Economic Review February 2013

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1. Kingdom of Lesotho 2013/14 Budget: Promoting Growth for Economic and Social Development

1.1 Introduction

A fiscal budget is a statement of the intent of government in a particular year based on estimates of anticipated tax revenues and expenditures. It signals the government's fiscal policy direction during the said period.

The 2013/14 budget was tabled before Parliament by the Honourable Minister of Finance, Dr Leketekete Victor Ketso, on 22 February, 2013. The overall economic objective of the budget was to promote sustainable economic growth that is inclusive, employment generating and leads to the improvement in the quality of life of the Basotho people. Pursuant to this objective the budget aims to shore up growth to sustained levels of 6 to 7 per cent per annum through targeted spending on the National Strategic Development Plan (NSDP) components that will promote growth, create jobs, and contribute meaningfully towards poverty reduction. The budget also sought to improve budget implementation and outcomes, through improvements in the Public Financial Management and Accountability. The budget further recognised the importance of maintaining macroeconomic stability. To that end, the government would continue to build on the progress made in the fiscal consolidation efforts pursued in recent years, which have facilitated the restoration of fiscal and external stability.

1.2 Economic Setting

The global economy continued to be surrounded by uncertainty regarding the ultimate resolution of the sovereign debt crises in the US and Euro zone despite recent progress. Growth in emerging market and developing economies was estimated at 5.1 per cent in 2012 supported by sound domestic policies although some countries continued to struggle with weak external demand and domestic bottlenecks. Advanced economies were estimated to grow by 1.3 per cent in 2012 against 1.6 per cent in 2011, pulled down by weak financial systems and the continued fiscal consolidation that dampened demand.

Looking closer to Lesotho, economic activity in South Africa deteriorated to a 2.8 per cent growth in 2012 compared to 3.1 per cent in the previous year, reflecting the impact of the weak global demand, a protracted labour unrest in the mining sector and domestic structural impediments. The unemployment rate also remained high at 25.5 per cent in the third quarter of 2012. The annual average rate of inflation, measured by changes in the consumer price index (CPI) increased from 5.0 per cent recorded in 2011 to 5.8 per cent in 2012.

With regard to the domestic economic environment, the budget speech identified the major macroeconomic challenges in the period leading to the preparation of the budget speech as low agricultural production and the subdued performance of the textiles and clothing manufacturing sector. Nonetheless, the mining sector remained resilient and continued to support growth, complemented by construction and government investment in infrastructure. Consequently, Real output grew by 4.3 per cent in 2012 compared with 3.7 per cent in the previous year.

1.3 Performance of the 2011/12 Budget

Preliminary indications on the 2011/12 budget outturn suggested that government budgetary operations resulted in a surplus equivalent to 5.0 per cent of GDP. This was markedly different from the budgeted deficit of 0.9 per cent and was primarily a result of the lower than budgeted expenditure for the fiscal year 2011/12. While the surplus would help build reserves, it came at a cost to development, as some of it was a result of slower implementation of capital projects.

Total revenue was estimated at M13.5 billion (63.8 per cent of GDP), slightly lower than the budgeted M13.7 billion (64.3 per cent of GDP). The lower than expected revenue performance was attributed to the low receipts of grants, especially budget support, as result of the slow implementation of some grant funded projects and slippages in the achievement of the agreed conditions for budget support. Other revenues were also lower due to lower collections in property income and from the sales of goods and services. Nevertheless, the tax revenue performed better than budgeted while SACU revenue maintained the budgeted level.

Total expenditure was projected to be M12.5 billion (58.7 per cent of GDP) against the budgeted spending of M13.8 (65 per cent of GDP) as a result of lower recurrent and capital spending. Recurrent expenditure was estimated to fall from the budgeted level of 39.8 per cent of GDP to 37.8 per cent while capital expenditure was estimated at 20.9 per cent of GDP against the budget of 25.5 per cent of GDP. The fall in recurrent spending was attributed mainly to lower than budgeted expenditure on the compensation of employees. Use of goods and services underperformed by about 0.4 per cent of GDP while interest payments and social benefits were estimated to be 0.3 and 0.2 per cent of GDP below the budget.

The poor performance of capital expenditure relative to the budget reflected the slow implementation of government investment projects, especially the grant funded spending. This continued to highlight the low absorptive capacity and possibly inadequate planning on the part of implementing ministries.

1.4 The Budget for 2013/14 Fiscal Year

The 2013/14 budget seeks to continue building on the fiscal consolidation efforts that have helped the Government of Lesotho to regain fiscal stability and strengthen international reserves position.

This was the first budget under the new government, with expanded number of ministries. Nevertheless the government remained resolute in the overriding objective of implementing programs to support growth while safeguarding priority social spending. It aims to contain the fiscal deficit at 0.4 per cent of GDP, which is lower than the 0.9 per cent deficit that was budgeted in 2012/13. Total revenue and grants are budgeted to increase by 31 per cent, relative to the last year's budget, to M14 561.8 million. At this level, it will be equivalent to 61.9 per cent of GDP. The budget proposes a total spending of M14 566.5 million, about 62 per cent of GDP.

Total revenue and grants is expected to rise by 6.5 per cent, to M14 561.8 million in 2013/14. Revenue will be supported mainly by an increase in total domestic tax revenues by 31 per cent. While SACU receipts are budgeted to grow by 1.5 per cent to M6 054.6 million it is expected to decline as a percentage of GDP from 28 per cent to 25.7 per cent.

The increase in domestic taxes is expected to emanate from improved collections from all tax categories. This will be supported by the continued efforts to improve the efficiency of tax collection and revenue administration. Income tax collections are expected increase from the previous budget level by 20 per cent while value-added tax collections would to rise by 36.9 per cent, together with the anticipated improvement in economic performance.

Non tax revenue and donor grants are estimated to decline at respective rates of 2.8 per cent and 25.5 per cent compared with the previous year's budget.

The 2013/14 Budget proposes a nominal increase in total expenditure by 5.4 per cent over the 2012/13 budget to M14566.5 million. The amount of M9 724.0 million, which represents an annual increase of 15 per cent, will go towards recurrent spending while the capital budget will fall by 10.3 per cent to M4 842.5 million. The largest proportion of recurrent spending remains the wage bill which constitutes almost 50 per cent of the recurrent budget. The government recognises that that was too high, even by international standards and it was possibly unsustainable. Thus there is a need to explore some public sector reforms to contain it. The fall in the planned capital spending reflects the expected reduction of donor funded projects by almost half. Nevertheless, Government funded and loan funded capital spending are budgeted to increase by 5 per cent and 23.3 per cent respectively.

The 2013/14 budget proposes a fiscal deficit of 0.4 per cent of GDP. It is estimated that this will be financed from external loans to the tune of M962.9 million, with a remaining financing gap of M97.0 million to be covered by borrowing from domestic sources.

1.5 Budget Allocations for 2013/14

The 2013/14 budget sought to advance the implementation of the NSDP, particularly with regard to promoting growth, creating jobs and enhancing food security and reducing poverty. This is reflected in proposed ministerial budget allocations. The largest recipients of the budget are discussed below.

Firstly, the budget proposes that the largest allocation of M1.29 billion which constitutes 29.5 per cent of the capital budget be made to the Ministry of Energy, Metereology and Water affairs. The bulk of this will be financed through donor assistance to the tune of M1.1 billion. This budget will go towards the improvement in the supply of portable and reliable water and energy, and towards meeting the Government commitment under the Millennium Development Goals (MDGs) in that regard. With regard to water supply and sanitation, the Government has embarked on an elaborate programme for the improvement of these in the urban and rural areas. Thus, a number of water supply and sanitation projects will be implemented, with considerable support from development partners, in

2013/14. These will help bridge the water supply gap in area that will not be covered under the Metolong Dam Project.

In view of the importance of reliable and cost effective energy supply in facilitating the growth of industries and expansion of economic activity to remote areas, the second priority under the Ministry of Energy, Meteorology and Water Affairs, is to address the electricity supply needs of the economy. Government will continue to implement rural electrification projects and refurbish the power distribution network to prevent power cuts as well as to minimize environmental hazards associated with a poorly maintained network. In addition, other power generation options will be explored to ensure sustainability of energy sources and to promote private investment in the sector. To this end, a feasibility study of three wind energy sites as well as the regulatory and gap analysis for the renewable energy sector has been commissioned, with the assistance of the IFC.

The second largest proportion of the capital budget - M892 million or 20.56 per cent was allocated to the ministry of Public Works and Transport to support roads construction, maintenance and rehabilitation. This was done in consideration of the importance of the development of road infrastructure in facilitating economic activity. While Government has continued to improve the road network in the country, the minimum requirement has not yet been realised. Regular and adequate maintenance of the existing road network is necessary to support easy access to different parts of the country and to minimise future maintenance costs. In 2013/14, Government will improve the road network through the construction of new roads and maintenance and rehabilitation of existing roads, especially those damaged by the recent floods. Government will also construct major bridges and foot bridges in the rural areas.

With regard to Agriculture, an increase of about 43 per cent over the allocation for 2012/13 the budgetary allocation to M194 million was proposed to support the development of the agricultural sector. It was recognised that, notwithstanding the adverse impact of the weather, recent Government efforts to assist farmers through subsidies on agricultural inputs have not borne much fruit due to shortcomings in the management and application of modern methods in agriculture. Agricultural production continued to decline, coming from a contribution of 16 per cent of GDP the 1990's to around 7 per cent currently. Government will continue to support farmers through further provision of subsidies to the tune of M138 million for Summer Cropping. This will be accompanied by other programmes including support for irrigated agriculture and procurement of agricultural machinery.

The Ministry of Education and Training was allocated, the highest share (19.28 per cent) of the recurrent budget (highest proportion of recurrent spending). This will go towards to go towards the provision of free primary education, to ensure access to basic education to all children of school going age. A large portion of this allocation would be for the provision of complimentary infrastructure in the sector, including the construction of classrooms in primary and secondary education as well as the improvement in the quality of education. To this end Government plans to introduce an integrated curriculum and assessment for primary education. This is intended to provide holistic learning and set a concrete foundation for higher education. At the secondary level, the Government will localise the secondary leaving examinations, introduce A-levels and develop a new curriculum that seeks to align learning with pupil aptitude. The budget will also support the primary school feeding programme, which aims to make schooling meaningful for the majority of children from poor households. The Government will continue to support bursaries for tertiary education through the National Manpower Development Secretariat.

The second largest recurrent budget allocation of M1.3 billion, 14.25 per cent, went to the Ministry of Health. This is intended to help improve the provision of health services, which remains major challenge in Lesotho. While Government has, with the assistance of development partners, been able to build up considerable health infrastructure, the challenge, of providing adequate technical staff remains, particularly in the remote areas. To address this, the Government is reviewing the incentives in the sector including introducing a performance-based pay.

Government is committed to protecting the vulnerable sections of society, which includes the elderly and the destitute. In pursuit of this, the recurrent budget allocation of M156.2 million and capital budget of M30.9 million of which M25.4 million is assistance from the development partners was proposed. To improve the administration costs, access and targeting of the vulnerable groups, the government has the re-grouped of social benefits under one administration, the Ministry of Social Development. The Government will also employ a new approach to social benefits, which seeks to empower the recipients of such benefits to graduate into self-employers, through identification of potential income generating activities and their financing. To this end, the Government is developing a National Social Development Policy and streamlining the National Information System for Social Assistance. This is expected to help strengthen efficiency and effectiveness of the Government intervention and strategies for inclusion and meaningful participation of the beneficiaries in the economy.

The budget proposed the proposed to increase the old age monthly pension from M350 to M450. Government will continue revising the level of pensions as and when the financial situation permits to bring it closer to the cost of living. The monthly cash assistance to the destitute, under social safety nets, was also increased from M100 to M250.

1.6 Conclusion

The 2013/14 budget was set against the challenging economic background, plagued by the uncertainty surrounding the global economic recovery. Nonetheless, the budget indicated the continued commitment of the government of Lesotho to maintain macroeconomic stability and continue to build on the recent success in fiscal consolidation. At the same time the government had ensured that this does not stifle the much needed economic growth by creating space for critical social spending and growth promoting infrastructure projects. In this regard the budget aimed for a lower fiscal deficit while directing spending to areas that support economic and social spending. The government also aims to improve the effectiveness of the budget through the implementation of the PFM reforms.

2. Featured Definition

Fiscal Space

Fiscal Space is the room in a government´s budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or the stability of the economy.

The idea is that fiscal space must exist or be created if extra resources are to be made available for worthwhile government spending. A government can create fiscal space by raising taxes, securing outside grants, cutting lower priority expenditure or borrowing. Fiscal space must be created without compromising fiscal sustainability and macroeconomic balance.

Definition benefitted from:

Heller, Peter, (2005) “Fiscal Space: What is It and How to Get It?” *Saving and Development*, Vol.42, No.5

3. Featured Event: US Budget Sequestration in 2013

The 2013 budget sequestration is dictated by the US Budget Control Act of 2011 aimed at correcting and containing its federal budget deficits and government debt a new budget enforcement mechanisms for reducing the federal deficit over the 10-year period FY2012-FY2021 was established through the promulgation of the Budget Control Act of 2011 (BCA). The BCA placed statutory limits, on discretionary spending for each of the 10 fiscal years, which was estimated to save an estimated $0.9 trillion during that period. In addition, it created a Joint Select Committee on

Deficit Reduction (Joint Committee) with instructions to develop legislation to reduce the federal deficit by over $1 trillion by FY2021. Under the BCA, the reductions would be achieved by a combination of sequestration and, beginning in FY2014, by lowering the discretionary spending caps.

Expenditures on the following would be exempt from the sequester: Social Security, Medicaid and food stamps, further, Medicare's annual cuts will be limited to 2% and made to provider payments. In addition, some non-defence discretionary programs are also exempt, including Pell grants, Department of Veterans' Affairs programs, transportation programs by the Highway Trust Fund, and a cap at 2% for cuts to Indian health and migrant health centres.

Budget sequestration is expected to contain the high US government deficits and provide a significant amount of debt service savings. However, it may also have adverse effects on the provision of government services as resources for government agencies would be reduced. It would also lead to increase unemployment as government employees and military personnel are reduced and some companies that suffer loss of government contracts as a result of budget cuts lay off workers. The sequestration is expected to slow down economic growth in the US and the recovery in the labour market. This would also have negative repercussion to the global economic recovery through reduced demand as the US is a major market for most world economies.

4. Featured Descriptor

Annualised Change

This term describes change in some economic indicator that occurs in intervals less than a year – usually a month or a quarter. In the case of a monthly change the question asked is 'if the observed change was to continue, how much cumulative change would have occurred in twelve months' time? Similarly, a transformation of an observed quarterly change into a cumulative change over four quarters would result in an *annualised* change.

By way of example an annualised change of 1 per cent per month is 12.7 per cent. By the same token an annualised change of 6 per cent per quarter is 26.2 per cent.