



## LESOTHO NATIONAL IDENTIFICATION CARD SYSTEM AS A PREREQUISITE FOR THE ESTABLISHMENT OF A CREDIT BUREAU: IMPLICATIONS FOR FINANCE ACCESS AND ECONOMIC GROWTH

*The Ministry of Home Affairs and Public Safety and Parliamentary Affairs in collaboration with the Millennium Challenge Corporation-Lesotho hosted a one day workshop to sensitise participants from different government ministries on the Government plan to introduce Lesotho national identification system .....*

### Background

The absence of the national identification system in Lesotho has been a major obstacle in policy implementation in Lesotho. The national identification (ID) card restricts all citizens and lawful residents to a single unique identity number. The ID cards can be used by holders in banking, employment institutions and any place where identification is required. The practice in Lesotho has been to use a passport as a form of identification in addition to travelling purposes. The high demand for the passport led to significant backlog and delays in their issuing. The delays in the issuance of passports were identified as one of the priority area within the improvement of public service delivery in the Poverty Reduction Strategy (PRS). The PRS also recognised that the delays were costing people job opportunities especially in the industrial sector in Lesotho and in the mining sector in South Africa. For anyone to be employed some form of identification is a requirement.

#### INSIDE

<b>2 The Continued Interest Rate hike in SA.....</b>	<b>4</b>
<b>3. Monetary Policy Operations for June 2008.....</b>	<b>6</b>
<b>4. Selected Monetary and Financial Indicators.....</b>	<b>8</b>

In July 2007, the Government of Lesotho signed for a five year grant with the Government of the United States (US) and Millennium Challenge Corporation aimed at, among others, private sector development. The private sector development project includes the establishment of the credit bureau and national ID system in Lesotho. The setup of a credible national identification system in Lesotho is a prerequisite for establishment of the credit bureau. A credit bureau collects both private and public information and disseminates it to its clients. Public information includes basic information such as the individual's full name, address and passport and identification numbers.

Normally, this data is available at the Ministry of Home Affairs. Private information on the other hand includes the individual arrears profile, outstanding debt, judgements and court actions. The credit bureau is expected to enhance access to credit by the majority of the rural poor communities in Lesotho. Lesotho has decided to link with the already existing credit bureaus in South Africa. This will ensure increased benefits due

to the integration of the goods and financial markets between the two countries.

This review intends to briefly highlight the importance of the credible national identification system and credit bureau in the link between finance and economic growth. The dynamics of private sector credit extension in Lesotho during the period 2003-2008 will also be presented.

### **Finance and Economic Growth Nexus: The Roles of ID System and Credit Bureau**

The relationship between finance and output is well articulated in economic theory. It is believed that a well functioning financial system facilitates the channelling of funds from surplus agents to deficit agents. The deficit agents are then able to invest in projects with high return sufficient to compensate the intermediary and the surplus units. However, there are a number of bottlenecks in the process arising from the presence of asymmetric information in financial markets. The financial intermediaries are faced with a number of risks including credit risk. This is the probability that the borrower of the funds may default. The probability increases because the intermediaries do not have all information about the borrower. Thus a credit bureau becomes handy for lenders to augment their information. It ensures that lenders make their decisions with full information about the borrower. Lenders can access information on borrowers from the credit bureau at a charge per query. Commercial banks in Lesotho have cited the absence of national identification system and the credit bureau as one of the major obstacle in credit extension.

Credit extension in Lesotho has not been very impressive following the privatisation of state-owned enterprises and the restructuring of the financial sector in the late 1990s. During the period 2003 to 2007, credit extended to the private sector grew by an average of 23.9 per cent. Measured relative to GDP, total credit accounted for an average of 7.8 per cent in the period while as a ratio of total deposit it averaged 36.5 per cent. The bulk of the credit has been received by households compared with the business enterprises and statutory bodies. On average, households accounted for 35.9 per cent while business enterprises accounted for 31.4 per cent of total credit. Statutory bodies have been on a downward trend reaching a low of M17.4 million in 2006. A sizeable number of government parastatals were privatised in the period 1995 to 2000. It is important to note that a sizable amount of credit is geared towards consumption expenditure relative to investment expenditure as would be reflected by business enterprises.

Table 2 below presents the commercial banks' loans and advances to business enterprises and statutory bodies by economic sectors for the period 2003 to 2007. The

### **Private Sector Credit in Lesotho**

construction sub-sector has been the largest recipient of credit in Lesotho. Construction is mainly driven by Government delivery of infrastructure to support economic activity. The main infrastructural development has been in areas of roads construction, building of schools and factory shells. The manufacturing sub-sector has also been receiving some credit particularly the textiles and clothing firms. It is important to note that relative to its size in terms of contribution to GDP, credit to the textile and clothing sub-

sector, is quite small. The third largest recipient of credit is wholesale, retail, hotel and restaurant sub-sector. This sub-sector has benefited from increased employment opportunities in Lesotho coupled with sustained economic growth in the last six to seven years. The sub-sectors transport, storage and communication, and mining and quarrying grew significantly in the last three years. The latter is expected to continue to grow as mining operations increase in the country.

**Table 1: Domestic Credit**

	2003	2004	2005	2006	2007
Private Sector Total	456.51	509.64	825.03	817.37	1149.43
<i>Per Cent Growth</i>	6.11	11.64	61.89	-0.93	40.63
Business Enterprises	146.05	162.04	316.63	409.53	494.78
<i>Per Cent Growth</i>	0.25	10.95	95.40	29.34	20.82
Households	158.59	256.64	369.28	390.45	603.18
<i>Per Cent Growth</i>	13.32	61.83	43.89	5.73	54.48
Other	112.93	38.80	105.75	0.00	0.00
<i>Per Cent Growth</i>	10.88	-65.64	172.55	-	-
Statutory bodies	38.94	52.16	33.37	17.39	51.47
<i>Per Cent Growth</i>	-8.91	33.94	-36.02	-47.90	196.04
GDP at Market Prices	7861.8	8519	9065.2	10120	11358.4
Credit to GDP Ratio	5.81	5.98	9.10	8.08	10.12

### Implications for Lesotho's economy

The implementation of the ID cards system has a number of implications for Lesotho's economy. First, the ID system will facilitate the establishment of the credit bureau in Lesotho which is one of the impediments for credit extension in Lesotho. As already indicated, Lesotho has opted to link the credit bureau with some of the existing ones in South Africa, there is a potential that some large retail outlets from South Africa may increase their presence in Lesotho through additional investment. It is noteworthy that there

may be a need for harmonisation of certain laws in Lesotho to those of South Africa in implementing this initiative. Second, the ID cards would enhance government efforts to fight poverty. The majority of the people who did not have passports would be able to access services like opening a bank account, insurance policies, applying for a school bursary and getting employment with their cards. Third, the public service delivery would improve as the passport would be solely for travelling purposes and the often cited backlogs and delays in their issuance would be overcome.

**Table 2: Commercial Banks loans and advances To Business Enterprises and Statutory bodies**

**(Million Maloti; End of Period)**

Economic Activities	2003		2004		2005		2006		2007	
	Amt	%	Amt	%	Amt	%	Amt	%	Amt	%
Agriculture, Hunting, Forestry and Fishing	0.0	0.0	0.0	0.0	0.0	0.0	1.3	0.3	2.9	0.5
Mining and Quarrying	0.0	0.0	0.0	0.0	0.0	0.0	2.8	0.6	32.4	5.9
Manufacturing	23.6	12.5	29.3	13.5	47.8	13.6	45.7	10.7	42.2	7.7
Electricity, Gas and Water	8.9	4.7	8.0	3.7	5.3	1.5	53.1	12.4	58.5	10.7
Construction	97.0	51.2	132.5	60.9	132.6	37.9	108.0	25.3	132.0	24.2
Wholesale, retail, Hotel and Restaurant	20.7	10.9	20.9	9.6	27.5	7.9	12.3	2.9	19.5	3.6
Transport, Storage and Communication	7.3	3.9	8.6	4.0	129.9	37.1	202.6	47.5	205.2	37.6
Non-Bank Financial Institutions, Real Estate	5.3	2.8	7.9	3.6	6.9	2.0	0.7	0.2	1.4	0.3
Community, Social and Personal Services	26.7	14.1	10.2	4.7	0.1	0.0	0.4	0.1	52.2	9.6
<b>Total</b>	<b>189.5</b>	<b>100.0</b>	<b>217.4</b>	<b>100.0</b>	<b>350.0</b>	<b>100.0</b>	<b>426.9</b>	<b>100.0</b>	<b>546.2</b>	<b>100.0</b>

## Conclusions

The implementation of the ID card system would require that all stakeholders engage in extensive public awareness campaign to sensitize all citizens. The implementation would be a challenge given the topography of the country and the dispersion of the villages. A

successful implementation would ensure that the credit bureau is established to improve the local financial market. Other projects like the establishment of microfinance institutions in Lesotho would also benefit from the improvement.

## 2. The Continued Interest Rate hike in South Africa (SA): Implications for Lesotho Economic Growth

### Introduction

The financial sector in Lesotho is highly integrated to that of the neighbouring South Africa. The integration is mainly due to the membership of both countries to the Common Monetary Area (CMA) together with Swaziland and Namibia. The main objectives of the CMA are: (i) to monitor monetary arrangements that should provide for the sustained economic development in the area, (ii)

encourage economic advancement of less developed members and (iii) should afford to all members equitable benefits arising from maintenance and development of the area. The agreement provides a framework for exchange rate and monetary policies in member countries. According to the agreement the South African Currency, the Rand, is allowed to circulate freely in all the member countries and the other smaller members are allowed to issue their

currencies which circulate in parallel with the Rand in their respective countries. These currencies are expected to be fully backed by holding of international reserves. In return, the government of South Africa compensates the smaller states for the loss of monetary and exchange rate policy discretion.

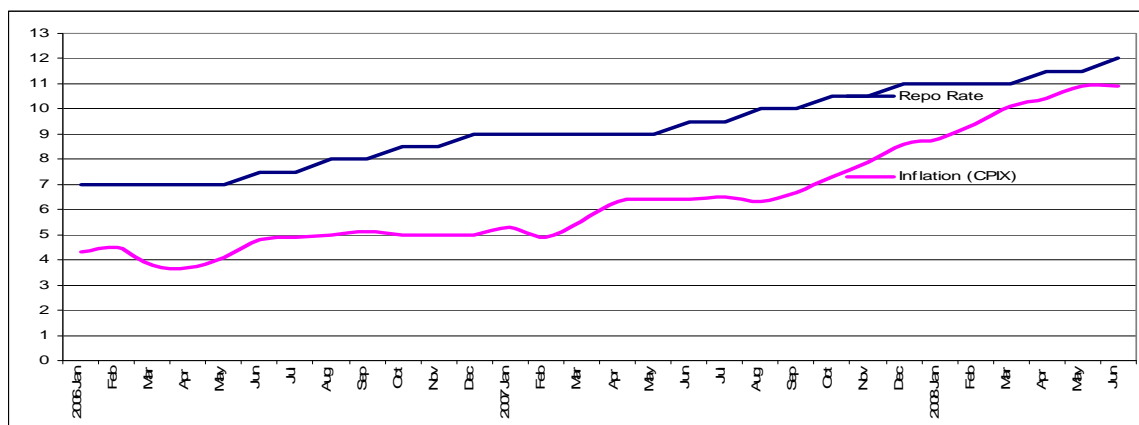
In 2002, the Government of South Africa adopted inflation targeting policy framework with the policy instrument as the repurchase rate, commonly known as the repo rate. The repo rate is the rate at which commercial banks borrow money from SARB in order to finance their short-term liquidity needs. It is also used to control flow of money and as a benchmark for cost of funds in the economy. The inflation target is currently set at a band of 3 per cent to 6 per cent. The interest rate responses in pursuit of the target is transmitted to the other CMA countries. It also

follows that interest rates in the region would move in line with the repo rate.

### Interest Rates Developments

The sustained increases in the price of crude oil have exerted inflationary waves throughout the world, and the CMA region has not been immune. This has seen the inflation rate in South Africa rise to 5.0 per cent, 8.6 per cent, and 11.6 per cent at the end of 2006, 2007 and in June 2008. Inflation rate surpassed the upper limit of the target range in April 2007. As expected, the policy response has been a continued increase in the repo rate by the South African Reserve Bank (SARB). The repo rate rose by 350 basis points to 12.0 per cent in the period from January 2006 to June 2008. Figure 1 presents the repo rate and inflation rate in the period January 2006 to June 2008.

**Figure 1: SA CPIX and Repo Rate**



A similar pattern is observed in the commercial banks interest rates. The prime lending rate in Lesotho continues to be above that of South Africa due to perceived risk premium in Lesotho. In June 2008, the prime rate in Lesotho was 75 basis points above that of South Africa. As for the deposit

rates in Lesotho no significant upward movement has been observed. Savings deposit rate and 31-day time deposit increased from 5.0 per cent and 3.5 per cent in December 2007 to 5.04 per cent and 5.14 per cent in June 2008, respectively.

## ***Implications for Lesotho Economic Growth***

The high interest rate environment may have a number of implications for employment and output in Lesotho. Conventional economics assert that there is a negative relationship between investment expenditure and interest rates. It is possible that businesses may delay their investment activities in Lesotho as their investment projects become less viable. This also includes the commercial and residential building financed by bank loans as mortgage bond prices continue to increase. Thus private investment is expected to slow down in response to the high interest rate environment in Lesotho. Consumers are also expected to manage their budgets tightly as they have to incur higher interest costs on their different loan facilities. The high interest rates are occurring at the time

that the cost of the basic households stuff like food, paraffin and transport are on the increase. Customers on the other hand, may prefer to increase their investments to enjoy higher returns on financial assets.

Government expenditure is also likely to be affected as interest payment increase. This is particularly the case as relates to domestic debt whose interest rates in the local market move in line with those of South Africa. Government of Lesotho domestic debt is mainly in treasury bills and the return on Lesotho's treasury bills move in line with those of the comparable instrument in South Africa. The external debt is highly concessional and denominated in US dollars and the interest rates are fixed.

## ***Conclusion***

The high interest rate environment in the region poses a great challenge for the smaller CMA members. The high interest rates are occurring at the time when the prices of basic commodities such as food and fuel are

skyrocketing. This is likely to counter the government efforts to foster private sector led economic growth in the fight against poverty. Businesses in particular are likely to delay their investment projects because of high cost of capital.

## **3. Monetary Policy Operations for June 2008**

The main objective of the Central Bank of Lesotho is to maintain price stability. This is attained through the maintenance of an adequate level of the bank's net international reserves (NIR). The adequate level of NIR ensures that the parity between the Loti and the Rand is maintained. The Bank controls reserve money as an operating target of monetary policy and ensures that it does not grow in a manner that would encourage depletion of the Bank's net foreign assets.

The Bank uses open market operation (OMO) instrument to achieve monetary policy target. It offers competitive discount rate relative to rates of comparable instruments offered in the region as to encourage investors to invest in the government of Lesotho's securities instead of investing abroad. The Bank's Monetary Policy Committee continues to set the quarterly target for NIR. The target range remained between US\$450.0

and US\$500.0 during the period under review.

Table 3 below depicts amounts auctioned and discount rates that prevailed for each of the auctions during the period under review. The level of competitiveness in the market, as estimated by the number of participants in an auction continued to stay around 15. The number of bidders

has proven that there is adequate potential of producing market clearing rates that are in line with regional interest rates. This improvement indicates that the existing investors are well informed of the financial developments in the region, and use this information in their bidding. However, there were six bids rejections in the auction during the period under review.

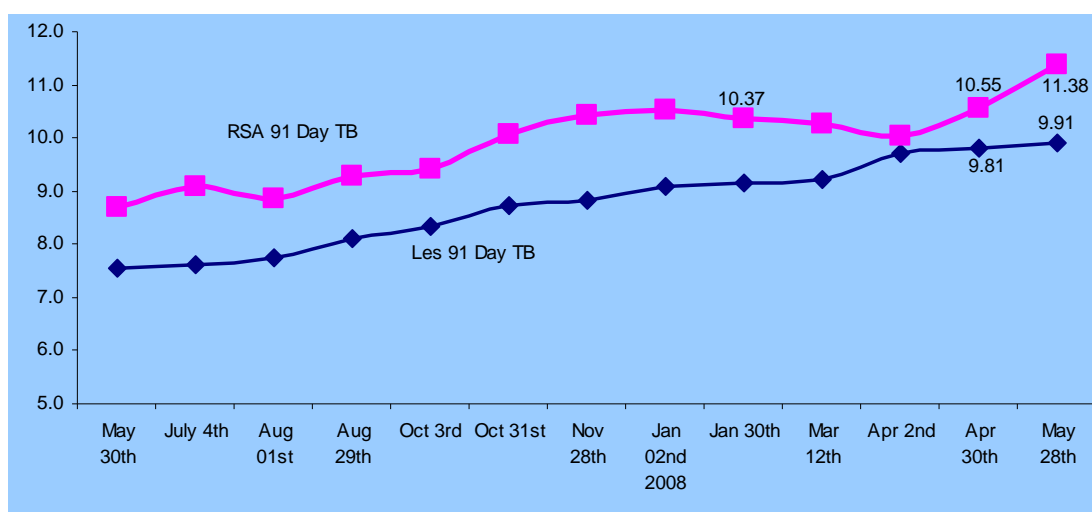
**Table 3: Treasury Bill Auctions**

Type of Security	Action Date	Maturity Date	Auction Amount (Million)	Amount Issued (Million)	Discount Rate
91-day TBs	05-Mar-08	06-Jun-08	M150.0	M150.0	9.21
182-day TBs	12-Mar-08	12-Sep-08	M20.0	M20.0	10.45
91-day TBs	02 Apr-08	02-Jul-08	M150.0	M150.0	9.71
91-day TBs	30-Apr-08	01-Aug-08	M150.0	M150.0	9.81
182-day TBs	07-Mar-08	07-Nov-08	M30.0	M30.0	10.45
91-day TBs	28-May-08	29-Aug-08	M150.0	M150.0	10.91

The 91-day treasury bill in Lesotho and South Africa have generally been following a steady upward trend in the recent months, with SA rate higher than that of Lesotho.

Monetary policy operations undertaken during the review month were successful in attaining their desired objectives of financial stability and the target NIR level.

**Figure 2: Measuring the Success of Monetary Policy Objectives**



**Table 4: Selected Monetary and Financial Indicators**

	2008		
	March	April	May
<b>1. Interest rates (Percent Per Annum)</b>			
1.1 Prime Lending rate	15.67	15.92	15.92
1.2 Prime Lending rate in RSA	14.50	14.50	15.00
1.3 Savings Deposit Rate	4.57	4.57	4.84
1.4 Interest rate Margin( 1.1 – 1.3)	11.10	11.35	11.08
1.5 Treasury Bill Yield (91-day)	9.21	9.08	9.81
<b>2. Monetary Indicators (Million Maloti)</b>			
2.1 Broad Money (M2)	4176.62	4591.71	4626.55
2.2 Net Claims on Government by the Banking System	-3273.76	-4049.23	-3741.15
2.3 Net Foreign Assets – Banking System	9258.58	10151.90	9746.02
2.4 CBL Net Foreign Assets	7560.44	8048.03	7892.64
2.5 Domestic Credit	-1933.78	-2689.44	-2325.60
2.6 Reserve Money	427.35	489.40	617.67
<b>3. Spot Loti/US\$ Exchange Rate (Monthly Average)</b>	7.9741	7.7769	7.6179
<b>4. Inflation Rate (Annual Percentage Changes)</b>	10.7	9.5	9.5
<b>5. External Sector (Million Maloti)</b>	2007		2008
	QIII	QIV	QI
5.1 Current Account Balance	440.15	328.39	517.63
5.2 Capital and Financial Account Balance	248.60	-83.21	310.40
5.3 Reserves Assets	-870.86	-116.19	-774.19

+ 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 5: Selected Economic Indicators**

	2004	2005	2006	2007+
<b>1. Output Growth( Percent)</b>				
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
<b>2. Sectoral Growth Rates</b>				
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
<b>3. External Sector – Percent of GNI</b>				
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
<b>4. Government Budget Balance (Percent of GDP)</b>	5.7	4.8	11.8	5.3

\* Preliminary estimates

+CBL Projections