Economic Review March 2007

Private Sector Competitiveness and Economic Diversification Project for Lesotho

The World Bank's Board of Executive Directors approves an International Development Association (IDA) credit of US$8.1 million of which US$4.2 is a grant to support the government of Lesotho's private sector competitiveness and economic diversification programme………

Introduction

The Government of Lesotho realises the potential of private sector led growth to achieve sustainable development. To this end, Government secured funding from the World Bank to implement the Private Sector Competitiveness and Economic Diversification project. The aim of the project is to improve efficiency of the public sector to create an enabling environment for the private sector to develop, as well as expand market access for the latter. The project is estimated to cost US$10.1 million, with Government of Lesotho contributing US$2.0 million, while the World Bank covers the remainder. About 41.6 per cent of the cost is a grant and 38.6 per cent is concessional financing.

The project will target the micro and macro impediments to growth and job creation. It will focus on reducing the cost of doing business by improving the legal and regulatory framework, increasing economic diversification through skills development, and providing support for small, micro and medium enterprises (SMME). In addition, it will help identify areas of comparative advantage and support activities that encourage regional integration efforts.

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Furthermore, it will contribute to poverty reduction by creating conditions necessary to improve private sector competitiveness, which will benefit growth, and eventually job creation.

Project Focus

The project aims to achieve the following main components.

i. Improve the Business Environment, and
ii. Support Economic Diversification.

Improvement of the business environment

To improve the business environment, the project intends to undertake the following three broad complementary subcomponents.

a) Company registration and licensing reforms

It has been determined that the rules and procedures for establishing a business are lengthy, cumbersome and costly, while their administration also imposes significant costs on the public sector. This project intends to implement recommendations from the *Private Sector Development strategy that was developed after a consultative workshop held in May 2005*.

The project intends to improve the effectiveness of the company registry by introducing a modern and efficient company registry which will consolidate all business related registration in one institution. It will streamline the industrial and trading licensing regimes so as to reduce the time and costs to both the public and private sectors of registration and to restrict the process to essential regulatory purposes.

b) Support, upgrade and enhancement of immigration and passport services (IPS) operations and staff capacity

This is intended to streamline and simplify the procedures to issue visas, work permits and residency permits, improve the public perception of the IPS by instilling the principles of productivity, courteousness and efficiency in IPS officers and reduce corruption during border crossing activities and in the dispensation of immigration benefits.

c) Improvement of access to finance by SMMEs

This subcomponent will assist Government in addressing issues of limited access to finance by SMMEs from commercial banks. This will be achieved through two main activities. The first will be an enterprise development facility which will provide guarantees to SMMEs to access loanable funds from the commercial banks. The second will be the development of legal and regulatory environment for establishing a well functioning leasing industry.

Support Economic Diversification

The second component aims to diversify Lesotho's products and widen markets. One of its subcomponents will benefit the garment industry by providing necessary skills to employees at their different levels to sustain firms operations at management level. This is particularly important in the event that the foreign owned factories close down. It has potential to increase productivity and eventually output for the local market as well.

Horticulture outgrower scheme is another venture that is identified to diversify Lesotho's products, targeting both the domestic and regional market. This will be piloted on the northern border of the country with technical assistance from some entrepreneurs from South Africa. The intention is to improve productivity at firm level, with high value cash crops.

Tourism industry support as identified in the Poverty Reduction Strategy (PRS) is one of the beneficiaries of this project. With this sub-sector, the project will improve the quality of existing services, attract new investments and improve market access linkages for tourism business using the already existing structures.

Implications on the Lesotho economy

The first component of the project will address the unnecessary rigidities in doing business, and review and update relevant legislation. Business registration and licensing will improve significantly since most of the processes will be carried out under one roof. The imminent company registry will provide necessary information for potential investors.

In addition, the project will provide the necessary finances and offer marketing and promotion of SME products. This will stimulate demand which in turn will lead to an increase in employment and may attract entry of new merchant and development banks.

A well functioning IPS has potential to benefit the tourism sub-sector, with relatively easy access to relevant travelling documents, and attract more foreign investments. Computerisation of immigration services and decentralisation of some services will become handy to achieve national aspirations.

If the horticulture project succeeds, it will be replicated to other parts of the country. This, coupled with the tourism project has potential to address the unemployment problem which is rampant in the rural areas. Overall, the project will strengthen and grow tourism products, improve market presence and generate a positive image globally.

Conclusion and Recommendations

This project is viewed a sustainable means of creating employment beyond project life. The skills acquired will continue to be used after completion of the project at individual level. Financial intermediation is also likely to improve.

The country has one of the best sceneries, with contrasting weather conditions. The tourism subcomponent has potential to attract visitors from all over the world for either the hot summers, or the cold winters, while some may visit specifically to experience snow. It will also assist to diversify the market for Lesotho's exports, which are presently dependent on one major destination, the US.

However, to realise all the embedded benefits, Government has to improve absorptive capacity in implementation of projects. The project alone is not a sufficient condition to realise intended goals, but it should be accompanied by provision of the necessary infrastructure to access the entire country. Roads networks and utilities are some prerequisites to facilitate storage and transportation of products to the markets, and attraction for tourists. Moreover, the other laws that impede on access to finance and property ownership have to be revised in conjunction with this project implementation.

2. Lesotho's Budget Speech for the Fiscal Year 2007/08

Conducive investment climate essential for sustainable economic growth, job creation and poverty reduction………….

A budget speech highlights the objectives that Government commits to achieve during the year. It is a device for ensuring a continuous monitoring procedure, reviewing and evaluating performance with reference to previously established standards. Through budgets, governments allocate anticipated revenue collection to various government programmes to address agreed priorities. The funds are allocated to effect delivery of social services and development of infrastructure in an effort to stimulate economic growth and reduce poverty. A budget can be used as a gauge to determine the fiscal incidence.

The 2006/07 budget rolled out a scope of the new budgeting tool, the Medium Term Expenditure Framework (MTEF) to other ministries that were not previously included. This is another step in fiscal prudence which resulted in a budget surplus of around 14.0 per cent of Gross Domestic Product (GDP).

Focus of the 2007/08 Budget and its Implications

a) Key policy issues

The current budget has become conscious of opportunities that arise from the regional and international cooperation, and the potential impediments to their realisation. As a consequence, the focus is mainly to address those and to further explore other areas that Lesotho has comparative advantage on. It is observed that high investment alone is not sufficient to raise growth and create jobs. The following pre-conditions are perceived to be key to achieve growth.

- Political and social stability
- Sound macroeconomic management
- Conducive and enabling investment climate
- Public investment in complementary physical structure and support service.
- Sound financial system.

Government recognises that the private sector is an engine to attainment of broad-based and sustainable economic growth, job creation and poverty reduction. To this end, government has decided to overhaul laws, regulations and procedures that may impede private sector growth.

Government seeks to build a Minimum Infrastructure Platform (MIP) to combine priority physical infrastructure investments. This approach to public investment will enable government to improve:

- Business environment
- Trade facilities regulations and institutions
- Skills development and industrial linkages
- Financial services, and
- Infrastructure and support services such as customs procedures and facilities, products certification and standards.

It is in this regard that Government is implementing a number of projects to enhance efficiency. This includes the overall public sector reform project, which aims to enhance among others, efficiency of financial management. In addition, a number of construction initiatives were started, for example, construction of Likalaneng - Thaba-Tseka road and water and sanitation project in Maseru peri-urban.

Furthermore, provision of Anti-retroviral (ARV) drugs was rolled out to cover the entire country, with increased support to people affected by the HIV and AIDS scourge. Moreover, the first cohort of Free Primary Education (FPE) beneficiaries completed the final year, and was expected to be accommodated at post-primary level.

b) Sectoral allocations

The 2007/08 budget estimated revenue at 57.1 per cent of GDP, while expenditure was budgeted at 60.0 per cent. This means Government will need 2.9 per cent to finance the access of expenditure over revenue.

Table 1: Government Budgetary Operations (Million Maloti)

Budget Item	**Approved 2006/2007 Budget**	**2006/2007 Budget Outturn**	**Proposed 2007/2008 Budget**
Revenue and Grants	5782.6	6676.8	6883.1
Revenue	5352.8	6461.8	6393.1
Grants	429.8	215.0	490.0
Expenditure and Net Lending	5722.5	5116.3	7229.7
Recurrent Expenditure	4388.2	4203.7	5315.5
Capital Expenditure	1343.5	918.3	1924.2
Net Lending	-9.1	-5.7	-10.0
Surplus/Deficit after Grants	60.1	1560.6	-346.7
Financing	-60.1	-1560.6	346.7
Foreign Financing	-29.0	-65.2	61.8
Domestic Financing	-31.1	-1495.3	284.9

According to table 1 above, government expenditure is largely driven by all economic classifications (personal emoluments, transfers and subsidies, interest payments increasing by 78.2 per cent and purchases of goods and services). Development spending is proposed to grow by over 40.0 per cent to meet infrastructure requirements. Recurrent expenditure will largely benefit social services and the general public services, public order and safety.

The social services category remains government priority in the current budget. As a percentage of GDP, it was recorded at 24.2 per cent, compared with 21.6 per cent observed last fiscal year. It also represented 40.3 per cent of the total budget. This category comprises spending on public health, social security and welfare affairs, education, culture and recreation. Education is allocated the largest share, mainly following extension of secondary schools to accommodate the first graduates of Free Primary Education (FPE). It registered 12.1 per cent of GDP, followed by health with 7.0 per cent, largely on account of construction of a referral hospital, coupled with renovation and refurbishment of health centres throughout the country. As a result, allocation for infrastructure provision increased significantly relative to the previous budget. It is also going to benefit construction of roads and provision of utilities, with Metolong dam due to be built during the year.

c) Budget financing

The proposed budget forecasts an overall deficit equivalent to 2.9 per cent of GDP. This is likely to be financed by running down government deposits with the banking sector, or through issuance of government securities. The latter financing option has a potential to support development of money and capital market in the economy. However, government should be cautious in this as it may crowd out the private investment if not well implemented.

Challenges

Though government expenditure has been relatively contained, the recurrent component has been significantly above, and growing faster than the development component. This is not desirable since SACU revenue is expected to decline as more international trade initiatives are implemented. Therefore, there is a need to ensure that more government investment is undertaken to boost domestic economic activity, which may curb the ultimate fall in SACU revenue. In addition, government has to undertake initiatives to diversify revenue sources to improve domestic revenue collection.

Absorptive Capacity is another constraint that emerges at different fora. To realise efficiency in service delivery, Government has to put in place relevant superstructures that support the intended reforms. Relevant training and staff placement should be emphasised at all levels of government. This will go a long way to realising the overall goals of economic growth and poverty reduction.

3. Monetary Policy Operations Report for March 2007

During the period under review, monetary policy operations successfully attained the desired objectives. The primary objective of the monetary policy is price stability, which is achieved through maintenance of adequate level of NIR. The adequate level of NIR ensures that the parity between Loti and Rand is maintained. The NIR target for the period January to March 2007, as determined by the CBL Monetary Policy Committee (MPC), ranged between $400 and $450 million.

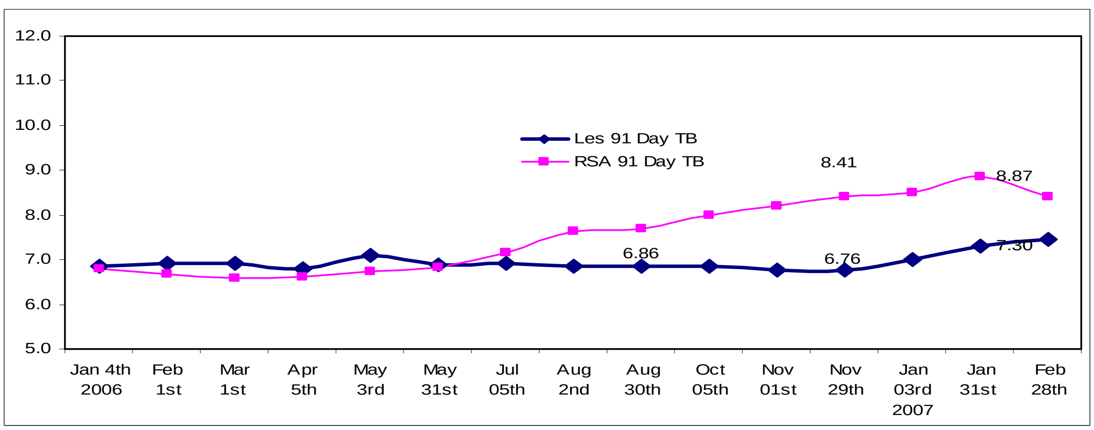
CBL uses Open Market Operations (OMO) to achieve the stated monetary policy objectives. The table below shows amounts auctioned and discount rates that prevailed for each of the auctions. The March auction was fully subscribed and as a result, the auction amount worth M170.0 million was issued. The level of competitiveness in the market, as estimated by the number of participants in an auction, declined during the auction. The recent auction saw a participation level of 5 bidders who submitted 13 bids for the auction and all bidders became partially successful. However, the success rate was below the February figure of 8 successful bidders.

Table 2: Treasury Bill Auctions

Type of Security	Auction Date	Maturity Date	Auction Amount (million)	Amount Issued (million)	Discount Rate
91-day TBs 182-day TBs	03 Jan 2007 09 Jan 2007	05 Apr 2007 13 Jul 2007	M160.0 M50.0	M160.0 M50.0	7.02% 7.30%
91-day TBs	31 Jan 2007	04 May 2007	M170.0	M170.0	7.30%
91-day TBs 182-day TBs	28 Feb 2007 06 Mar 2007	01 Jun 2007 07 Sep 2007	M170.0 M20.0	M170.0 M20.0	7.46% 7.46%

During the month under review, the Lesotho 91-day treasury bill remained below its SA counterpart rate. In March, the Lesotho 91-day treasury bill increased by 16 basis points to 7.46 per cent. On the contrary, the counterpart SA rate declined from its previous level of 8.87 per cent in February to 8.41 per cent in March. Hence, the margin between the two rates narrowed from 157 basis points to 95 basis points at the end of the review period.

Figure 1: <u>Measuring the Success of Monetary Policy Objectives:</u>



4. Selected Monetary and Financial Indicators+`

	2006		2007
	Dec	Jan	Feb
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	13.50	13.58	13.58
1.2 Prime Lending rate in RSA	12.00	12.50	12.50
1.3 Savings Deposit Rate	2.68	2.68	2.68
1.4 Interest rate Margin(1.1 – 1.3)	10.82	10.90	10.90
1.5 Treasury Bill Yield (91-day)	7.05	7.30	7.46
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	3505.80	3476.78	3592.63
2.2 Net Claims on Government by the Banking System	1498.76	2062.88	1592.07
2.3 Net Foreign Assets – Banking System	6149.69	6815.00	6383.92
2.4 CBL Net Foreign Assets	4377.24	4950.54	4500.71
2.5 Domestic Credit	-576.82	-1060.21	-603.61
2.6 Reserve Money	490.92	401.27	409.89
3. Spot Loti/US$ Exchange Rate (Monthly Average)	6.9930	7.1867	7.1693
4. Inflation Rate (Annual Percentage Changes)	6.4	6.0	5.6*
5. External Sector (Million Maloti)	**2006**		
	QII	**QIII**	**QIV**
5.1 Current Account Balance	256.41	151.78	18.88
5.2 Capital and Financial Account Balance	-154.91	-23.94	-81.15
5.3 Reserves Assets	-442.82	-641.50	-32.81

+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.

5. Selected Economic Indicators

	2003	2004	2005	2006*
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	2.7	4.0	2.7	4.8
1.2 Gross Domestic Product	4.3	4.5	3.2	5.1
1.3 Gross National Product – GNI	6.0	6.1	3.4	5.7
1.4 Per capita –GNI	3.7	3.9	2.2	4.4
2. Sectoral Growth Rates				
2.1 Agriculture	0.3	13.5	20.0	10.7
2.2 Manufacturing	5.7	2.1	-8.0	1.2
2.3 Construction	-4.9	-4.4	2.5	2.8
2.4 Services	6.1	2.6	3.5	2.8
3. External Sector – Percent of GNI				
3.1 Imports of Goods	84.0	84.5	69.5	77.7
3.2 Current Account	-6.3	-1.2	-1.0	8.6
3.3 Capital and Financial Account	3.9	1.5	2.0	2.3
3.4 Official Reserves (Months of Imports)	5.6	5.2	6.4	7.1
4. Government Budget Balance (Percent of GDP)	-0.4	5.6	4.4	9.3

* Preliminary estimates