Economic Review November 2009

The role of Private Sector Development in economic growth: the case of Lesotho

The Government of Lesotho recognises the significance of private sector development in reducing high rates of unemployment and promoting sustainable economic growth

Background

The role played by the private sector development in economic growth and its impact on eradicating poverty is currently at the centre of national development plans for many countries around the world. Private enterprises do not only promote economic growth and reduce poverty, but they contribute greatly in the provision of employment opportunities for the poor, better standard of living. This means that supporting the private sector development, through conducive environment and increased entrepreneurial capacity building, is a critical step towards achievement of sustainable economic growth.

INSIDE:

Private sector can, therefore, be defined as a basic organising principle for economic activity in a market–based economy where physical as well as financial capital is generally privately-owned and production decisions are made for private gain. In Lesotho, the private sector consists mainly of three sectors, namely, primary, secondary and tertiary sectors. Like other developing countries, Lesotho recognises the critical role that a well-developed private sector plays in economic growth and development. This article intends to assess the role played by the private sector in Lesotho's economic growth. Some policy implications will also be highlighted.

Organisation of the private sector in Lesotho

The relationship between the private sector and economic growth has been recognised globally. Most of the developed and developing countries have drawn up strategies and implemented programmes aimed at developing the private sector. The private sector comprises individual households, corporate sector (firms) and multinational companies. In Lesotho, the private sector consists of small and medium enterprises. Most of what could be regarded as large enterprises are either multinationals or subsidiaries of multinationals. In the informal private sector, trade activities are undertaken by individuals who are regarded as self-employed. They work as street vendors, farmers, domestic workers and a range of other occupations. These people earn their income almost entirely from the private sector.

The link between the private sector and economic growth.

There is a growing recognition, in the countries giving donations to the poor and developing economies, of the role played by the private sector in creating employment opportunities for the poor, improving investment climate for entry of new firms into the market thus fostering competition, increasing efficiency and productivity, and promoting economic growth. According to World Development Report (WDR) 2005, private sector entities invest in new markets and new facilities that help strengthen the infrastructural foundation of the economy which, in turn, lays a good ground work for attracting investors from abroad and facilitating achievement of economic growth.

The private sector development also helps in reducing unemployment and corruption which have far reaching implications for both economic and social lives of the country's population. Jobs and incomes created by the private sector enterprises lead to economic diffusion of growth by having a direct impact on poverty alleviation.

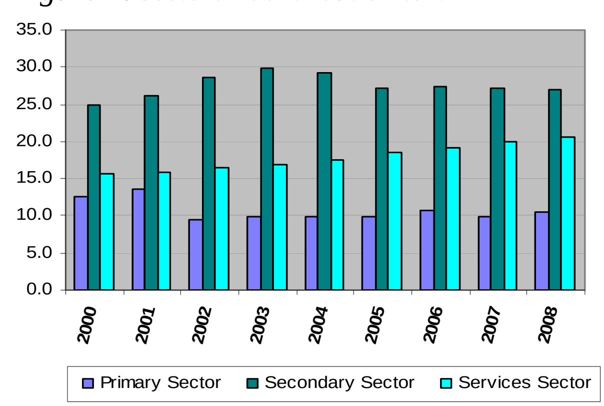
Moreover, developing the private sector helps in making more people to be actively involved in economic activities and decision-making processes by attracting new stakeholders into the economy, provided the driving motive behind the economic activity is profit.

Private sector is also the main source of tax revenue, contributing to public funding of health care, clean drinking water, food and agricultural inputs (e.g. seeds) for the poor and satisfying other public demands.

Overview of the Private Sector performance in Lesotho and economic growth.

The highest proportion of economic activities in Lesotho is attributable to the private sector. In the primary sector, the highest contribution to GDP comes from privately owned mines and agricultural farms. The industrial sector consists of manufacturing, utilities and construction sub-sectors and all of these are entirely in the private hands. Except for public administration and large portion of education sector, the greater part of the services sector is controlled or managed by the private individuals and organisations. However, in some cases, it is not easy to measure economic output that is solely attributable to the private sector and this has led to underestimation or over estimation of the contribution of the private sector to total economic output. Figure1 below shows sectoral contribution to total GDP.

Figure 1. Sectoral Contribution to GDP

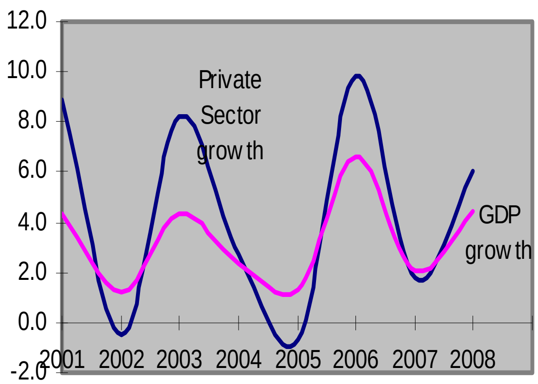


Source: Bureau of Statistics, Lesotho

The figure shows the sectoral contribution to GDP for the period spanning 2000 to 2008. The percentage share of primary sector averaged 10.0

per cent for the whole period while the secondary sector was highest from 2003 to 2004. The primary sector was supported by rising contribution of mining sub-sector to GDP. The mining share in GDP increased from virtually 0.0 percent in 2000 to 2.7 per cent in 2008. However, the contribution of the private secondary sector remained well above 25.0 of GDP for the whole duration. This is attributable to the manufacturing sub-sector, the dominant sector in the secondary industry. The share of manufacturing sub-sector in total GDP increased from 11.7 per cent in 2000 to 17.9 per cent in 2008. The highest increase was recorded in 2004, with its percentage share at 20.0 per cent. The percentage contribution originating in the services sector gained momentum from around 15.0 per cent of GDP in 2000 to around 20.0 per cent of GDP in 2008. The increased contribution, emanating from the services sector, may be a result of the reforms taken in the financial intermediation and trade activities in the period under review.

Figure 2. Private sector and economic growth



Source: Bureau of Statistics, Lesotho

Figure 2 above depicts the relationship between the private sector growth and the growth of economic activity in Lesotho. As the figure shows, there is a co-movement of the private sector GDP growth and overall economic growth in Lesotho. The private sector recorded the growth of around 8.0 per cent in 2000 and since then it has moved in tandem with the economic performance for the whole period. In 2002, 2005, and 2007 the growth rate of the private sector output was below that of the general economy.

Policy framework for the private sector development in Lesotho.

The policy climate for private sector development in Lesotho is tabulated in the Poverty reduction Strategy paper. The policy is that the private sector is best placed to promote investment and growth, with it providing the enabling environment for private sector participation in economic activity. This means that Lesotho has to provide an enabling business environment for the growth and development of the private sector (business sector) through provision of competition policy, legal and regulatory framework, good investment climate, good governance, etc. However, Lesotho is not yet in doing for promoting the vibrant business environment. Nonetheless, its private sector benefits a lot from its access to the South African well-developed infrastructures, wider capital markets and good financial markets. The other advantage to Lesotho's private sector is its access to international export markets with preferential treatment in the European Union, the US and Japan.

The private sector development in Lesotho is constrained by several factors. The first obstacle is outdated laws and regulations. They involve unnecessarily long and complex procedures when registering and licensing firms, as well as administrative requirements that make it unnecessarily long and cumbersome to obtain work and residents permits. It takes 28 days to register a business in Lesotho, and 73 to start a business.

The second obstacle is underdeveloped Foreign Direct Investment (FDI) policy. It is important to note that Lesotho has been successful in attracting FDI than most other least developed countries. Foreign investors have created jobs, particularly, in the apparel industry. Though Lesotho is open to FDI, the current taxation laws and regulations in the country are only partially addressing the investors' needs and this poses a concern for further FDI flows.

As mentioned above, competition is a necessary condition for private sector development. Competition strongly encourages efficient use of methods of production, and channelling of firms' resources to production of such goods and services that the society values the most. Hence, competitive business environment is a conducive tool in the allocation, utilisation and efficient distribution of economic resources for the betterment of people. In Lesotho, there is no competition policy as yet, that is, Lesotho has no competition law or overall competition regulator**.** Instead**,** under the industrial and trading licenses system, a business can apply for protection from competition for up to 10 years. This also poses an impediment to the development of the private sector.

Policy Suggestions

For the private sector development to be pro-growth, enhancing policy measures for its development are necessary. Having realised the weaknesses in the promotion of private sector development, the Government of Lesotho is currently moving towards major policy reforms. These reforms include:

- Measures to improve business environment.
- Reducing the cost of doing business by reviewing the obsolete laws and business procedures;
- Increasing economic diversification through skills/ entrepreneurial development;
- Improving access to credit;
- Increasing participation of women in the formal sector;
- Establishment of Trade Facilitation and Investment centre and
- Review of Land Bill.

To augment the Government of Lesotho's efforts in developing the private sector in order to deliver growth, the following interlinked and mutually reinforcing factors are required:

- Provision of incentives for entrepreneurship and investment, especially in education;
- An Increase in productivity through greater competition and innovation;
- Harnessing international linkages through trade and investment;
- Strengthening the already improved market access and functioning;
- Reducing risk (political, economic, etc) and vulnerability.

All these measures are intended to bring about a foundation upon which the development of the private sector would be grounded. Since competition policy involves all government policies that affect the functioning of the markets, the main challenge facing the Government of Lesotho is to draft and complete the competition policy for the private sector growth. Competitive firms find and try to discover better ways of producing, distributing goods and services, innovating and thus driving lower costs to all economic inputs. Competition benefits both the consumers and producers, rich or poor, through lower prices, better quality and improved choice of inputs and products, as well as through its indirect effect on productivity, investment and living standards.

Conclusion

A developing or growing private sector allows new investments that increase flow of goods and services, creates employment opportunities, promotes innovation and entrepreneurial capacity and increases income directly through employment and indirectly through higher national output. High employment and income enhance eradication of poverty. The development of the private sector also promotes better living standards through cheaper but high quality goods and services.

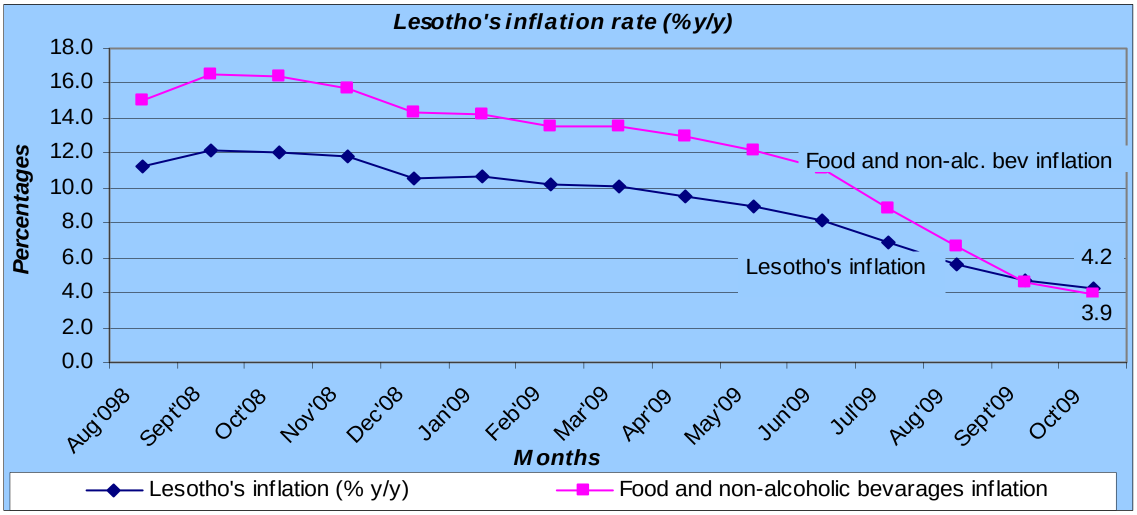
2. Recent developments in domestic Inflation

Lesotho's annual inflation rate, measured as a percentage change in consumer price index (CPI), has been in a downward trend since a record high rate of 12.1 per cent, year-on-year, in October 2008. These developments are welcome in the face of global economic recovery. Recent global economic developments indicate that global economies have started to recover. Other economies have started to realise positive growth, though at a slightly low pace. If a low and stable inflation rate is maintained, other economic challenges are likely to be manageable.

Figure 3 below shows that domestic inflation rate recorded 4.2 per cent, year-on-year, in October 2009 – a decline of 790 basis points since September 2008. On a monthly basis, it declined by 50 basis points from 4.7 per cent in September 2009. The fall in inflation rate has been on the back of falling food and non-alcoholic beverages inflation, which is the main contributing category to the overall inflation rate. Food and non-alcoholic beverages inflation recorded 3.9 per cent, year-on-year, in October 2009 compared with 16.5 per cent in September 2008. Figure 3 below shows both the overall inflation and food and non-alcoholic beverages inflation.

Other contributing factors have been the strengthening of the loti/rand against major currencies and weak domestic demand due to economic slowdown. Appreciation of the local currency moderated the impact of imported inflation (particularly commodities denominated in dollars) on domestic inflation.

Figure 3: Lesotho's inflation rate



Low and stable inflation is a necessary condition for high and sustainable economic development. It gives macroeconomic authorities enough space to worry about other economic problems.

Low inflation is normally associated with low interest rates. This is mainly due to the fact that monetary authorities widely use interest rates as a tool to manage inflation, while at the same time preserving sustainable economic growth. When inflation is high, monetary authorities tend to increase interest rates in an endeavour to slowdown economic activities and therefore inflation. However, at a relatively low inflation rates, there is no immediate need for the authorities to increase interest rates. Low interest rates translate into low cost of credit and therefore encourage borrowing for investment. This has a potential to stimulate domestic investment and economic growth.

In addition, low levels of inflation have a potential to boast purchasing power of households, particularly at this time of economic slowdown. This has a potential to boast aggregate demand and therefore encourage investments. It also has a potential to attract foreign direct investment.

In conclusion, a decline in inflation rate has come at the time when the economy needs some form of a stimulus to curb the negative impact of the economic slowdown.

3. Monetary Policy Operations Report for November 2009

During the review period, monetary policy operations undertaken by the Central Bank of Lesotho (CBL) were successful in attaining desired objectives. The primary objective of monetary policy is to achieve and maintain price stability within the economy. As a result, the Bank employs Open Market Operations (OMO) to attain the stated objective. The initiative enables CBL to maintain the parity between the local currency, Loti, and the South African Rand which is important for price stability.

The report presents economic and operational issues surrounding the monetary policy operations conducted during the review period to assess the success of the operations.

Table 1 below shows that the entire amounts of treasury bills (M30.0 and M40.0 million) announced during the auctions conducted in November 11 and 25, 2009, respectively, were ultimately issued. During the review period, the market responded relatively well to the 91-day treasury bills auction held in November, 2009 compared with the previous auctions conducted in October, 2009.

Competitiveness of the 91-day TBs auction (as measured by the number of bidders and bids received, over/under subscription of the auctions as well as the movements of discount rates) moderated during the review period. The number of bids received fell slightly from an average of 10 bids to an average of 8 bids in November 2009. The number of bidders remained unchanged at an average of 5 participants from the previous month. Nevertheless, oversubscription increased from an average of M21 million to M26.0 million in November.

Table 1: Treasury Bills Auctions

Type of Security	Auction Date	Maturity Date	Auction Amount (Million Maloti)	Amount Issued (Million Maloti)	Over/(under) subscription (million)	Discount Rate (%)	RSA Discount Rate (%)
91-day	***11-Nov-2009***	10-Feb-10	M12.0	M12.0	M24.0	6.76%	7.01%
182-day		12-May-10	M12.0	M12.0	M12.6	7.11%	7.19%
273-day		11-Aug-10	M8.0	M8.0	M8.5	7.92%	7.30%
364-day		10-Nov-10	M8.0	M8.0	M8.7	7.83%	7.16%
91-day	***25-Nov-2009***	24-Feb-10	M9.0	M9.0	M27.0	6.70%	7.01%
182-day		26-May-10	M9.0	M9.0	M15.6	7.00%	7.14%
273-day		25-Aug-10	M6.0	M6.0	M10.5	7.80%	7.30%
364-day		24-Nov-10	M6.0	M6.0	M10.7	7.83%	7.17%
Total for reporting period			**M70.0**	**M70.0**	**M117.6**	-	**-**

The intermediate target, the 91-day TBs rate (discount rate) declined by 8 basis points from 6.78 per cent recorded at the end of October to 6.70 per cent at the end of November, 2009, as shown in figure 2 below. However, SA 91-day TBs rate declined by 2 basis points, from 7.03 per cent to 7.01 per cent in November 25, 2009. Therefore, the margin between the two rates (discount rates) widened by 6 basis points to 0.31 per cent in November 25, 2009. This implies that there was a minimal incentive for undesirable cross border transfers of funds between the two countries.

In relation to the progress towards attaining Monetary Policy objectives, the minimum NIR limit set for the period under review was successfully met. The level of NIR at the end of November 2009 was US$972.8 million, above the upper limit of the target range of US$500 million to US$550 million set by the Monetary Policy Committee (MPC) by US$422.8 million. Therefore, the Monetary Policy operations undertaken during the review month were successful in attaining their desired objectives of price stability by maintaining the target NIR level.

Figure 2: Measuring the Success of Monetary Policy Objectives: Performances of Lesotho 91-day T-bills vs RSA 91-day T-bills rate

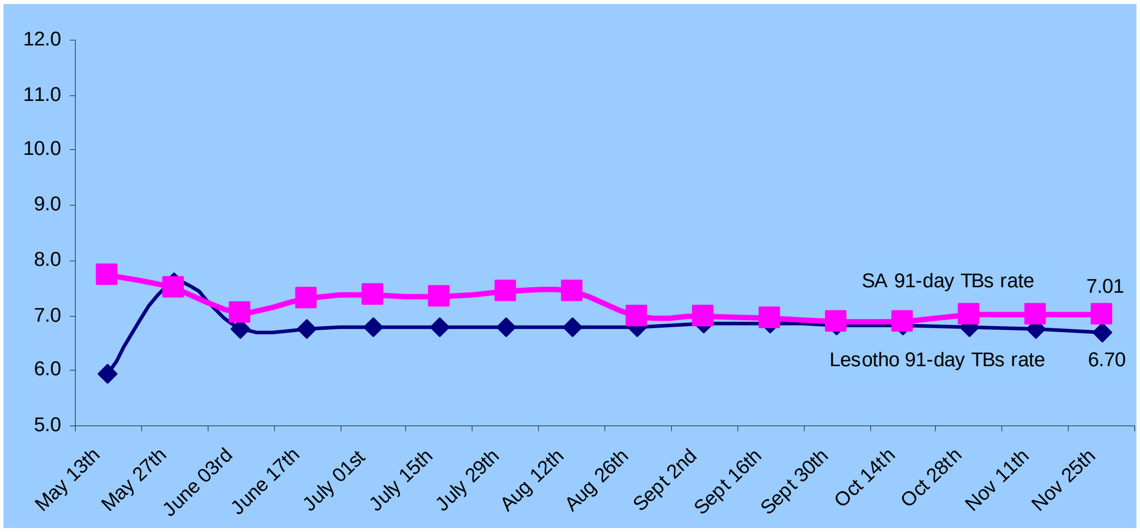


Table 2: Selected Monetary and Financial Indicators

	2009		
	September	***October***	***November***
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	*11.83*	*12.0*	*11.83*
1.2 Prime Lending rate in RSA	*10.5*	*10.50*	*10.5*
1.3 Savings Deposit Rate	*2.11*	*2.11*	*2.11*
1.4 Interest rate Margin(1.1 – 1.3)	*9.72*	*9.89*	*9.72*
1.5 Treasury Bills discount rate (91-day)	*6.84*	*6.78*	*6.70*
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	*6411.20*	*5415.24*	*5697.69*
2.2 Net Claims on Government by the Banking System	*-3 644.00*	*-5 078.61*	*-4348.79*
2.3 Net Foreign Assets – Banking System	*11 331.01*	*11 766.13*	*11152.62*
2.4 CBL Net Foreign Assets	*7289.78*	*8617.92*	*8041.93*
2.5 Domestic Credit	*-1 855.95*	*-3 254.39*	*-2498.74*
2.6 Reserve Money	*710.08*	*779.7*	*820.94*
3. Spot Loti/US$ Exchange Rate (Monthly Average)	***M7.5345***	***M7.4880***	***M7.5164***
4. Inflation Rate (Annual Percentage Changes)	***4.7***	***4.2***	***4.1***
5. External Sector (Million Maloti)	***2009***		
	QI	***QII***	***QIII+***
5.1 Current Account Balance	*322.98*	*341.82*	*297.57*
5.2 Capital and Financial Account Balance	*132.85*	*607.24*	*-501.76*
5.3 Reserves Assets	*67.28*	*70.01*	*875.49*

+Preliminary Estimates.

**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*