long term foreign currency remained unchanged at BB- while its short-term foreign currency is 'B'. Regardless of favourable BOP position over the last five years, Lesotho's economy is currently facing acute fiscal and external position imbalances. This is mainly due to declining SACU transfers as a result of the global financial crisis. This implies that Lesotho's international creditworthiness is likely to be severely affected making the country a high sovereign risk economy. This is detrimental to investment and hence economic growth. Moreover, reforming our institutions and the structure of the economy that will diversify the export basket and economic base may improve Lesotho's growth potential, leading to narrow income and development gaps. This will also translate into impressive international creditworthiness.