Economic Review January 2012

Lesotho's Budget for Fiscal Year 2012/2013: Strengthening Fiscal Resilience and National Competitiveness for Accelerating Economic Growth and Development

The Honourable Minister of Finance and Development Planning (MoFDP) tabled the national budget before the Parliament of Lesotho on the 18th January, 2012……..…..

Background

The budget is an important government policy tool through which political commitments, economic policies and goals aimed at achieving sustainable economic growth are executed. A well-functioning budget system is critical for sustainable fiscal policy and consequent economic growth, while a weak system becomes a breeding ground for economic ailments, social disintegration and political upheavals. Lesotho, like many countries around the globe, implements its goals and objectives through various national development tools amongst which is the budget.

On 18 January, 2012, the budget proposals for the fiscal year 2012/2013 were tabled before the Parliament of Lesotho. The budget speech outlined past achievements by the Government and laid out economic plans for the future. Notable among those was the fiscal strategy for the next five years aligned to the draft National Strategic Development Plan (NSDP). The NSDP is the Government's blueprint for achieving a sustained economic growth of at least 5.0 per cent per annum over the medium term, increased employment and better standards of living for Basotho by improving access to quality health services, education and training, water supply and sanitation.

Economic Setting for the 2012/2013 Fiscal Budget

The global economy was hit by a credit crunch and consequent economic meltdown, caused by extension of credit to non-creditworthy clients in the United States' (US) sub-prime mortgage market. The global financial crisis and the consequent economic recession led to massive job cuts, rising unemployment and increasing external current account deficits. In an effort to take economies out of the global recession, many countries around the globe adopted expansionary fiscal and monetary policies, by implementing stimulus packages and cutting interest rates.

The expansionary fiscal and monetary policies became unsustainable and the need for exit strategies, particularly from fiscal expansion, became eminent. Recovery stalled in 2011 as private sector demand was slow to take over from the dwindling public demand in advanced economies and as domestic demand was not enough to compensate for the fall in external demand's contribution to growth in emerging and developing economies. In 2011, global economic activity weakened as strains in the Euro area and fiscal fragilities in other economies intensified. The global economic slowdown mainly reflected the sovereign debt and banking sector problems in the Euro area, supply chain disruptions as a result of the Japan earthquake and tsunami, the surge in oil prices and the effects of fiscal consolidation and slowdown in exports in the US. Fiscal tightening characterised a number of economies around the globe as fiscal deficits widened and debts soared to unsustainable levels.

In the emerging market economies, growth remained relatively strong though it varied significantly across countries as in some instances country specific downside risks still persisted. The South African economy was expected grew at a higher rate of 3.1 per cent in 2011 compared with 2.9 per cent in the previous year. Positive pressure on growth was expected to emanate from robust consumption and reinvigorated investment expenditure, supported by the low interest rates environment.

The performance of the global economy in 2011 affected Lesotho's economy and also presented some implications for the national budget for 2012/2013. On the one hand, Lesotho's manufacturing sub-sector registered a lower growth rate of 4.6 per cent in 2011 compared with 7.9 per cent in the previous year. This was mainly due to slow economic recovery and associated low consumer demand in the US. On the other hand, the strong recovery of South Africa's economy in 2011 led to the significant recovery of the Southern African Customs Union (SACU) revenue hence Lesotho's share and government revenue for the 2012/2013 fiscal year.

These international and domestic developments were taken into consideration in drawing Lesotho's budget for 2012/2013. They indicated that bold and decisive measures required to be taken to address the impacts of the Euro debt crisis and the sluggish US economic recovery on Lesotho's economy. Thus the 2012/2013 budget could be seen as continuation of efforts aimed at ensuring that Lesotho's fiscal resilience is strengthened and that Lesotho's international competitiveness is enhanced with the objective of fuelling economic growth and development.

The Government Budget Outturn for 2011/2012

The Government budgetary operations for the fiscal year 2011/2012 registered a projected deficit of 12.3 per cent of GDP, lower than the budgeted 17.2 per cent of GDP. The lower projected deficit was due to an upward adjustment, of about M900 million, in Lesotho's 2011/2012 SACU - receipts as well as reduced expenditure by line Ministries.

Table 1: Government Budgetary Operations (Million Maloti; Per cent of GDP)

Budget Items	Approved Budget for 2011/2012		Projected Outturn for 2011/2012		Proposed Budget for 2012/2013	
	Value	%	Value	%	Value	%
Revenue and Grants	**10038.3**	**55.3**	**9235.4**	**50.9**	**13676.3**	**66.5**
Revenue	7623.8	42.0	7650.5	42.2	11486.5	55.9
Tax	3952.6	21.8	3855.4	21.3	4412.9	21.5
Other	918.6	5.1	1042.5	5.7	1107.3	5.4
SACU	2752.6	15.2	2752.6	15.2	5966.3	29.0
Grants	2414.5	13.3	1584.9	8.7	2189.8	10.7
Expenditure	**-13157.6**	**72.5**	**-11463.0**	**63.2**	**-13871.0**	**67.5**
Recurrent Expenditure	-8041.5	44.3	-7510.6	41.4	-8474.3	41.2
Capital Expenditure	-5116.1	28.2	-3952.4	21.8	-5396.7	26.3
Surplus/Deficit after Grants	**-3119.3**	**-17.2**	**-2227.6**	**-12.3**	**-194.7**	**-0.9**

Source: Lesotho Government Budget Speech 2012/2013

In 2011/2012 total expenditure was projected to reach 63.2 per cent of GDP against the budgeted 72.5 per cent as a result of the fall in both the recurrent and capital expenditures. Recurrent expenditure was expected to fall from a budgeted 44.3 per cent to 41.4 per cent of GDP in 2011/2012, while capital expenditure was expected to decline by 6.4 percentage points from 28.2 per cent of GDP during the same period.

The fall in recurrent expenditure largely reflected a decrease in compensation of employees, especially wages and salaries. The compensation of employees declined from a budgeted 20.0 per cent to 18.4 per cent of GDP. Expenditure on goods and services also declined from a budgeted 10.3 per cent to 8.1 per cent of GDP. This was in line with Government's efforts to prioritise expenditure following a decline in revenue as a result of the global recession. The drop in capital expenditure mainly reflected the fall in foreign grants and the inherent low absorptive capacity of Government that is often reflected in slow implementation of development projects. Total revenue and grants recorded a projected outturn of 50.9 per cent of GDP against the budgeted 55.3 per cent of GDP. Almost all components of revenue recorded an improvement except tax revenue which slightly edged downwards by 0.5 percentage points from the budgeted level. The bulk of the decline was attributable to grants, which had fallen by 4.6 per cent of GDP.

The Budget for 2012/2013 Fiscal Year

Revenue, Expenditure and Financing

The Government of Lesotho aims to reduce the budget deficit to 0.9 per cent of GDP in the fiscal year 2012/2013 from the projected deficit of 12.3 per cent of GDP in 2011/2012. Total revenue and grants are budgeted to increase to M13676.3 million, an equivalent of 66.5 per cent of GDP in

2012/2013, compared with 55.3 per cent that was budgeted for 2011/2012.

Total revenue is expected to increase at the back of an envisaged improvement in tax revenue as personal income tax and Value Added Tax (VAT) and SACU revenue are expected to increase. Nonetheless, personal income tax is expected to rise marginally from 7.3 per cent of GDP to 7.8 per cent as the private sector is expected to expand slightly, whereas the VAT-to-GDP ratio is expected to decline from a budgeted 7.9 per cent in 2011/2012 to 6.8 per cent in 2012/2013 due to sluggish economic recovery. In the medium term, VAT is expected to improve as economic activity gets into better shape. Lastly, SACU receipts are expected to improve from 15.2 per cent of GDP to 29.0 per cent during 2012/2013. Grants are expected to decline from 13.3 per cent of GDP in 2011/2012 to 10.7 per cent in 2012/2013 as major donors remain under pressure from the effects of tepid global economic recovery.

Total expenditure is expected to decline from 72.5 per cent of GDP to 67.5 per cent of GDP in the fiscal year 2012/2013. Both the recurrent and capital expenditure are expected to decline by 3.0 per cent of GDP and 1.9 per cent of GDP, respectively, during the fiscal year 2012/2013. This is in line with Government's efforts of restraining expenditure as part of its continuing fiscal consolidation strategy. According to the budget speech, the overall deficit is envisaged to improve to 0.9 per cent of GDP in 2012/2013 and it is expected to be limited to 3.0 per cent of GDP in the medium term. During this period, the deficit is expected to be financed by issuance of government bonds and external borrowing.

Budget Allocations for the fiscal year 2012/2013

The ministerial budget allocations reflect the Government's priorities towards the attainment of its national goals. The top four ministries that got the largest portion of the national budget are discussed below.

In the 2012/2013 budget, the Government has shifted its focus by allocating the largest share of the budget to the Ministry of Natural Resources, while in the previous budget the Ministry of Education and training got the highest share of the budget. The Ministry of Natural Resources, which includes water, energy and the mining sectors, was allocated M2.1 billion in the fiscal year 2012/2013. The bulk of the budget would go towards improving the water sector to which over M1.6 billion has been allocated for construction of the Metolong Dam and Water Supply Project. The top priority of the Government and its development partners is to conserve, harness, distribute and recycle water in the most efficient and resourceful way. Moreover, M50.0 million was allocated for the Village and Rural Water Supply Programme that is supported by the Irish Aid, European Development Fund, World Bank and Millennium Challenge Corporation. There are other projects under the Ministry of Natural Resources, in particular, the water sector, that are being undertaken. These include, but are not limited to; Maseru per-Urban Phase I and Five Towns Water and Sanitation projects.

Moreover, the electricity sub-sector was allocated funds to undertake a feasibility study on a Hydropower Generating Plant at the Lesotho Highlands Water Project

(LHWP) Katse Dam (Kobong) which has the potential capacity to produce more than 1000 Mega Watts of electricity. The Government and the Southern African Development Community (SADC) Power Pool have developed a Power Purchase Agreement in an effort to boost Lesotho's energy sector.

Recently, the diamond mining sector in Lesotho has expanded, increasing its contribution to economic growth from a marginal 0.2 per cent of GDP twelve years ago to 7.0 per cent in 2010. Given the current state of minerals in the country, a focus towards mining could prove to be a good step towards poverty reduction and growth in the country. In this regard, the Government has identified areas that need critical attention in order to reap the largest benefits from the sector. These include reviewing and reforming some legislative frameworks, which will encompass revision of the mining code, development of appropriate polices and supporting frameworks as well as adopting international best practices.

The second largest recipient of the 2012/2013 budget was the Ministry of Education and Training (MOET). This is one area through which the Government invests in human development. In this regard, the medium term strategy of the Government is to improve the relevance and applicability of skills and enhance labour productivity to levels commensurate with high international competitiveness. The Government, in consultation with the private sector, intends to reform curricula, expand and upgrade Technical, Vocational Education and Training (TVET) institutions. The Government also intends to encourage existing institutions to focus on excellence in Mathematics and Science, Business and Entrepreneurship and Information and Communications Technology. Moreover, the allocation is intended to give leverage to free the primary education programme and improvement of salaries and working conditions of teachers.

The third largest recipient of the national budget was the Ministry of Health and Social Welfare (MoHSW), which received approximately M1.7 billion. Of this, M655.0 million was earmarked for the development of health care infrastructure, TB control and Immunisation, while M175.7 million was allocated for the purchase and distribution of drugs.

The Ministry of Finance and Development Planning (MoFDP) received the fourth largest portion of the national budget in the current fiscal year. The Ministry is responsible for, amongst other things, the development of education in the country through financing education of students who go for higher learning, that is, universities and colleges. The National Manpower Development Secretariat (NMDS), which operates under the ambit of the Ministry, is largely responsible for extending loan bursaries to Basotho nationals to study in tertiary institutions in Lesotho and South Africa. In this years' budget the NMDS was allocated M713.1 million.

Infrastructure Development: Minimum Infrastructure Platform

As in the previous budgets, infrastructure development remained high on the national development agenda. Government continued to allocate more funds to road infrastructure development in order to enhance, among other things, the efficiency of the transport system, which is important for accelerated economic growth and development.

In this regard, road networks across the country will be built, upgraded, maintained and bituminised. Funds to the tune of M295.0 million were allocated to upgrade urban roads, M180.0 million for developing roads in rural communities, and M834.0 million to cover several road networks across some parts of the country, built the Koma-Koma Bridge and computerise the Traffic Department. For air and railroad transport, the feasibility study for upgrading and rehabilitating the national airport and the Maseru Container Terminal was envisaged to kick-off very soon.

Without proper and efficient Information and Communication Technology (ICT) infrastructure, a country could lose competitiveness in the international arena. The Government, in partnership with the private sector is developing the backbone fibre optic infrastructure that will enhance speedy internet and broadband across the country. This strategy is intended to improve efficiency in education, health and other areas where the economy of Lesotho has the potential to reap benefits.

The Government also allocated funds to various sectors of the economy which have been the main drivers of growth and also have the potential to further enhance growth. These include the manufacturing, agriculture and tourism sectors.

The manufacturing sector makes a significant contribution towards economic growth and employment. The Government's strategy is to expand the industrial infrastructure and to increase local participation in this sector. An allocation to the tune of M104.0 million was made for the construction of factory shells for local entrepreneurs, establishment of a skills training centre and financing of efforts to entice investors and attract investments into a fabric mill so as to anchor the textile sector. This is done in order to address some of the challenges that the sector is grappling with, including the long lead time to export, erosion of preferences overtime and insufficient backward and forward linkages, inter alia.

In addition, the Government recognises the need to resuscitate the agricultural sector's contribution to economic growth. The Government in conjunction with the private sector has, therefore, identified the means through which agricultural output could be enhanced. These include, but are not limited to, commercialisation, diversification of products and expansion of irrigation. To jumpstart production the sector was allocated M61.7 million to support rehabilitation of existing irrigation schemes, farmers training centres, woolsheds and recapitalisation of the Lesotho Agricultural College.

The tourism sector has long been identified as having ample potential to contribute to growth of the economy. Developing a strategic plan for the sector is seen as a vehicle through which the potential of this sector could be unlocked. In its first leg to improving this sector, the Ministry of Tourism has sought technical assistance from a company originating in Ireland, the Shannon Development Corporation. It has also agreed with the Free State Provincial Government to develop joint tourist facilities. This sector was allocated an initial budget of M234.0 million for building information centres.

Promoting entrepreneurship and supporting Small, Micro and Medium Enterprises (SMMEs) is the national objective. M50.0 was set aside for capitalisation of the Partial Credit Guarantee Fund (PCGF). This was intended to address the growing concern of high youth unemployment. The PCGF it was intended to provide collateral for new and existing SMMEs to access credit from local banks.

Conclusion

The global and domestic economic developments in 2011 presented a number of challenges that had to be taken into account when drawing the national budget for 2012/2013. These challenges meant that bold and decisive measures were required to be taken to minimise their impact on Lesotho's economy. Thus the 2012/2013 budget continued implementation of efforts aimed at ensuring that Lesotho's fiscal resilience was strengthened and that Lesotho's international competitiveness was enhanced with the objective of fuelling economic growth and development. The fiscal consolidation strategy of the Government produced positive results as the deficit was reduced in 2011/2012. Expenditure would be reduced further in 2012/2013 as efforts to prioritise expenditure and achieve fiscal consolidation would continue. The Government's medium-term strategy aimed to limit fiscal deficits to 3.0 per cent of GDP and to build up foreign exchange reserves to five months of imports cover. The build-up in foreign reserves is important for the maintenance of the fixed exchange rate regime and to cushion against external shocks.

The Loti against Major Currencies in January 2012

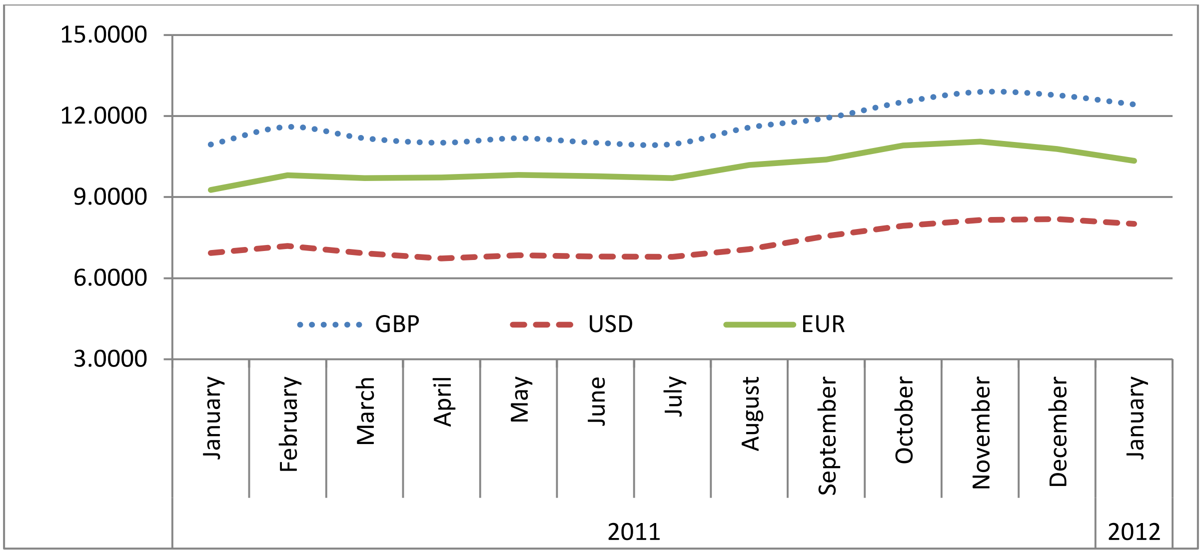
The Loti depreciated against the US Dollar, Euro and Pound Sterling in January 2012……..

Introduction

The Loti was weak against the major currencies in January 2012 compared with January 2011. It depreciated from M6.93 per US Dollar, M9.26 per Euro and M10.95 per British Pound in January 2011 to M8.26, M10.14 and M12.87 per US Dollar, Euro and Pound, respectively, in January 2012. These represented depreciation of 19.2 per cent, 9.5 per cent and 17.5 per cent against the US Dollar, the Euro and Pound Sterling, respectively when compared with the position in January 2011.

The observed weakening of the loti against the major trading currencies could be attributed to a number of factors. Changes in investor sentiment and global risk aversion in global financial markets that fed through to emerging-market currencies led to the observed depreciation of the Rand exchange rate. Risk aversion towards emerging market economies increased as a result of the European debt crisis and other issues around it, including that Europe appeared to be struggling to come up with solutions for the debt crisis and that fears arose that Greece's contagion effects would spread to other European countries including Portugal, Italy and Spain. In addition, the US Dollar appreciated during this time because it became a safe haven as investors' aversion for riskier emerging market assets increased.

Figure 1: The Exchange Rate of the Loti against Major Currencies



Implications for Lesotho's Economy

The weakening of the Loti against the major currencies presents a number of positive and negative implications for Lesotho's economy. On the positive side, it could enhance competitiveness of Lesotho's exports and increase the value of Lesotho's export earnings in Maloti terms. This could in turn stimulate speedy recovery of the textiles and clothing manufacturing sub-sector which has been struggling on account of low consumer demand in the US. The sub-sector is one of the major employers in the country and recently had to lay-off workers due to low demand by US based retailers. The weakening of the loti could partly reverse this, thus reducing the high unemployment in Lesotho.

On the negative side, the depreciation means that more Maloti are needed to purchase a unit of a foreign currency. This is likely to increase the costs of imports hence fuel inflationary pressures. It is also likely to increase the stock of Lesotho's US Dollar denominated debt and the cost of servicing such debt in Maloti terms. The current account balance of the balance of payments and the foreign exchange reserves position could improve or worsen depending on the magnitude of the impact on exports vis-à-vis the magnitude of the impact on imports. If the positive impact on exports outweighs (is less than) the negative impact on imports the current account balance and the foreign exchange reserves could improve (worsen).