97812

WORLD BANK GROUP

Lesotho: Systematic Country Diagnostic

June 25, 2015

Lesotho -GOVERNMENT FISCAL YEAR
April 1 – March 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of June 16, 2015)
Currency Unit = Lesotho Loti (LSL)
LSL 12.40 = US$1.00

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
AIDS	Acquired Immune Deficiency Syndrome
ART	Antiretroviral Therapy
ARV	Antiretroviral
BEDCO	Basotho Enterprises Development Corporation
BFP	Budget Framework Paper
BLNS	Botswana, Lesotho, Namibia and Swaziland
BoS	Bureau of Statistics
CAS	Country Assistance Strategy
CGP	Child Grant Program
CHAL	Christian Health Association of Lesotho
CPF	Country Partnership Framework
CPIA	Country Policy and Institutional Assessment
DCEO	Directorate on Corruption and Economic Offenses
DFID	Department of International Development from United Kingdom
DPO	Development Policy Operation
ECF	Extended Credit Facility
ESW	Economic Sector Work
EU	European Union
FDI	Foreign Direct Investment
FIA	Financial Institutions Act
FIRST	Financial Sector Reform and Strengthening Initiative
GDP	Gross Domestic Product

GNI	Gross National Income
GoL	Government of Lesotho
GPOBA	Global Partnership for Output-Based Aid
GTZ	German Technical Corporation
HBS	Household Budget Survey
HIV	Human Immunodeficiency Virus
HMIS	Health Management Information Systems
HRH	Human Resources for Health
IBRD	International Bank for Reconstruction and Development
ICOR	Incremental Capital Output Ratio
ICT	Information and Communication Technologies
IDA	International Development Association
IDM	Institute of Development and Management
IEC	Independent Electoral Commission
IFC	International Finance Corporation
IFMIS	Integrated Financial Management Information System
IFPRI	International Food Policy Research Institute
IMF	International Monetary Fund
LDHS	Labor and Demographic Health Survey
LEC	Lesotho Electricity Company
LHWP	Lesotho Highlands Water Project
LNDC	Lesotho National Development Corporation
LRA	Lesotho Revenue Authority
MAFS	Ministry of Agriculture and Food Security
MCC	Millennium Challenge Council
MDGs	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
M&E	Monitoring and Evaluation
MDP	Ministry of Development Planning
MoF	Ministry of Finance
MoH	Ministry of Health

MoSD	Ministry of Social Development
MSME	Micro, Small, and Medium Enterprises
MTEF	Medium-Term Expenditure Framework
NER	Net Enrollment Rate
NISSA	National Information System for Social Assistance
NPAB	National Planning Advisory Board
NSDP	National Strategic Development Plan
NUL	National University of Lesotho
OBFC	One Stop Business Facilitation Center
PAF	Performance Assessment Framework
PEFA	Public Expenditure and Financial Accountability
PMT	Proxy Means Test
PPAD	Procurement Policy and Advice Division
PPP	Public/Private Partnerships
PSCEDP	Private Sector Competitiveness and Economic Diversification Project
PSIRP	Public Sector Improvement and Reform Program
PFM	Public Finance Management
PFMRAP	Public Finance Management Reform Action Plan
PRS	Poverty Reduction Strategy
R&D	Research and Development
ROC	Regional Operations Committee
RVP	Regional Vice President
SACMEQ	Southern and Eastern Africa Consortium for Monitoring Educational Quality
SACU	Southern African Customs Union
SADC	Southern African Development Community
SARS	South African Revenue Service
SLM	Sustainable Land Management
SME	Small and Medium Size Enterprises
STI	Sexually Transmitted Infection
SWC	Soil and Water Conservation

TB	Tuberculosis
TCF	Third Country Fabric
TFP	Total Factor Productivity
TTCI	Travel and Tourism Competitiveness Index
TVET	Technical and Vocational Education Training
UNEP	United Nations Environment Program
UNFCCC	United Nations Framework Convention on Climate Change
WASCO	Water and Sewerage Company

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The report was also prepared in close consultation with the IFC, whose input was coordinated by Carla M. N. Faustino (Johannesburg) and John Barnham (Washington DC).

The report was also prepared in close consultation with the World Bank's Lesotho country office, with specific involvement of Macmillan Anyanwu (Country Representative; Senior Operations Officer, AFMLS), Edmund Motseki (Operations Officer, AFMLS), and Keneuoe Mofolo (Program Assistant, AFMLS).

Many thanks to our peer reviewers: Oscar Calvo-Gonzalez (Practice Leader, LCC2C) and Ambar Narayan (Lead Economist, GPVDR). Thanks also to all the participants of the review meetings who provided comments.

Many thanks to Laura Rudert (MCC Representative for Lesotho) and Elizabeth Wilke (MCC Economist) for their useful comments.

The work was carried out under the overall supervision of Asad Alam (Country Director, AFCS1). We are particularly grateful to the practice leaders Catriona Purfield (Practice Leader, AFCS1), David Sislen (Practice Leader, AFCS1) and Patrick Osewe (Practice Leader, AFCS1) for their useful comments and guidance. We are also grateful to Marcelo Giugale (Senior Director, GMFDR), John Panzer (Director, GMFDR), Mark Roland Thomas (Practice Manager, GMFDR) and Sudarshan Gooptu (Practice Leader, GMFDR) for their support.

Executive Summary

Introduction

1. **Lesotho is one of the poorest and most unequal countries in the world. It is a small, mostly mountainous, and largely rural country of about 2 million people, completely surrounded by South Africa.** Preliminary estimates based on the FY2010/11 household survey show a national headcount poverty rate of 57.1 percent, virtually unchanged from the FY2002/03 survey.[1] At the same time, inequality increased from a Gini coefficient of 0.51 to 0.53. The bottom 40 percent of the population's per capita consumption contracted 0.4 percent annually over the past five years. By comparison, annual growth was 0.9 percent for the remaining 60 percent and 1.1 percent for the top 20 percent. Poverty is not only high but also deep—and the depth has increased over time. A poverty gap of about 30 percent indicates that substantial growth would be needed to lift a majority of the poor out of poverty. Human development outcomes are below the norms for a country of Lesotho's income level.

2. **The persistence of poverty and rising inequality are striking for an economy that grew at annual rates of 4 percent per capita over the past decade.** This raises questions about the growth model's lack of inclusiveness. Over this period, Lesotho underwent an important change in the drivers of growth, shifting from an economy dependent on net exports to one driven primarily by government spending. Public spending is large, inefficient, and is not helping the government achieve its development objectives. The current government-driven growth model is not conducive to achieving the twin goals of poverty reduction and shared prosperity. From a sustainability point of view, it faces serious macroeconomic and social risks. The main macroeconomic risk comes from the threat to the sustainability of the exchange-rate peg. The social risk arises from further increases in income inequality that may fuel social discontent and increase socio-political instability.

3. **Redefining the role of the state will be critical for meeting the twin goals through boosting inclusive growth and avoiding macroeconomic and social risks.** Reducing the large footprint of the government will be needed to promote broad based growth and support macroeconomic stability. This would require a series of measures to improve competitiveness. Greater effectiveness, efficiency, and quality of public spending will be critical for making the state more effective. This will require a modernization of the public sector. More effective use of Southern African Customs Union (SACU) receipts will boost private sector-led, jobs-intensive growth.

4. **In this context, this Systematic Country Diagnostic (SCD) is intended to assess development challenges and identify priorities for rapid progress in achieving the objectives of: (i) eliminating extreme poverty on a sustainable basis and (ii) ensuring shared prosperity by improving the welfare of Lesotho's poorer citizens.** The report analyzes the opportunities and challenges in meeting these objectives, focusing on growth, inclusiveness, and sustainability. The SCD concludes by prioritizing the key challenges.

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[1] Using the US$1.25 per day international poverty line leads to nearly similar results (55 percent), confirming the severity of poverty in Lesotho.

Slow job creation seems to be keeping poverty and inequality high

5. **Poverty rates have remained high in rural areas, remote communities, and household headed by females and among the unemployed and those with low levels of education.** Most notably, together, children (up to 14 years of age) and the elderly (60+) account for about 44 percent of the poor, with important implications for inclusion and inter-generational transmission of poverty. A large number of Basotho are still just above the poverty line and at risk of falling back to poverty. This is important risk for smallholder households in rural areas.

6. **Poverty and location are both correlated with worse health, nutritional, and educational outcomes.** Access to health facilities is still a challenge for the poor. Educational outcomes have not changed that much in rural areas, and access to post-primary education remains a challenge for the poor. Despite huge investments in the social sectors, poverty stagnated and social outcomes have not improved. It maybe that Lesotho is in a poverty trap, which will require rethinking the way the country fights poverty.

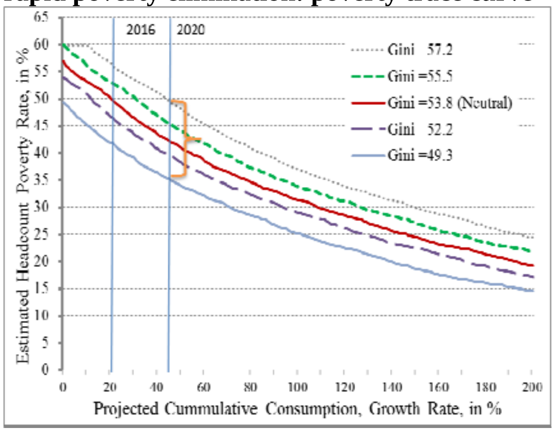
7. **Lesotho's poverty stagnation could be attributed to a decline in remittances and a still large dependence on subsistence farming among many households.** The proportion of households relying on wages and salaries from work in the private and public sectors has increased, particularly among the poor. The role of social protection has increased, but the proportion of households mainly relying on these benefits remains rather small. Improvements in labor-market outcomes flowed to the richer segments of Lesotho's population, adversely impacting the consumption distribution.

8. **Although having a household head with a job reduces the probability of being poor, employment does not seem to be enough to lift people out of poverty.** Among households depending primarily on public-sector wages, 78 percent are in the two highest income groups, compared with 32 percent of the population as a whole. Lack of high-paying jobs outside the well-paid public sector could be one possible explanation of why even wage-paying jobs do not guarantee a way out of poverty. [2]

9. **Both economic growth and policies to lower inequality will be required for faster poverty reduction (Figure 1 and Figure 2).** It will require a broad set of integrated measures, including the deepening of inclusive growth and improving the targeting and efficiency of the social safety net. Inclusiveness will require broad-based job creation, greater productivity, and a different the structure of growth. This will require a structural shift in Lesotho's growth model from one dependent on the public sector to one driven by a strong and competitive private sector.

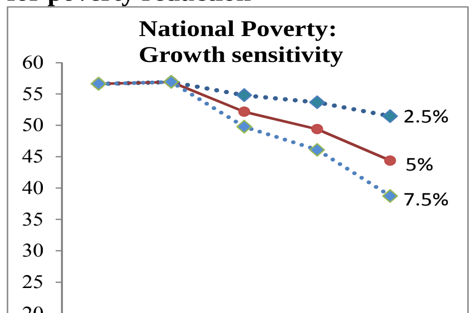
[2] Public sector is well-paid locally but not necessarily if compared with neighboring countries.

Figure 1: Reducing inequality is the key to rapid poverty elimination: poverty trace curve



PTC illustrates elasticity of poverty to growth and inequality.
Source: Staff estimates.

Figure 2: Economic growth is essential for poverty reduction



	2002	2011	2014	2016	2020
a1	56.6	56.9	54.8	53.7	51.5
b	56.6	56.9	52.2	49.4	44.4
c1	56.6	56.9	49.8	46.1	38.7

a1- 2.5% growth,
b 5% growth (baseline) ,
c1 7.5 growth

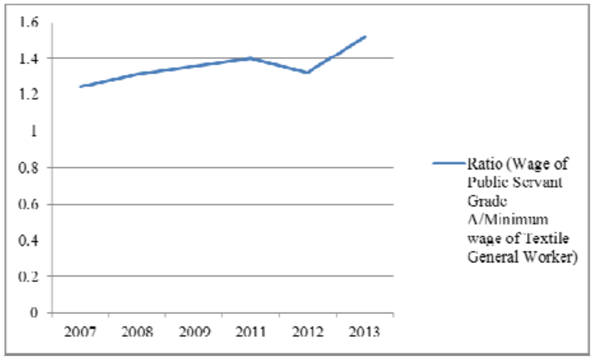
Growth: current model is unsustainable; jobs-intensive, export-oriented, private-sector driven model needed

10. **The state plays an important role in development, particularly through fiscal and regulatory channels.** In Lesotho, three key fiscal and regulatory issues hinder broad-based growth:

- *High levels of public spending.* Public spending cannot drive the economy forever. Fueled by volatile SACU receipts, public spending grew from 45 percent of GDP in FY2004/05 to 63.1 percent in FY2014/15, one of the highest ratios in the world. The large SACU inflows were absorbed mostly by government consumption, particularly employee compensation. Over this period, the government's wage bill increased more than 45 percent in real terms, reaching 22.7 percent of GDP. The government became the formal economy's largest employer,[3] and most of these employees are paid well enough to make the top quintiles of the income distribution. As spending grew, the government's budget became more rigid, and now it cannot afford to add more public employees. Finally, maintaining a high level of public spending after the global crisis seems to have eroded the private sector's competitiveness, with the spending of SACU receipts leading to a rise of the relative price of non-tradables to tradables (Figure 3). As a result, the private sector's share of total investment has declined (Figure 4). In sum, the government's role as "preferred" employer seems to be crowding out the ability of the private sector to create jobs, and this situation cannot continue over the medium run because it threatens macroeconomic stability.

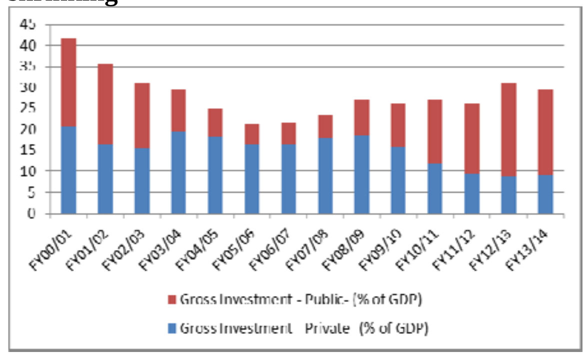
[3] The high unemployment rates, estimated at 25.3 percent for the 15-49 age group and 15.5 percent for youth, drove the government to take on the role of main employer and led to the establishment of the Graduate Placement Unit in the Public Service Department.

Figure 3: Rising relative price of non-tradables to tradables



Source: GoL.

Figure 4: Private sector's share of total investment is shrinking



Source: GoL.

- *Poor efficiency, effectiveness, and quality of public spending.* Lesotho spends almost half of its budget in the social sectors. This is very high compared to peers. However, social outcomes in terms of mortality rates, life expectancy, educational achievements and poverty levels are not commensurate with these spending levels. This suggests deep inefficiencies in social spending. The incremental capital-output ratio (ICOR) was a relatively high 6.3 in 2004-10. Lesotho's ICOR trailed other developing countries. Government processes for project selection, appraisal, and monitoring are relatively weak and need to be strengthened. The high ICOR explains why, despite a relatively high level of public investment of about 14 percent of GDP, the growth impact is muted.
- *High number of business regulations.* The NSDP acknowledges an "uncompetitive business environment" as one of the most binding constraints on the growth of private enterprises, adversely affecting both FDI and local SMEs. All quantitative measures—including Global Trade Reports, Doing Business Indicators, and Enterprise Surveys—suggest that business regulations are a serious constraint on growth. In Ease of Doing Business, for example, Lesotho ranked 128th among 185 countries in 2014. Lesotho has made important reforms, notably in streamlining the processes for starting businesses and registering property. Nevertheless, a number of factors that hinder private-sector growth remain at almost every stage of business—from accessing land to obtaining construction permits, engaging in cross-border trade with South Africa, and accessing finance. For example, it may take more than a year for foreigners to establish firms in Lesotho, compared with less than a year in peer countries.

11. Improving the prospects for high levels of sustained and broad-based growth will require greater productivity and investment. With investment of 30 percent of GDP and labor force growth of 1.1 percent a year, achieving the NSDP target economic growth of 7 percent a year will require annual total factor productivity (TFP) increases of 4.9 percent. Over a sustained period of time, such a TFP growth rate is high by international standards. In fact, Lesotho's productivity growth has slowed substantially in recent years, with TFP only contributing 0.7 percent. The marginal productivity of labor is relatively low and negatively affected by HIV/AIDS. Weak TFP also appears to reflect inefficient inter-sectoral allocations, with labor concentrated in the economy's least-productive sectors.

12. In recent years, mining has become one of the economy's fastest growing sectors, but it is not a solution for sustainable poverty reduction because of its limited job-creation potential. What is needed instead is development of a more competitive, outward-oriented private sector, particularly in employment-intensive services sectors where Lesotho can exploit global or regional comparative advantages. With a small domestic economy, successful private sector development will depend crucially on export markets. This requires improving the integration of Lesotho's firms into regional value chains, which depends in turn on addressing the trade-policy and trade-facilitation barriers that hamper regional trade and investment.

13. For Lesotho, transitioning to a new growth model will require the private sector to take the lead in developing competitive, outward-oriented firms. Encouraging entrepreneurs to invest in export-oriented activities will require reforming the existing inward-looking investment environment, which raises the relative rewards of focusing on domestic non-tradables and government contracts. It will also require addressing the high cost of operating in Lesotho. Progress is being made on many aspects of the Doing Business agenda, but firms remain only weakly competitive. Investing in workforce development (skills and training), addressing health barriers (HIV/AIDS), and adopting technology will be critical to improving productivity and fostering more competitive firms. In addition, developing key infrastructure is critical to lowering costs and increasing competitiveness. This includes the trade-facilitation environment (promoting value-chain integration), road connectivity that is sustainable and safe, and the quality and cost of ICT infrastructure.

Inclusion: despite high investment in the social sectors, barriers still remain

14. Experience from around the globe has shown that growth alone is not sufficient for poverty reduction and shared prosperity. Human development is essential to individual well-being and contributes significantly to ensuring the sustainability of economic gains. The government has invested substantial resources— over 30 percent of GDP—in the social sectors, but it has achieved poor outcomes

15. The effectiveness and efficiency of public spending in the health sector is an issue. Over the past decade, Lesotho has seen worsening health outcomes. The country's health systems have been overwhelmed by HIV/AIDS, with the adult prevalence rate the world's third highest at 23.6 percent. In addition, the country faces a high burden of tuberculosis (TB). Maternal mortality in Lesotho is among the highest in sub-Saharan Africa, and infant mortality has also increased in recent years, highlighting serious shortcomings in the health-care system. The government responded to worsening health outcomes by doubling the Ministry of Health's budgetary allocations to almost 9 percent of GDP (around 15 percent of the overall budget), but the ministry's ability to absorb the budget worsened. As a result, increases in available resources to the sector have not translated into improvements in key health outcomes. In the health sector, system-wide problems contribute to Lesotho's worsening outcomes. The first is low utilization of health facilities due to the poor quality of services, perceived and actual. Service quality is undermined by a lack of equipment, unavailability of essential commodities (approximately 60 percent of women cite "no drug availability" as their concern for accessing care), a poor referral system between health centers and hospitals, and an inadequate number of skilled healthcare workers. However, tertiary health services have improved recently with the opening of the Queen Mamohato Hospital.

16. Despite huge public spending in the education sector, poor educational outcomes persist amid concerns about equitable access. Education received around 20 percent of the overall budget (about 13.5 percent of GDP) in recent years. This level of spending is exceptionally high for a country with Lesotho's income level. At the primary level, enrollment rates have improved, but quality remains an issue. Lack of post- primary education is a major constraint to successful employment. However, secondary education is a privilege to the rich. Low enrollment among students from low-income families stems from: poor rates of completion and learning in primary schools, the secondary-level fee policies that restrict demand for education; the still-widespread lack of secondary-education supply, especially in rural areas; and the scale of absolute poverty. The vocational system is poorly aligned with labor market needs. About 85 percent of tertiary students come from families in the upper two income quintiles. Upon graduation, as many as a third of NUL students seek jobs abroad, mainly in South Africa, where they are attracted by higher salaries, better career prospects, and more favorable living conditions. Most graduates that remain in the country seek jobs in the public sector. The curricula in the universities have weak linkages to private sector employers' needs. Poor Basotho, especially in rural areas, have limited access to financial services, which heightens vulnerability and hinders their capacity to invest in sustainable livelihoods, such as improving farm productivity or household enterprises.

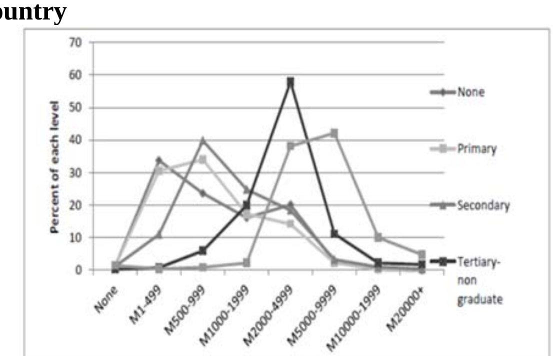
17. Access to basic services suffers from major rural-urban gaps. For instance, an estimated 25 percent of the population has access to electricity, but only 5 percent live in rural areas. Road quality and access to transport services in remote rural areas is low. Sanitation in rural areas is much worse than in urban areas.

Table 1: Participation in secondary education a privilege for the rich

	PrimarySchool Net attendance ratio			PrimarySchool Gross attendance ratio		
Wealth Quintile	Male	Female	Total	Male	Female	Total
Lowest	87	94.3	90.5	146.2	170.2	157.6
Second	90.4	97.2	93.8	177.8	177.9	177.9
Third	94.2	96.7	95.4	172.6	175.2	173.8
Fourth	94.5	98	96.2	183.7	170.6	177.5
Highest	97.8	97	97.4	174.4	156.2	164.5
	Secondary School Net attendance ratio			Secondary School Gross attendance ratio		
Wealth Quintile	Male	Female	Total	Male	Female	Total
Lowest	6.7	14.8	10.7	11	19.1	15
Second	15.3	27.1	21	23.2	33.6	28.3
Third	24.9	38.1	31.2	33.7	46.3	39.7
Fourth	37	51.6	44.4	53.7	70.9	62.5
Highest	59.9	61.8	61	84.2	83.6	83.9

Source: LDHS (2009).

Figure 5: Wages rise with education levels across the country



Source: LDHS (2009).

18. Lesotho spends substantial resources on social transfers, but coverage of the very poor is very low. Lesotho spends a large amount on transfer programs—about US$197 million a year, or 9 percent of GDP (around 15 percent of the overall budget). Most of the money goes to the universal Old Age Pension, school feeding, and tertiary bursaries. These programs yield some positive outcomes and enjoy strong popular and political support. However, they are for the most part not designed to reduce poverty and vulnerability or promote investment and employment. The majority of the transfers go to people who are not among the poor or extreme poor. In sum, the current transfers and policies do not adequately support resilience, equity, and opportunity. The government has recently started addressing such weaknesses in the social protection system.

19. Social inclusion and voice in Lesotho do not seem to be negatives for poverty reduction and shared prosperity. In terms of gender, the 2006 Legal Capacity of Married Persons (LCMP) Act, which gives women the right to engage in economic transactions in the absence of their husbands, has not been fully implemented.

20. Political instability is still an issue. In the past, political stability helped reduced volatility and led to higher growth. More recently, due in great part to political uncertainties, GDP growth dipped to a projected 2.8 percent in FY2014/15, down from 4.6 percent in FY2013/14.

Sustainability: the need for reform and modernization of the public sector

21. Sustaining the exchange rate peg, achieving fiscal sustainability, and rebuilding buffers will depend on reducing ongoing fiscal liabilities. Fiscal consolidation efforts are challenging when the government plays a critical role in employment and growth. Savings will depend on greater efficiency and effectiveness of public spending. In other words, fiscal consolidation can be achieved by downsizing, consolidating, or eliminating programs and projects and by reviewing the wage policy and addressing recurrent irregularities in the public finance and human resources management. In the end, fiscal consolidation will eventually involve debating the size of public administration following an institutional and functional review of the government.

22. Above all, improving outcomes in Lesotho will require a significant reform and modernization of the public sector, which is increasingly seen as a source of weakness rather than strength. Poor outcomes in public investment have been most visible, but the problems appear to run across the board. Reforms will require improvements in planning, procurement, and management processes. They will also require far greater attention to monitoring and evaluation. But more than anything, they will require a new approach to government—a mindset that focuses on efficiency and accountability. This will in turn require improvements in capacity (human capital) as well as adoption of modern techniques and, more important, strengthening of the management culture through establishment of a Performance Management System. Support for a more effective public service and more informed policymaking will require substantial upgrading of statistical capacity to ensure access to more regular, consistent, and comprehensive data. Finally, important environmental issues need to be addressed, such as land degradation.

Priorities for eradicating extreme poverty and boosting share prosperity

23. Lesotho faces a broad range of constraints in achieving the transition to this new growth model, and subsequently in making continued, rapid progress toward eliminating extreme poverty and boosting shared prosperity. The SCD identifies 26 main challenges, organized across three pathways of: (i) redefining the role of the state; (ii) promoting private sector-led, jobs-intensive growth; and (iii) strengthening individual and group assets. A combination of desk assessment and consultation were used to identify the highest priority challenges. The most important criteria was the impact that addressing these challenges would have on eradicating extreme poverty and boosting shared prosperity. This process resulted in identifying five broad priority areas for intervention:

24. None of the priority interventions outlined below will deliver rapid and sustainable progress on the twin goals without addressing the fundamental challenge—the need to **redefine the role of the state:**

- *Fiscal consolidation:* The sheer size of the state, coupled with misaligned expenditures, including a high wage bill, is one of the fundamental obstacles to the sustainability of inclusive growth, more diversified growth itself, and building assets among the poor. Fiscal consolidation can be achieved through downsizing or eliminating programs and projects and through headcount reductions, while at the same time improving outcomes. In addition, strengthening management of SACU receipts will be essential for macroeconomic stability. Other countries dealing with similar revenue fluctuations have successfully aligned public spending through credible estimates of long-term government revenue. Strengthening domestic revenue could be an alternative that would reduce dependency on SACU revenues. With other revenue sources in place, SACU windfalls could be used to restore buffers and to invest in key infrastructure to boost private-sector development.

- *Public-sector modernization for effectiveness and efficiency:* Fundamental to addressing the challenges are: regularizing human resource management and establishing a Performance Management System; improving the effectiveness and efficiency of public spending; adopting systems and processes to improve public investment management, project management, procurement, and program delivery; and putting in place systematic and meaningful processes for monitoring and accountability. Finally, a skilled and effective civil service is needed.

25. The SCD argues for a fundamental shift to a new growth model, one that inclusion place a central role and one that it creates sufficient, broad-based employment. This will require **developing a competitive and export-oriented private sector:**

- *Establishing incentives to support an outward-oriented private sector,* including trade, competition, and business-regulation policies that ensure access to competitively priced inputs and skills and incentives to compete in tradable sectors. This will require redefining the role of the state in moving away from areas that should be undertaken by the private sector (for example, provisioning factory shells), cutting red tape in business regulation processes, and abandoning policies to promote national champions.

- *Developing key infrastructure:* To increase market access and lower costs, it will be necessary to close infrastructure gaps. This will require a focus on improving: (i) trade facilitation, (ii) access to electricity, (iii) sustainable and safe road connectivity, and (iv) the speed, quality, and cost effectiveness of ICT infrastructure.

26. Developing a competitive private sector capable of generating broad-based employment will take time. During this time, a large share of the population, particularly those in rural areas, will still rely on farming. Many of the poor and "near poor" that fall outside the formal labor market will continue to face the risk of falling back into poverty. For this reason, the country needs to focus on **increasing the opportunities and returns to self-employment by raising productivity of smallholders and microenterprises**. Improving productivity and increasing agricultural incomes is key to developing a more vibrant rural economy, which will in turn create non-farm employment opportunities. The agenda for raising smallholder productivity will focus on establishing the right incentives for adopting more appropriate technologies and production methods to improve yields and mitigate risks. This will require strengthening the extension system. In addition, seeking new opportunities, such as developing horticulture for regional markets, will be important. Outside agriculture, interventions will promote a more dynamic microenterprise sector, both in rural and urban areas, with a focus not only on entry into self-employment and the SMME sector but also on improving productivity within the sector through capacity-building and access to services.

27. Developing a new growth model will also require major increases in productivity at Lesotho's firms, which will depend on substantial improvements in **human capital:**

- *Human capital for employment, productivity, and human development*: Lesotho's private sector requires a workforce with better and more appropriate skills; this will be key to improving firm-level productivity and driving competitiveness in diversified sectors. But it also requires a much-improved health environment to ensure that all individuals have the capacity to contribute to productivity and enjoy adequate human development outcomes. This will require a specific focus on elements of both education and health.

- *Education*: Raising the quality of education, with a specific focus on aligning skills with labor market needs, will equip Basotho, especially the youth, to participate productively in the economy, whether through formal employment or microenterprises. The focus will be on improving the relevance of skills, primary education quality, primary completion rates, vocational training, and access to post-primary education for the poor.

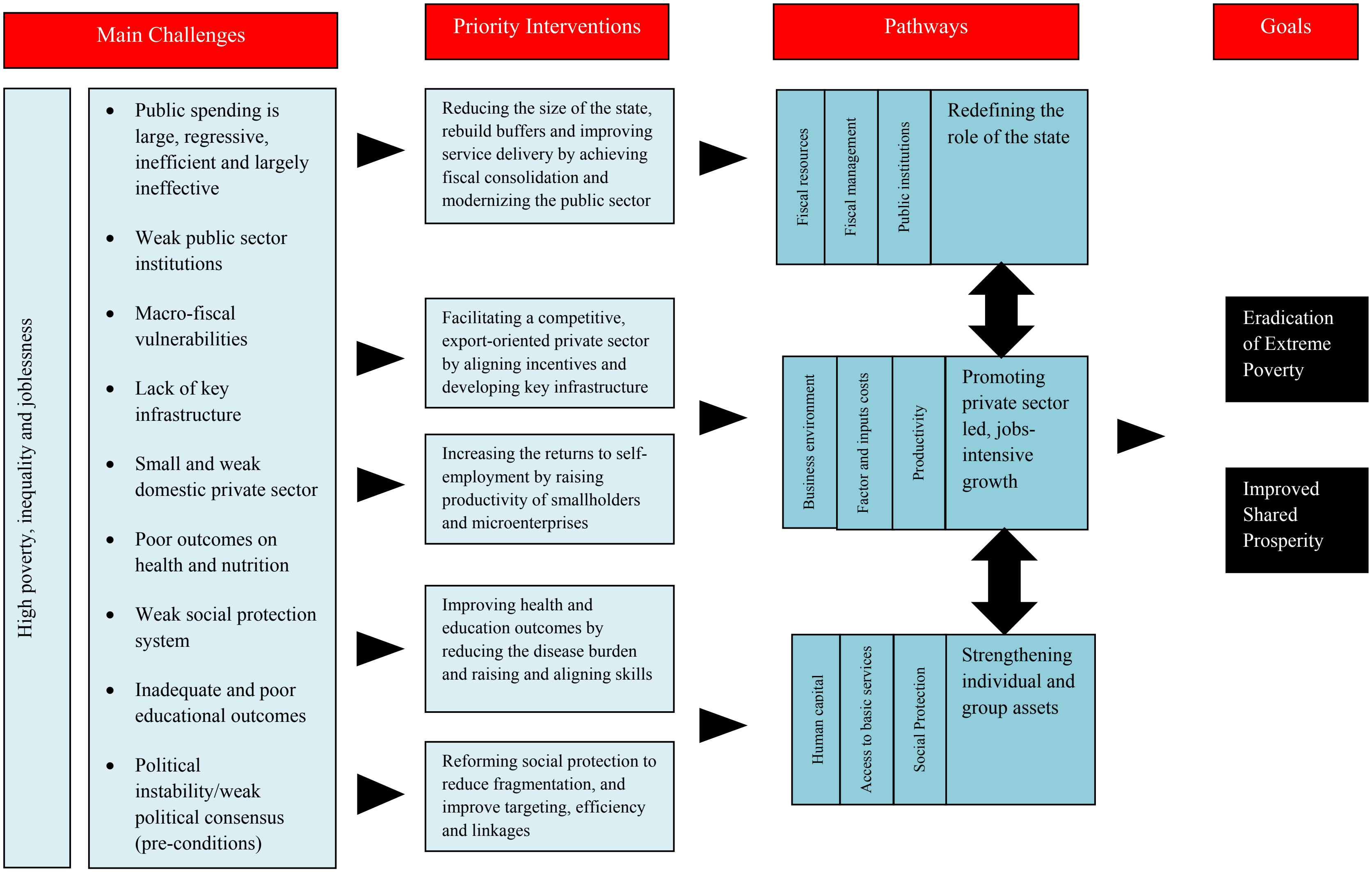
- *Health*: Improving health care will focus on: (i) the health barriers to skills acquisition and labor-market participation, particularly infant and child malnutrition and the impact of disease (especially HIV) on female participation in income-earning activities and (ii) efforts to improve access to reproductive health services. Intensifying efforts to improve outcomes in HIV prevention is likely to be critical over the medium term. Life expectancy and incidence of disease are critical elements for Lesotho's future.

28. Achieving this transformation will take time. In the short term, it will be necessary to **strengthen the social-protection system**. A social-protection reform is needed because of the magnitude and depth of poverty in Lesotho, stagnation in the labor market, and the urgency to arrest the rise of inequality in the short run. The priorities include improving targeting and coordination, harmonizing fragmented programs, and moving toward a more effective system.

Conclusion

29. Lesotho has an opportunity to eradicate extreme poverty and boost shared prosperity in coming years. It will require shifting to a growth model led by an export-oriented private sector, fortified by higher skilled, more productive, and more entrepreneurial individuals, households, and firms. Lesotho cannot realize this new growth model without redefining the role of the state. For this new model to develop, strong political consensus is necessary to push the difficult reforms needed.

Figure 6: Overview of identified priorities to eliminate extreme poverty and promote shared prosperity



1. SETTING THE SCENE

1.1 HIGH ECONOMIC GROWTH BUT NOT SHARED AMONG ALL THE BASOTHO

1. **Lesotho is a lower middle-income country with per capita gross national income of US$1,500.**[4] It is a small, mostly mountainous, and largely rural country of about 2 million people, completely surrounded by South Africa. It is one of the poorest countries in Southern Africa, and one of the most unequal in the world (Figure 7). Lesotho has an open economy, traditionally centered on trade. Its main exports are textiles, water, and diamonds. Lesotho's main trading partners are the United States and South Africa. As a member of the Common Monetary Area (CMA), its currency is pegged to the South African rand.

2. **Economic growth has not been inclusive, resulting in persistent high levels of poverty and inequality.** The economy grew at an annual rate of 4 percent per capita over the past decade (Figure 9), comparable to the rest of the SACU region, the African continent, and small states. Lesotho underwent an important change in the drivers of growth, shifting from an economy dependent on net exports to one driven primarily by government spending. Public spending rose from 44.4 percent of GDP in FY2004/05 to about 63.1 percent in FY2014/15, one of the highest such ratios in the world. This high level of public spending is unsustainable and can no longer be relied upon to drive growth. Preliminary estimates based on the FY2010/11 household survey show a national headcount poverty rate of 57.1 percent, virtually unchanged from the FY2002/03 survey.[5] At the same time, inequality increased from a Gini coefficient of 0.51 to 0.53. Per capita consumption of the bottom 40 percent of Lesotho's population contracted by 0.4 percent annually over the past five years, one of the world's slowest rates. In other words, the rich got richer and the poor got poorer. From a social point of view, the current growth performance is not sustainable as it may lead to more political instability.

3. **Macroeconomic stability is a necessary condition for growth.** The current growth model is not sustainable and may lead to macroeconomic instability. The government has been maintaining public spending above 60 percent of GDP over the past four years, and it is projected to remain at the same level over the medium term. SACU receipts are projected to decline over the next three years. As a result, it is expected that government deposits at the Central Bank will decline, sapping international reserves. It is projected that reserves will fall below four months of import coverage over the medium term. In the event of a shock, international reserves will be used and may threaten the sustainability of the exchange rate peg. Fiscal consolidation will be needed to rebuild the buffers and to help restore macroeconomic stability.

4. **Political stability and strong political consensus are essential to achieving the twin goals.** In the past, political stability has helped reduced volatility and has led to higher growth. Pre-1998 GDP per capita growth had a coefficient of variation of 0.73, compared to a post-1998

[4] 2013 Atlas GNI per capita.
[5] Using the US$1.25 per day international poverty line leads to nearly similar results (55 percent), confirming the severity of poverty in Lesotho.

coefficient of variation of 0.69 (Figure 11). In addition, GDP per capita almost doubled during the period of relative political stability. More recently, due in great part to political uncertainties, GDP growth dipped to a projected 2.8 percent in FY2014/15, down from 4.6 percent in FY2013/14. Over this period, three major US wholesale retailers canceled their textile purchase orders due to the political instability. Strong political consensus is necessary to make difficult reforms needed for broad-based growth, and these policies may arouse vested interests.

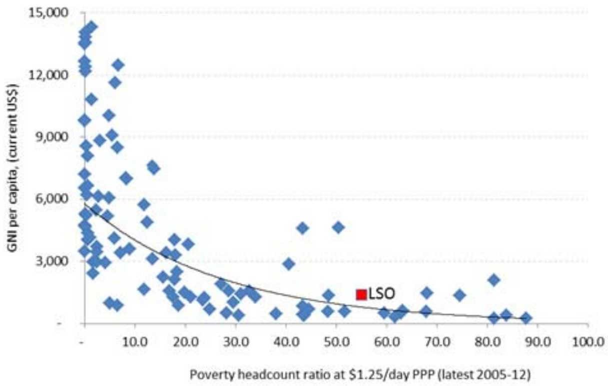
5. **The government recognizes the need for inclusive growth.** The National Vision 2020 document states these broad goals: "By the year 2020, Lesotho shall be a stable democracy, a united and prosperous nation at peace with itself and its neighbors. It shall have a healthy and well-developed human resource base. Its economy will be strong, its environment well managed, and its technology well established." To achieve these ends, the National Strategic Development Plan (NSDP) seeks to: (i) pursue high, shared, and employment-creating economic growth [led by the private sector]; (ii) develop key infrastructure; (iii) enhance the country's skills base, technology adoption, and foundations for innovation; (iv) improve health, combat HIV/AIDS, and reduce (social) vulnerability; (v) reverse environmental degradation and adapt to climate change; and (vi) promote peace and democratic governance and build effective institutions.

STATE PLAYS AN IMPORTANT ROLE IN DEVELOPMENT

6. **Government is the formal sector's largest employer.** Its wage bill is among the world's highest at 21 percent of GDP. Most of these employees are on the top quintiles of the income distribution (Figure 12). Among households depending primarily on public-sector wages, 78 percent are in the two highest income groups, compared with 32 percent of the population as a whole. Very few households supported by public-sector employment are in the lowest income groups. Government institutions show a weak capacity to plan and implement programs, resulting in poor social outcomes and poor service delivery.

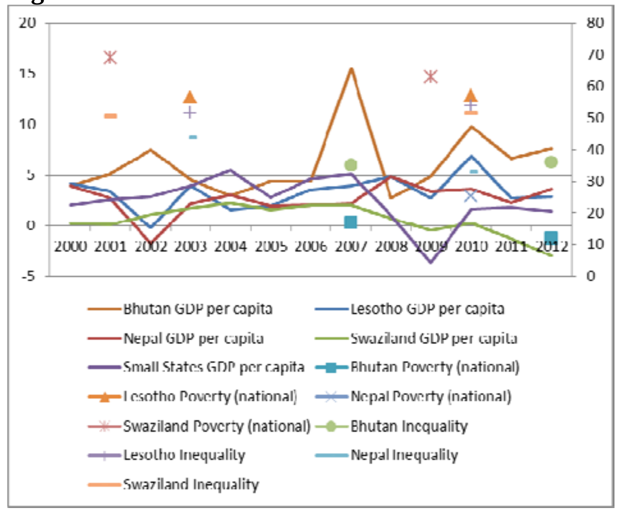
7. **Public spending is large, regressive, and inefficient and has poor effectiveness.** Government spending could have led to a rise of the relative price of non-tradables to tradables, leading to a decline in the private sector's share of total investment. At least 20 percent of public spending is regressive. Finally, Lesotho spends close to 32 percent of GDP, or more than half the government's budget, in three social sectors: education, health, and social protection. Deep-rooted inefficiencies in social spending have reduced the expenditures' effectiveness.

Figure 7: Extreme poverty high relative to Lesotho's level of income



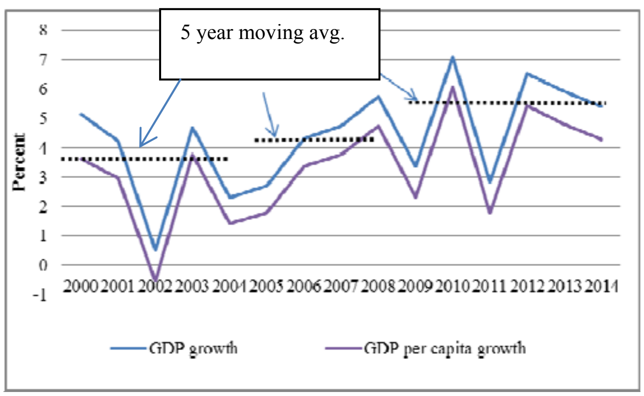
Source: BoS and WDI.

Figure 8: Peer countries have done better



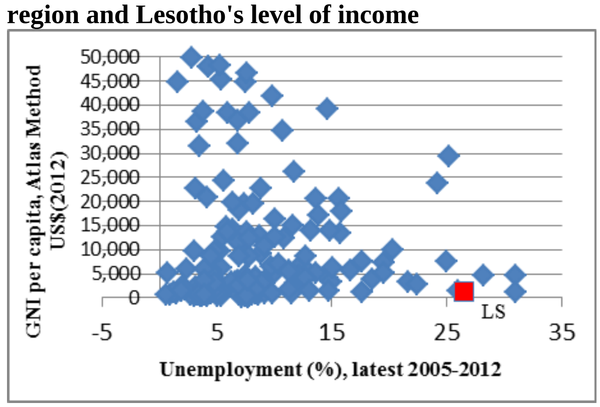
Source: WDI.

Figure 9: GDP



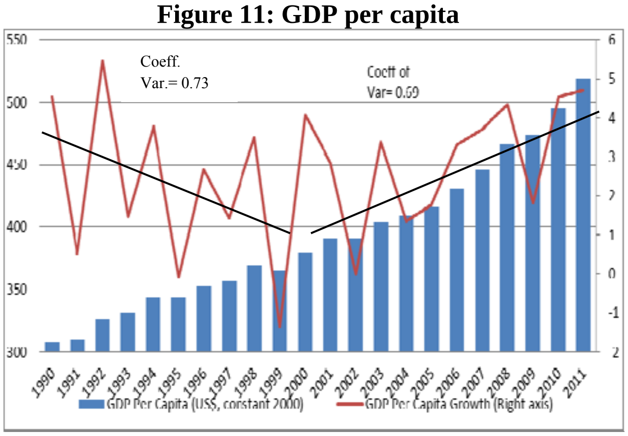
Source: BoS and WDI.

Figure 10: Unemployment rate high relative to region and Lesotho's level of income



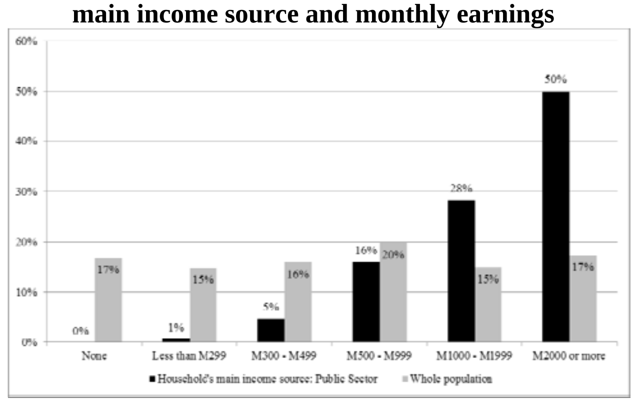
Source: WDI and BoS.

Figure 11: GDP per capita



Source: WDI and BoS.

Figure 12: Distribution of population by households' main income source and monthly earnings



Source: CMS/HBS 2010.

8. **A number of factors hinder Lesotho's private-sector growth.** The NSDP acknowledges an "uncompetitive business environment" as one of the most binding constraints on the growth of private enterprises, adversely affecting both FDI and local SMEs. All quantitative measures—including Global Trade Reports, Doing Business Indicators, and Enterprise Surveys—suggest that business regulations are a serious constraint on growth. In Ease of Doing Business, for example, Lesotho ranked No. 128 out of 185 countries in 2014 (Table 2). Lesotho has made important reforms, notably in streamlining the processes for starting businesses and registering property. Nevertheless, a number of factors that hinder private-sector growth remain at almost every stage of business—from accessing land to obtaining construction permits, engaging in cross-border trade with South Africa, and accessing finance. For example, it may take more than a year for foreigners to establish firms in Lesotho, compared with less than a year in South Africa, Rwanda, and Vietnam. According to the Lesotho data in Doing Business 2015, it takes 29 days to get a business registered, 179 days to obtain a construction permit, and 31 days to export. In addition, gaining access to land could take up to a year. Domestic investors are further constrained by the relatively high cost of capital, despite a well-capitalized banking system. Entrepreneurship is nascent in the country, with the domestic private sector still seen as reliant on the state and concentrated in non-tradable sectors.

Table 2: Overall business climate is challenging[6]

	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Registering Property	Getting Credit	Protecting Investors	Trading Across Borders
South Africa	43	61	32	97	52	17	100
Botswana	74	149	93	51	61	106	157
Namibia	88	156	25	173	61	87	136
Swaziland	110	145	55	129	61	110	127
Mozambique	127	107	84	101	131	94	129
Lesotho	128	108	161	93	151	106	147
Zimbabwe	171	180	176	94	104	87	180

Source: Doing Business 2015.

9. **Redefining the role of the state will be critical for development.** Improving the overall business environment by cutting the red tape in government processes and complementing it with trade facilitation will be essential to attracting new FDI, promoting domestic private-sector growth, and creating new jobs. Focusing on these sources of competitiveness is all the more important because some key policies for improving competitiveness are not under the government's direct control. They include: (i) exchange rate policy, determined by the maloti's peg to the rand; and (ii) trade policy, decided at the SACU level. A pickup in private-sector competitiveness and job creation would create the necessary space for public-sector fiscal consolidation, a prerequisite in restoring macroeconomic stability. Fiscal consolidation could weigh on future growth, especially if not matched by enhanced effectiveness of spending and

[6] Peer countries were selected on the basis of being part of the CMA. In addition, two neighbor IDA countries were included.

service delivery institutions.[7] In the government's view, however, right-sizing the public sector is extremely difficult when the private sector is not generating jobs.

1.2 PREPARING FOR A CHALLENGING FUTURE

10. An export-led model driven by the private sector is essential to Lesotho's prospects. As the country seeks to shift to high, shared, and employment-creating economic growth, it needs to be more effective in building assets from its existing endowments, while overcoming critical asset gaps. A brief summary of these main endowments follows:

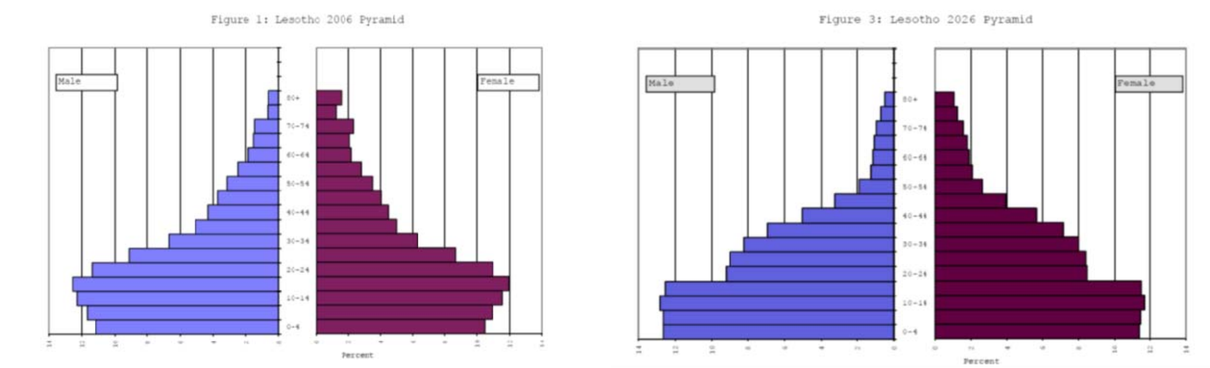
- *Natural resources:*
    - Minerals: Mining has become an important source of export revenues. The sector includes two diamond mines in commercial production; a third is shutdown but Lesotho is studying the feasibility of re-opening it on a larger scale. Three other diamond deposits are being sampled and tested, although one is mired in legal disputes. Lesotho also produces sandstone, and it is also believed to have reserves of uranium, coal, gas, and copper.
    - Water: The combination of high altitude, abundant water, and geographic proximity to major demand centers means that Lesotho is strategically situated as a water tower of Southern Africa. Lesotho currently generates on average about 3 percent of GDP a year in royalties from the LHWP.
    - Biodiversity: Lesotho's biodiversity resources in the Drakensberg and Highland areas have great potential for tourism.

- *Human capital:* In 2010, 31.5 percent of the Basotho population lived abroad. However, migration as a percentage of population has been declining along with remittances. Over the past two decades, emigration has shifted from young adults and teenagers to mostly older adults (Figure 13). The migration decline among teenagers and young adults has been tantamount to a considerable increase in the labor supply, creating pressures on the government to absorb a larger share of workers coming into the labor market because the private sector is unable to create enough jobs. Currently, people between the ages of 13 to 25 years are the largest population cohort. As these youth move into working age, they could generate a demographic dividend if (i) they have labor-market relevant education and skills and (ii) the private sector has the capacity to absorb them. Improvements in health and education could further boost to this dividend. However, key skills remain in short supply and entrepreneurialism is still nascent.

- *Location:* Lesotho's location has been one of its comparative advantages; being within South Africa provides access to markets and advanced infrastructure that creates links with the rest of the world.

[7] Lesotho's 2014 Country Policy and Institutional Assessment (CPIA) score was 3.5, slightly above the average for IDA borrowing countries (Figure 12). However, it lags the IDA's top performers. In particular, the country trails the IDA average in fiscal policy, equity of public resource use, building human resources, and quality of budgetary and financial management.

Figure 13: Teenagers and young adults could generate a potential demographic dividend



Source: BoS.

> Knowledge Gap: Remittances, Migration and Brain Drain
> There is very limited information on income on the household survey. Also, there is no information on migrants. A comprehensive household survey, which has an income and consumption module as well as social and economic characteristics of migrants is needed. This will allow seeing whether remittances may have created Dutch-disease type effects in the country or other effects on human capital formation. For instance, a large migrant population may also affect school decisions and the behaviour of children left behind. Also, there is only dated and anecdotal evidence on the brain drain. Further research on this issue is needed.

11. **To eradicate extreme poverty, Lesotho must build a larger and resilient middle class.** Achieving this will require an export-led model driven by the private sector. Lesotho's current model, where government spending drives the economy, is not sustainable and cannot be relied upon to create new jobs. The role of the state must be redefined. Government spending needs to be more effective and efficient. Achieving this structural change will require a more effective building of assets, especially human capital and institutions. A critical part of this asset-building strategy will be developing a larger, more dynamic, and more competitive private sector. Achieving this transformation will take time. In the short term, it will be necessary to strengthen the social protection system and to increase the productivity of smallholders. Maintaining political stability as well as macroeconomic stability will be critical, and in particular, fiscal sustainability will be necessary because of the currency peg.

12. **Reform of the public sector is fundamental.** From the fiscal perspective, it is key to sustainability. More important, it is critical to all aspects of the transformation and modernization of the country, including delivering on key infrastructure investments, supporting the development of the private sector, raising the level of health and educational outcomes, and improving the effectiveness of social safety nets.

1.3 OBJECTIVES AND STRUCTURE OF THIS REPORT

13. **The World Bank and the Government of Lesotho are engaged in defining the new Country Partnership Framework (CPF).** In-depth consultation began in the third quarter of FY15, with the CPF targeted for approval by the World Bank's Board in the first quarter of FY16. This Systematic Country Diagnostic (SCD) note is expected to play a central role in these consultations.

14. The SCD's objective is to address the question: What are the most critical constraints and opportunities facing a country in accelerating progress toward the goals of ending extreme poverty and promoting shared prosperity in a sustainable manner? The emphasis is on identifying priorities over the next five to seven years (the timeframe of the CPF), while recognizing some critical interventions will only bear fruit over the longer term.

15. The SCD is expected to be a relatively brief report, based on a comprehensive analysis of the available evidence[8] and developed in consultation with national authorities and other stakeholders as well as all parts of the World Bank Group.

16. The remainder of this SCD is structured as follows:

- *Chapter 2: Understanding poverty in Lesotho: profiles and progress*: presents an analysis of recent trends in poverty, inequality, and the welfare of the bottom 40 percent of the population; it includes profiles of the poor by demographic and geographic perspectives as well as a review of the main determinants of poverty.
- *Chapter 3: Assessing the drivers of growth in Lesotho*: presents a survey of past growth patterns and recent trends, including an analysis of the main sectors, trade and investment, and private sector development, along with implications for labor markets.
- *Chapter 4: Inclusion: building assets at the micro-level*: assesses the degree to which individuals and groups are in a position to build and leverage assets to contribute to and benefit from growth; this includes analysis of education, skills, health, and other key assets along dimensions of gender, location, socioeconomic status, and ethnicity.
- *Chapter 5: Is the growth model sustainable?:* assesses the sustainability of the current growth model.
- *Chapter 6: Prioritizing the challenges:* summarizes the main challenges and identifies key short- and medium-term priorities to meeting the goals of poverty eradication and improving the welfare of the bottom 40 percent in a sustainable way.

[8] SCDs are not expected to carry out substantial new research or analysis, but they should identify key knowledge gaps for future work.

2. UNDERSTANDING POVERTY IN LESOTHO

Identifying the challenges to eliminating poverty and promoting poverty reduction requires an understanding of the scope and nature of poverty in Lesotho today. This chapter will show that poverty has stagnated over the past decade. Poverty remains high and concentrated among certain groups. Most important, inequality has increased and it is relatively high, acting as a barrier to both growth and poverty reduction.

2.1 OVERVIEW: POVERTY, SHARED PROSPERITY, AND INEQUALITY

17. **Low quality and a lack of comparability in Lesotho's survey data hinder conclusive analysis on poverty trends.** This chapter uses the early adopted imputation method to partly restore the estimations' comparability. The main finding is that the national poverty rate in FY2010/11 was almost the same as it was in FY2002/03. The analysis below presents the main emerging results on poverty and inequality trends and validates the emerging results of poverty stagnation by using non-income dimensions of poverty and labor analysis. Box 1 discusses how the problem of survey incomparability and issues of consumption data quality was resolved.

Box 1: Calculating consumption aggregate using non-comparable surveys

The Lesotho Bureau of Statistics collected three rounds of the Household Budget Survey (HBS) over the past 20 years. They have serious comparability issues due to changes in the survey design, survey instruments, and data quality.

The FY1994/95 HBS and FY2002/03 HBS differ on questions aimed at capturing household consumption. Both surveys, for example, used a four-week diary module to collect consumption data. However, the FY1994/95 round has no separate recording for farming and other household businesses, only a joint recording. The 2002/03 HBS has separate questions for the two types of household activities (for a full list of data quality and comparability details, see World Bank, 2008). Previous studies have argued against drawing any conclusions about the evolution of poverty in Lesotho based on the FY1994/95 and FY2002/03 surveys.

The FY2010/11 household survey is a different type. Launched by the Bureau of Statistics in May 2009, it is known as Continuous Multipurpose Survey (CMS), with the aim of addressing a need for timely data. CMS is quarterly, with a core questionnaire and add-on modules, and each household is supposed to be revisited four times before being replaced. However, analysis of available datasets shows that the CMS failed to revisit the same households for four consecutive quarters. The attrition rate is substantial at the household level—only 35 percent of the original households could be re-interviewed in the following three quarters.

In addition to changes in survey design, there are significant changes in consumption data collection. The FY2010/11 CMS collected expenditure data via a diary over one-week period (versus four weeks in the FY2002/03 HBS), recording what households paid in total for food, drinks, hygienic products, and other consumables. The diary was supplemented by a recall of all purchases of food, non-food, and rent paid over a specified time period. The two surveys use different consumption items and, according to Allwine et al. (2013), almost half of the households in the first quarter sample do not report consumption of staple foods like cereals, bread, or potatoes over the prior week. This did not occur in the FY2002/03 HBS.

To overcome such discrepancies and provide comparable consumption aggregates, a survey-to survey imputation technique has been applied to the FY2010/11 CMS (Allwine et al., 2013). The approach consists of estimating the consumption model using expenditure data from the FY2002/03 survey and a set of household characteristics. It then applies the estimated parameters to FY2010/11 data to predict per capita consumption in that period. The predictions are reliable if the model is stable—i.e., the consumption patterns and the error structure do not change

over time; non-monetary correlates are good predictors of consumption and are comparable over time.
Different model specifications using various combinations of the FY2010/11 survey data from different quarters provided four different poverty numbers, ranging between 50.7 percent and 57.1 percent. The poverty headcount number endorsed by the authors is 57.1 percent, based on the first quarter of FY2010/11 CMS. It was estimated using a set of covariates, including a dummy for each district, a dummy for urban areas, a second degree polynomial in household size, the share of household members completing primary and higher education, a set of dummies to capture the employment status of household's head, and a dummy for whether households have access to electricity. The proposed method of estimating poverty in Lesotho has been adopted by Lesotho Bureau of Statistics and used in its official publications.

18. **Lesotho's national and extreme poverty are high.** In FY2010-11, an estimated 57.1 percent of the population lived below the national poverty line, and 34.0 percent were below the food (or extreme) poverty line, with expenditures below minimum food requirements (Table 3). National poverty has been stagnant, with a mild increase from FY2002/03 to FY2010/11, while extreme poverty increased 1.1 percentage points during the period. The national poverty estimates were almost identical to the international poverty estimated based on the US$1.25 per day standard (Table 3).

Table 3: Poverty rates by urban/rural area, FY2002/03 and FY2010/11

	National poverty rate			Extreme poverty rate			$1.25PPP/day poverty rate		
	2003	2010	Change	2003	2010	Change	2003	2010	Change
Lesotho	***56.6***	***57.1***	***0.5***	***34.0***	***35.1***	***1.1***	***55.3***	***55.8***	***0.5***
Urban	**39.0**	**39.6**	**0.6**	**20.3**	**20.4**	**0.1**	**37.1**	**38.5**	**1.4**
Rural	**60.9**	**61.2**	**0.3**	**37.4**	**38.5**	**1.1**	**59.8**	**59.9**	**0.1**

Data source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).
Note: National poverty rate calculated at national poverty line as defined by BoS; extreme poverty rate calculated based on food portion of the national poverty line as defined by BoS; US$1.25 per day is the internationally comparable measure of extreme poverty, which measures the share of the population with consumption per capita less than US$1.25 PPP a day, expressed in 2005 prices.

19. **International comparison suggests that Lesotho is one of the most unequal and, at the same time, one of the poorest countries in the world, and the grim situation has deteriorated over the past decade.** Lesotho is one of the 10 most unequal countries in the world, with inequality in FY2010/11 at 53.8, measured by the Gini coefficient. Inequality has increased from 51.7 in FY2002/03. Striking disparities remain across socioeconomic groups in income, wealth, and living conditions. Consumption is 14 times higher among the top 10 percent of the population than the bottom 10 percent. Figure 14 places low- and middle-income countries with available survey data in four quadrants, based on their levels of poverty and inequality circa 2010. Lesotho is among a small group of countries in the quadrant with extremely high poverty rates (measured by US$1.25 per day) and very high inequality. Only eight countries had higher poverty levels and only 10 had higher inequality. The situation has deteriorated over time—only seven other countries show inequality increases higher than Lesotho's. Poverty in Lesotho was stagnant between FY2002/03 and FY2010/11, while the majority of countries experienced reductions in poverty over the same period (Figure 15).

20. **Lesotho's poverty is not only high, but it is also deep, and the depth has increased over time.** The headcount poverty rate does not distinguish between those with consumption just below the poverty line and those deeper in poverty. Policies designed to improve the well-being of those at the bottom of the consumption distribution will result in poverty reduction only if

benefits are sufficient to cross the poverty line. The poverty gap measures[9] “the depth of poverty, or how far the poor are from the poverty line.” The poverty gap in Lesotho was reported at 29.5 in FY2010/11, an increase of 0.6 percentage point from FY2002/03. Among the 30 poorest countries, Lesotho’s poverty gap ranked ninth (Figure 16).

Figure 14: Poverty and inequality levels US($1.25)

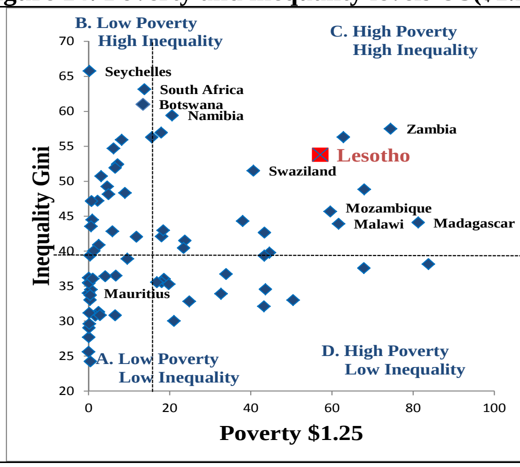
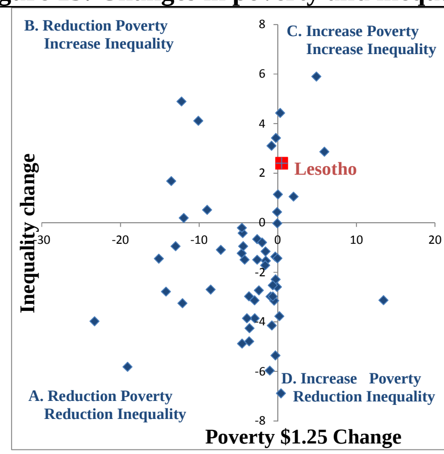


Figure 15: Changes in poverty and inequality



Source: Staff estimates for Lesotho. Povcalnet data for other countries. Selected countries. The levels of inequality and poverty are reported for 2010 or closest available year. The estimates are for illustrative purpose only; the periods differ across countries, and the surveys are not always comparable over time and across the countries. The change is the difference between the latest available data for 2005-10 vs. 2000-04.

Figure 16: Poverty headcount and poverty gap US$1.25, 30 poorest countries in the world

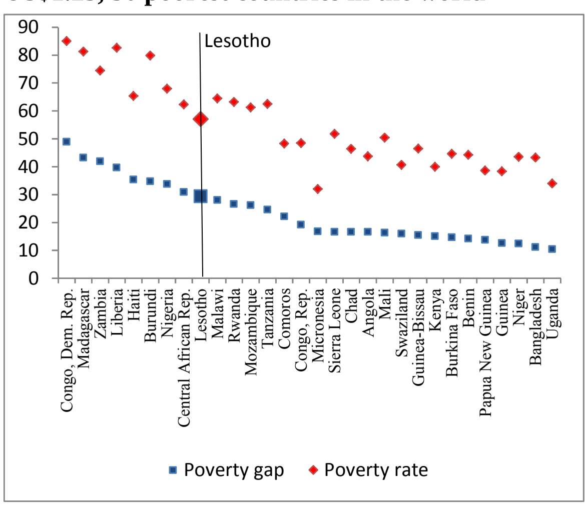
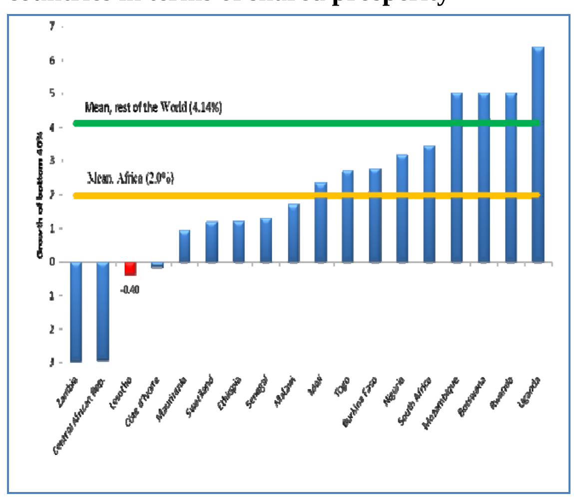


Figure 17: Lesotho fares worse than most African countries in terms of shared prosperity



Data source: Staff estimates based on HBS (FY2002/03) and CMS/HBS (FY2010/11). Povcalnet for the rest of the countries.

21. Lesotho was Africa’s third-worst performer in terms of shared prosperity over the past decade. Shared prosperity is measured by the annual growth in consumption per capita among the bottom 40 percent of the population. In Lesotho, this indicator was negative between FY2002/03 and FY2010/11 (Figure 17). In Africa, only Zambia and the Central African

[9] Poverty gap is the mean shortfall from the poverty line (counting the non-poor as having zero shortfall), expressed as a percentage of the poverty line. This measure reflects the depth of poverty as well as its incidence.

Republic had worse performances than Lesotho in terms of this shared prosperity indicator. To better illustrate the meaning of the shared prosperity indicator, the consumption growth by percentiles is presented in the Growth Incidence Curve analysis (GIC, Figure 18). The GIC shows that the bottom 40 percent of Lesotho's population experienced a 0.4 percent per year consumption decline in real terms between FY2002/03 and FY2010/11, compared to annual growth of 0.9 percent for the remaining 60 percent and 1.1 percent for the top 20 percent.

Figure 18: Growth incidence curves, FY2002/03 and FY2010/11

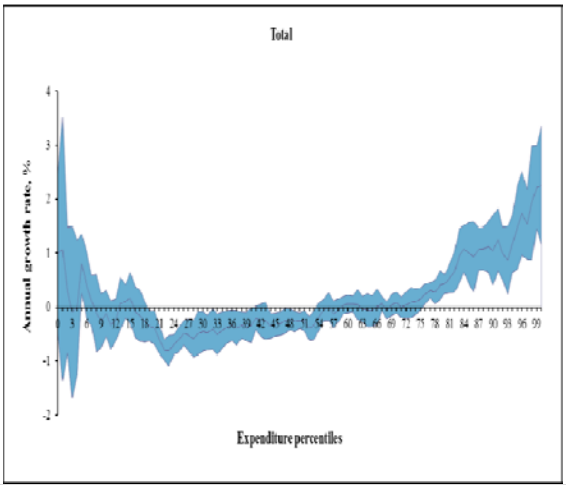
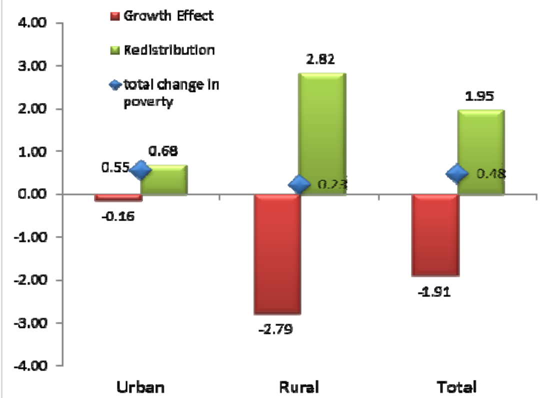


Figure 19: Growth and redistribution decomposition of poverty changes



Data source: Lesotho Bureau of Statistics (2014) comprising HBS (2002/03) and CMS/HBS (2010/11).

22. The high level of inequality is one of the main factors behind Lesotho's continuing economic stagnation, and the increase in inequality is attributed to the recent stagnation in poverty. Changes in poverty can be decomposed into growth and redistribution (inequality-related) effects. Assuming the imputation provides a good proxy of the actual unobserved consumption aggregated in FY201/11 in Lesotho, the inequality increase had an adverse effect on the poor. The analysis shows that poverty would have dropped by about 1.95 percentage points if not for the increase in inequality; it has actually increased 0.5 percentage points (Figure 19).

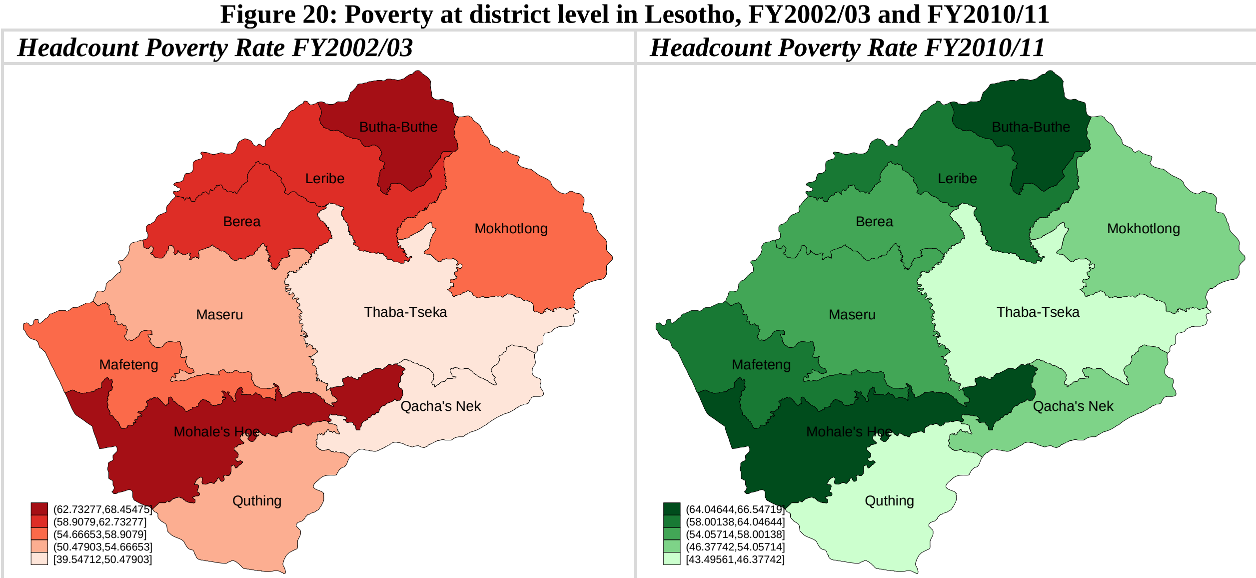
2.2 WHO ARE THE POOR AND THE BOTTOM 40 PERCENT IN LESOTHO?

Spatial dimension of poverty

23. Lesotho is marked by large geographical differentials in poverty and inequality. Like the majority of poor African countries, people who live in poverty tend to be clustered in certain regions and rural areas rather than being spread evenly across the country. Almost 80 percent of Lesotho's population resides in the rural areas. About 61 percent of the rural population is considered poor, while only 39 percent of the poor live in urban areas. The spatial rural/urban distribution of the poverty does not show significant changes over time (Table 3). As of FY2010/11, approximately 87 percent of the poor lived in the rural areas. The substantial differences across districts found in FY2002/03 still persist in FY2010/11. Poverty ranges between 43.5 percent in Quthing and 66.5 percent in Butha-Buthe. In general, poverty is higher in the north and northwest and relatively lower in the central and southeast areas (Figure 20).

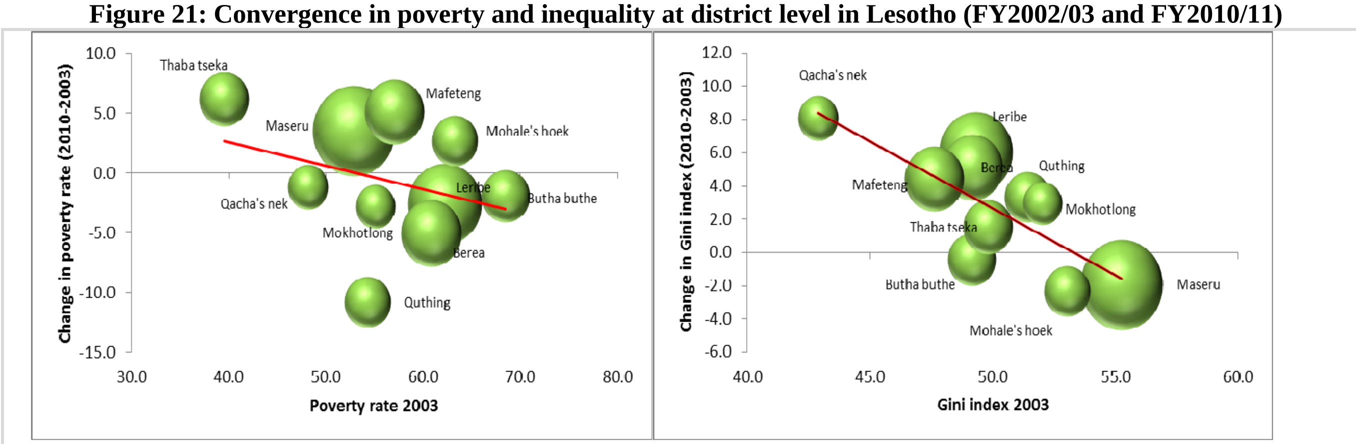
24. **Some indications point to a convergence in poverty and inequality across districts**. Figure 21 shows initial levels of district poverty and inequality and changes in the two indicators. Districts with higher poverty rates in FY2002/03 experienced declines in poverty—for example, Quthing district stands out with a reduction of about 11 percentage points. At the same time, districts with lower poverty rates in FY2002/03 had increases in poverty headcounts. In Thaba Tseka district, for instance, the poverty rate increased more than 6 percentage points to 45.8 percent in FY2010/11. Similarly, there was a convergence in inequality across districts between FY2002/03 and FY2010/11. Given the overall increase in inequality, the convergence occurred because districts with high inequality in FY2002/03, such as Maseru, experienced small reductions in inequality, and districts with low initial inequality saw increases of the Gini index of about 8 percentage points, as in the case of Qacha's Nek.

Figure 20: Poverty at district level in Lesotho, FY2002/03 and FY2010/11



Data source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

Figure 21: Convergence in poverty and inequality at district level in Lesotho (FY2002/03 and FY2010/11)



Note: Bubble size is proportional to the size of population in FY2002/03.
Data source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

Poverty profile

25. **For many people in Lesotho, poverty is associated with the inability to overcome hunger, very high illiteracy rates, illness, and large families**. As previously mentioned, the FY2010/2011 survey data show that almost 30 percent of Lesotho's population lived below the extreme (or food) poverty line and hardly had enough food for survival. About half of the adult population had completed less than primary education, and 61 percent of this group was poor.

26. **Poor households tend to have more children, and poverty rates increase with age, the highest (65 percent) being among the elderly over 64 years old.** The age-gender pyramid has a broad base that clearly characterizes a poor country, with a large proportion of children in poverty and a high childhood dependency ratio (Figure 22). Together, children (up to 14 years of age) and the elderly (60+) account for approximately 44 percent of the poor. Similarly, extreme poverty is concentrated among the elderly (the highest rate of 38.8 percent is among those aged 60 to 64), followed by children aged 6 to 14 (36.8 percent) and by those between 55 and 59 years of age (37 percent). The poverty age profile shows a typical U-shaped pattern, with poverty higher among youth and the elderly and lower among the working-age population (Figure 23). Changes occurred between FY2002/03 and FY2010/11, with poverty increasing among youth and elderly, and it led to higher poverty rates among the elderly, compared to the youngest generations.

Figure 22: Lesotho age–gender pyramid and poverty

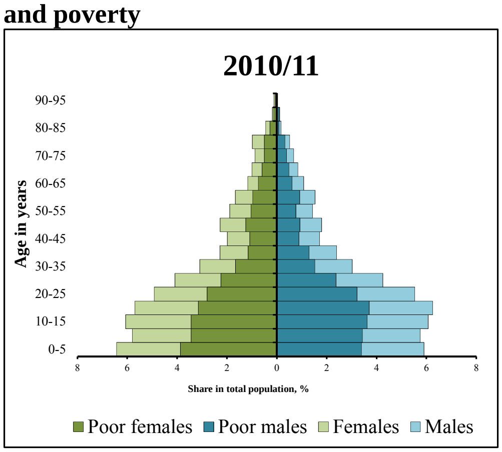
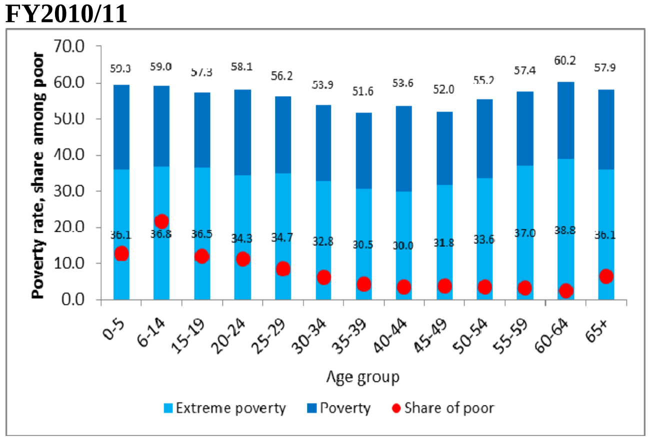


Figure 23: Poverty rates and distribution by age group, FY2010/11



Source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

27. **The age pattern of poverty is partly a reflection of the household composition; larger households, and particularly households with a larger number of elderly, are more likely to be poor.** Poverty rates increase monotonically with the number of household members. In FY2010/11, they were as low as 30 percent among households with just one member. Among households with seven or more members, it rises to 66 percent, or 9 percentage points above the national average. The average size of poor households was 6.5 persons in FY2010/11, compared to 5.8 persons for non-poor families. Poverty rates increase with the number of elderly (above 60 years of age) in the household—from 54 percent in households with no elderly to 62 percent in households with one or two elderly and 72 percent among households with three elderly members (Figure 23).

28. **Household structure and gender impact poverty, with females disadvantaged.** In comparison to two- parent families (57.8 percent poor), female headed households are slightly more likely to be poor (58.1 percent) and single-father families are substantially less likely to be poor (48.5 percent). However, the poverty rate for two-parent families increased by 3 percentage points over the past seven years, while it went down for single-parent families, particularly for single-father families, with a decline of 10.7 percentage points (Figure 24).

29. **Education is an important factor in poverty levels, with higher educational attainments corresponding to lower poverty rates.** Some 27 percent of individuals who completed less than primary education fall into the lowest quartile of the consumption distribution, compared with 23 percent among those completing primary education and less than 9 percent among those completing tertiary or higher education (Figure 25). Households headed by the uneducated (61 percent) had poverty rates twice as high as households headed by someone with higher education (30 percent) (Figure 26). Poverty and location are correlated with worse educational outcomes.

Figure 24: Poverty risk by household characteristics

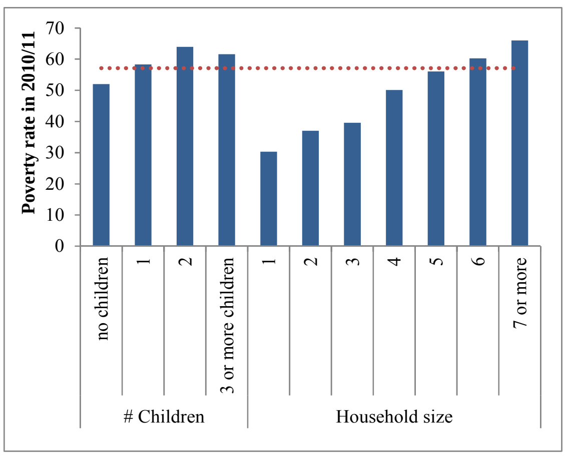
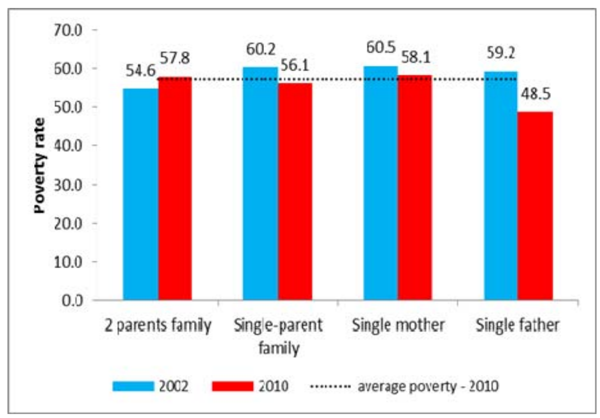


Figure 25: Poverty rates by family structure, FY2002/03 and FY2010/11



Data Source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

Figure 26: Households distribution by consumption quartile and level of education, FY2010/11

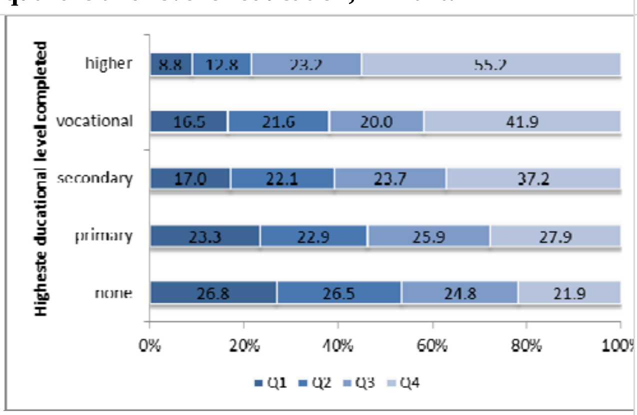
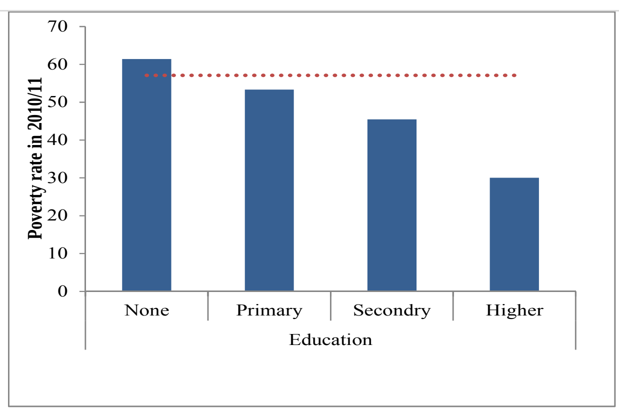


Figure 27: Poverty rate by level of education, FY2010/11



Data source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

30. Labor market deficiencies also play a role in Lesotho's persistently high poverty levels. The labor market is characterized by a low employment-to-working-age population ratio, a high level of unemployment, a high proportion of employment outside of the country, and a well-paid public sector.[10] As suggested in the IMF Article IV publication (2012), a relatively high proportion of Lesotho's labor force is employed outside of the country, and South Africa's shift toward the use of local labor significantly reduced the demand for workers from Lesotho, leading to a systematic decline in international remittances.[11] The broad unemployment rate, which includes discouraged workers, is estimated at 28 percent, and it is as high as 43.2 percent among youths aged 15 to 24.

31. Employment generally plays an important role in poverty reduction, but low earnings among subsistence farmers has adverse impact on the rural poverty. Data from FY2002/03 and FY2010/11 allow us to combine employment and poverty outcomes. An estimated 53 percent of the employed were poor in FY2010/11, compared with 61.4 percent among the unemployed and 58 percent among the inactive. The large differential in headcount poverty between urban and rural areas and the relatively small difference in poverty rates among working and non-working individuals are likely attributable to a larger share of the rural population being employed in subsistence agriculture and/or in agricultural jobs that do not pay high wages. On the contrary, urban areas are characterized by a larger share of the employed population in wage-earning jobs outside agriculture, including the well-paid public sector, where workers earn an average monthly salary about seven times higher than the minimum monthly wage of a skilled worker in the textile sector. Figure 28 illustrates that households headed by an employed person are less likely to be poor, compared to households headed by someone who is unemployed or, even worse, someone who is inactive or not participating in the labor market. It suggests that a substantial increase in productivity of the employed population will be needed to get out of poverty because poverty rates between the employed and unemployed don't differ that much.

[10] Public sector is well-paid locally but not necessarily if compared with neighboring countries.

[11] A large share of remittances flows through informal channels due to high cost. As specified in FSDS there is a need to make formal channels more efficient, accessible and affordable so that more funds can flow through formal financial system.

Figure 28: Household poverty rates by labor force status of head of household, FY2002/03 and FY2010/11

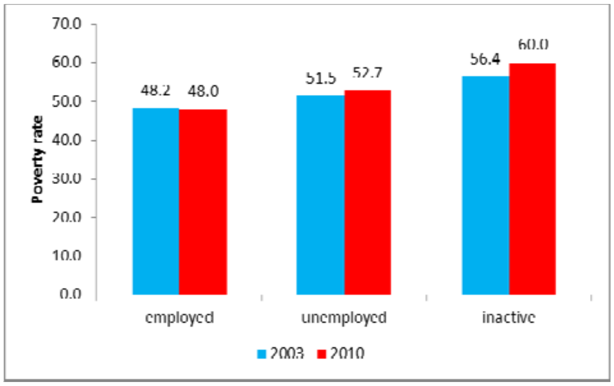
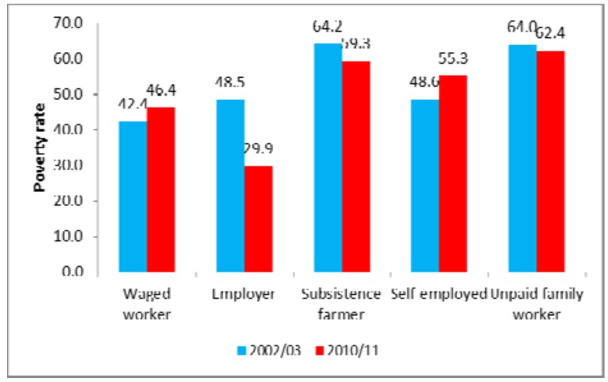
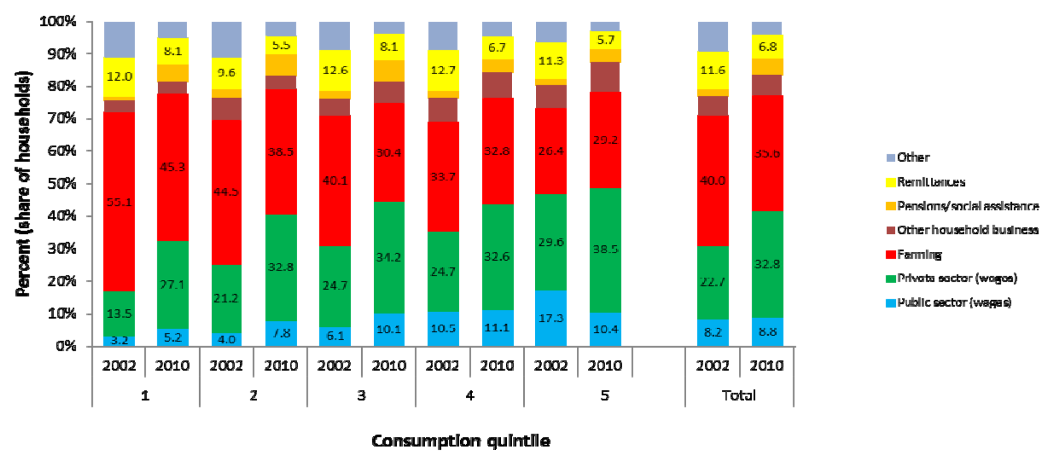


Figure 29: Household poverty rates by employment type of head of household, FY2002/03 and FY2010/11



Data source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

Figure 30: Distribution of households by self-reported main source of income and consumption quintile, FY2002/03 and FY2010/11



Data source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

Main correlations and drivers of poverty in Lesotho

<u>What has deteriorated?</u>

32. **<u>Farm earnings</u> (including subsistence farming) remains the main source of income in Lesotho, but its importance and possibly magnitude has been reduced.** The share of households reporting farming as the main source of income fell from 40 percent in FY2002/03 to 35.6 percent in FY2010/2011. The largest decline has occurred in the poorest quintile, the group mostly relying on subsistence agriculture. In other words, fewer poor households derived most of their income from farming.

33. Remittances went down for everybody. A 40 percent reduction has occurred in the share of households reporting remittances as the main source of income. The pattern is constant across all quintiles of the consumption distribution.

What has improved?

34. The growth of the salaries from the public sector as main source of household income was very strong for the bottom quintiles of the consumption distribution, yet the increase did not lead to a re-ranking of the main sources of income. The average increase was rather small—from 8.2 percent to 8.8 percent. Middle-income groups are relatively better off and rely more on public-sector wages, whereas the richest households rely less on wages from the public sector.

35. Salaries from the private sector gained importance in relative terms. The role of private sector wages doubled for the bottom quintile and increased by about 10 percentage points among all the consumption groups.

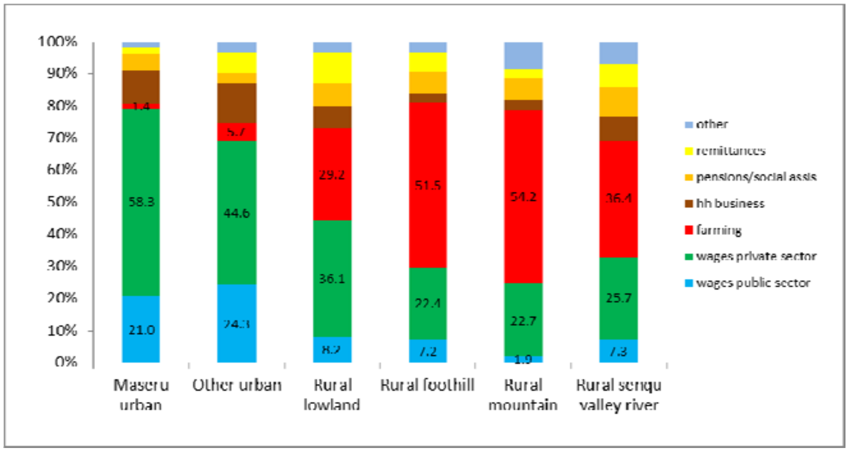
What has remained constant?

36. Non-farm self-employment remained largely constant, with some variation across quintiles of the consumption distribution.

37. The role of pensions and social assistance increased, but the proportion of households relying mainly on social protection incomes remains small. Slightly more households report pensions and social assistance as the main sources of income (Figure 30).

38. Regions show large differences in terms of the relative importance of sources of income (Figure 31). Earnings from the public sector are the main income source for a larger share of households in urban areas, both in Maseru and in other cities. Compared to rural areas, more households in the urban areas report the private sector as the main source of income; however, the gap across regions is much smaller than the difference for public-sector earnings. The proportion of households relying on farming in rural areas is still driven by proximity to Maseru and its job opportunities, rather than by the quality of the main agricultural resource (land). In the rural lowland region, which has the best agricultural land, less than 30 percent of households report farming as the main source of income, compared to 54 percent in the rural mountain region.

Figure 31: Distribution of households by self-reported main source of income and region, FY2010/11



Data source: CMS/HBS (FY2010/11).

39. Some improvements in labor-market outcomes occurred between FY2002/03 and FY2010/11. The share of individuals aged 15+ who were employed increased from 42 percent to 47 percent. The unemployed dropped from 12 percent to 8.5 percent; the inactives declined from 46 percent to 44.5 percent (Figure 32). Improvements in the share of individuals aged 15+ who are employed and unemployed were proportionally larger among the poorest segment of the population. Even so, the richest segment of those aged 15+ still accounted for the largest share of the employed—51 percent, compared with 43.3 percent among individuals in the bottom quintile. Figure 33 illustrates how the share of vulnerable employment—i.e., unpaid family workers and the self-employed (both inside and outside agriculture)—declined over time, with workers in wage-paying jobs increasing from 51.3 percent to 62.1 percent of the employed population aged 15+. The share of wage-earning workers increased along the consumption distribution, whereas the proportion of subsistence farmers and unpaid family workers declined among better-off households. The self-employed were more evenly distributed across consumption quintiles, indicating a significant amount of heterogeneity in the type and success of non-farm enterprises. Similar evidence was found for employers in FY2002/03, but seven years later employers were more likely to be in the top of the distribution.

40. The proportion of wage-earning workers increased more rapidly among poor households than among non-poor households, indicating that getting a wage-paying job might be instrumental in moving up the consumption ladder but may not always be enough to rise out of poverty. This stresses the need to increase labor productivity. The level of education emerges as a crucial factor, correlated with the type of employment. Farming does not require any formal education, and individuals completing less than primary education had the highest probability of working in this sector.

Knowledge Gap: Limited understanding of the growth-poverty link

There are important discrepancies between the income from national accounts and consumption from the household survey. Due to the poor quality of data, a deeper analysis cannot be made on the growth-poverty link. There is a need to strengthen the household survey methodology.

Figure 32: Distribution of employed population (15+) by labor force status and consumption quintile, FY2002/03 and FY2010/11

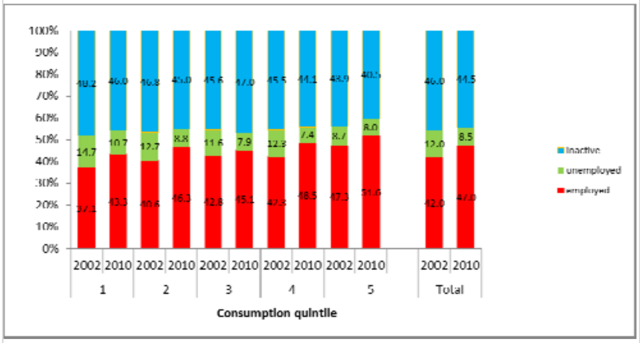
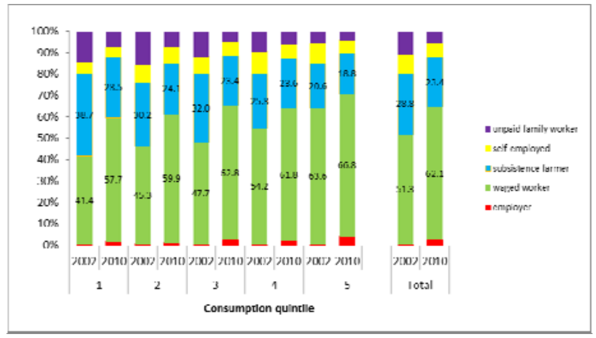


Figure 33: Distribution of employed population (15+) by type of employment and consumption quintile, FY2002/03 and FY2010/11



Sources: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

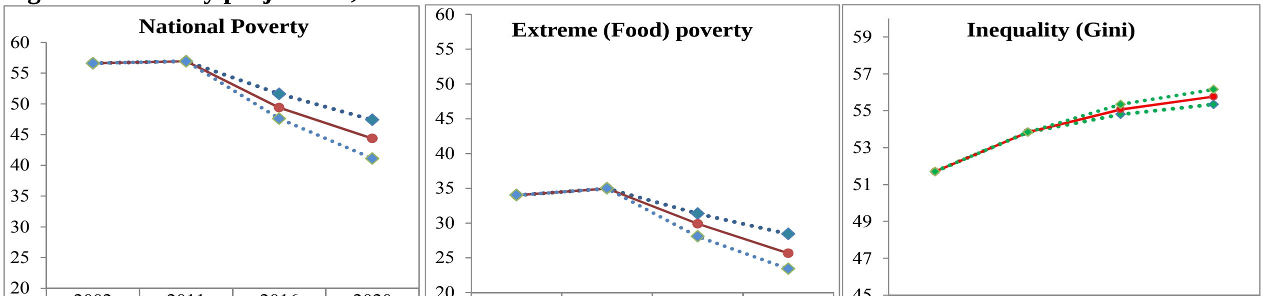
2.3 LOOKING AHEAD: ADDRESSING INEQUALITY IS THE KEY TO POVERTY ELIMINATION

41. **Micro simulations indicate that,[12] assuming 5 percent annual GDP growth, poverty in Lesotho will decline from 56.9 percent in FY2010/11 to approximately 50 percent in 2016 and close to 44 percent in 2020 (Figure 34)**. The reduction is primarily driven by the cumulative growth in per capita consumption that corresponds to 5 percent GDP growth. Our estimates suggest, however, that the range of poverty reduction could be quite wide, depending on the assumption for consumption elasticity. In 2016, the estimated range of poverty rates is between 47.6 percent and 51.6 percent; by 2020, the range is even wider, between 41.1 percent and 47.7 percent.

42. **Our projections foresee further increases in inequality.** The baseline scenario points to an increase in Gini-measured inequality from 53.8 in FY2010/11 to 55.8 in 2020**.** The disparities in poverty between urban and rural areas are also expected to increase. The main driver of the expected increase in the income inequality is the higher disparity in consumption between sectors and the continued relative deterioration of agriculture. Another factor contributing to higher inequality is the projected increase in educational disparities between urban and rural areas. The projected increase in inequality will have adverse effects on the pace of poverty reduction. To reverse the trend, policies to reduce income inequality will be required.

[12] See Annex 1 for more details.

Figure 34: Poverty projections, baseline scenario



	2002	2011	2016	2020
a	56.6	56.9	51.6	47.4
b	56.6	56.9	49.4	44.4
c	56.6	56.9	47.6	41.1

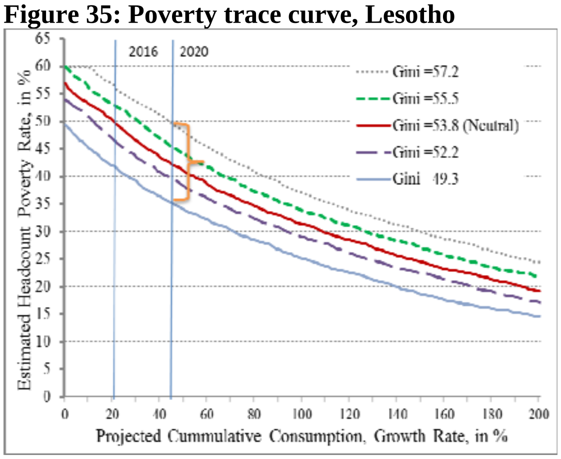
	2002	2011	2016	2020
a	34.0	35.0	31.3	28.4
b	34.0	35.0	29.9	25.7
c	34.0	35.0	28.1	23.4

	2002	2011	2016	2020
a	51.7	53.8	54.8	55.3
b	51.7	53.8	55.1	55.8
c	51.7	53.8	55.3	56.2

Source: Staff estimates. FY2002/03 and FY2010/11 are actual figures, 2016 and 2020 projections. Baseline scenario (b), where elasticity is 0.4 in scenario a, 0.6 in scenario b, and 0.8 in scenario c.

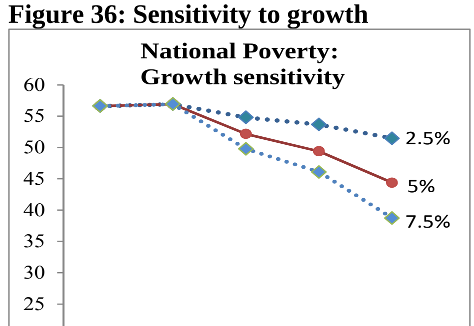
43. **Both economic growth and policy-driven inequality reduction are required for faster poverty reduction.** The scenarios suggest a relatively slow pace of poverty reduction and a significant increase in inequality. Even under very plausible assumptions on growth (5 percent a year), the socio-economic situation in Lesotho improves slowly. A slowdown in economic growth following internal or external shocks could hamper poverty reduction. The next figures explore the simulations' sensitivity to GDP growth and inequality changes. Figure 35 presents the so-called poverty trace curve, showing how poverty would fall under assumed changes in consumption growth and inequality. By 2020, it suggests, various combinations of poverty and inequality changes would produce a range of poverty changes in Lesotho. Just assuming GDP 5 percent growth could lead to an approximately 40 percent increase in consumption. However, poverty could range between 35 percent and 50 percent depending on the inequality level. Similarly, the consumption growth rate by itself has significant impact on poverty. Figure 36 shows a significant range of poverty based on different growth rates. It is estimated that increases in agricultural productivity equal to agricultural and services growth would lead to an additional poverty reduction of 3 percentage points, keeping average growth constant.

Figure 35: Poverty trace curve, Lesotho



PTC illustrates elasticity of poverty to growth and inequality.
Source: Staff estimates.

Figure 36: Sensitivity to growth



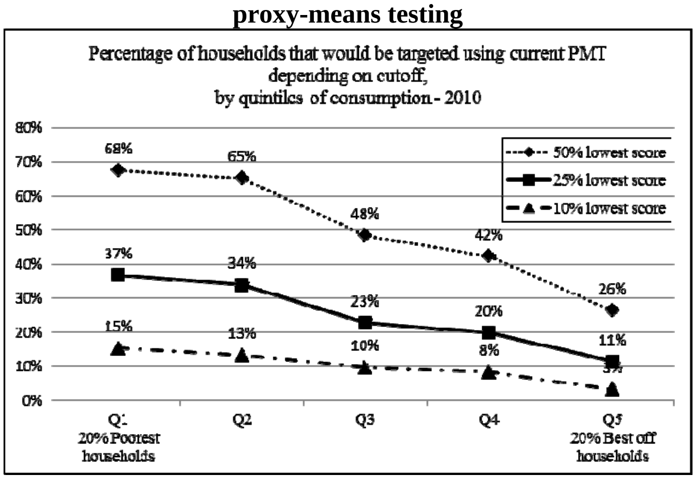
	2002	2011	2014	2016	2020
a1	56.6	56.9	54.8	53.7	51.5
b	56.6	56.9	52.2	49.4	44.4
c1	56.6	56.9	49.8	46.1	38.7

a1- 2.5% growth,
b 5% growth (baseline) ,
c1 7.5 growth

Social protection can play a major role in eliminating extreme poverty

44. **Because of the magnitude and depth of poverty in Lesotho, and stagnation in the labor market, a social protection reform is needed.** Lesotho spends about 4.6 percent of GDP on social protection transfers, but most of them do not target the poor. According to World Bank (2013), Lesotho spends about US$197 million annually in social transfers, or roughly US$104 per person. If this amount were targeted to the poorest 25 percent of the population, it would provide a transfer of about US$319 per person, an amount almost equal to poverty-line income.[13] In other words, the total amount Lesotho spends annually on social assistance would be more than enough to completely close the consumption gap and eradicate poverty. If all social safety net programs were targeted through a proxy-means testing method, the incidence of the social assistance would improve dramatically (Figure 37). Depending on the selection criterion, we would have up to two-thirds of individuals in the first two quintiles of the income distribution receiving benefits—a sharp improvement from the 5 percent to 6 percent currently receiving benefits.

Figure 37: Incidence of all Social Protection Programs by quintile of income distribution if targeted via proxy-means testing



Source: CMS/HBS 2010.

Job creation and skills are the key for poverty reduction

45. **While social protection plays an important role in reducing poverty and inequality, it will not be sufficient and will not be sustainable.** Based on the poverty analysis, broad-based job creation is needed. However, a job will not be a sufficient condition to lift people out of poverty. It will also require higher labor productivity, which puts the focus on improving the skills of the labor force. At the heart of the problem is the need of new growth model capable of creating the employment opportunities necessary to ensure the sustainability of poverty elimination and shared prosperity. Chapters 3 and 4 explore the potential for greater employment generation in more detail, assessing the macro environment for sustainable inclusive growth and the micro environment for individuals and groups to take advantage of growth to create productive employment opportunities and improve human development outcomes.

[13] Based very roughly on 525,000 people, a rough poverty line of US$340 (based on a recent UNDP estimate of M200 per month), and program operating costs of about 15 percent.

3. ASSESSING THE DRIVERS OF GROWTH IN LESOTHO

Eradicating extreme poverty and ensuring shared prosperity in a sustainable way requires strong broad-based growth. But as this chapter will show, the nature of growth will need to change from a model driven by the public sector to one that is private sector-driven, export-oriented, and job creating.

3.1 AN OVERVIEW OF LESOTHO'S GROWTH MODEL AND ITS CHALLENGES

46. Lesotho has undergone changes over the past three decades, adjusting to new realities and shocks. The economy has grown at an annual rate of 2.5 percent per capita—modest for its income level but comparable to the rest of the SACU region, the African continent, and small states.[14] The economy has adapted to new realities and taken advantage of new growth opportunities. The changes have involved shifts from subsistence agriculture and remittances toward mining, water exports, manufacturing exports, and services.

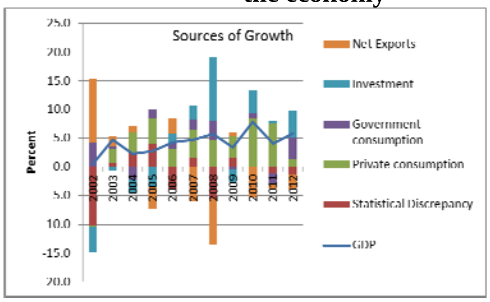
47. Over the past decade, the economy's drivers shifted from net exports to consumption and investment, led by government (Figure 38). Exports were the most dynamic component of aggregate demand in 2001-06, with annual average growth of 16.6 percent. During this period, economic growth benefited from expanding world trade; however, global export demand declined during the international financial crisis, and public spending and private consumption became Lesotho's main growth engines in 2008. The expansion of government spending on the back of volatile SACU revenues during these years partly offset the export slowdown—until government spending also fell victim to the international crisis. The crisis first had a negative impact on South African imports and later on SACU transfers to Lesotho. In response to the important decline in SACU receipts in 2010, the government cut its budget by 10 percentage points of GDP. The following year, however, the government continued its expansionary fiscal stance. Since 2012, government spending has been the main engine growth, driven primarily by higher government wages and investment. Over this shift in the drivers of growth, poverty has stagnated and inequality has increased.

48. From the supply side, the economic structure changed from manufacturing and agriculture, the largest employers, to mining, construction and government services (Figure 39). Over the past two years, growth has been driven largely by the construction sector, led by the ongoing Metolong Dam project and other government building and construction activities.[15]

[14] Small states are defined as sovereign countries with a population of 2 million or less. Favaro, Edgardo M., (2008), *Small States, Smart Solutions*, World Bank Press, Washington D.C.

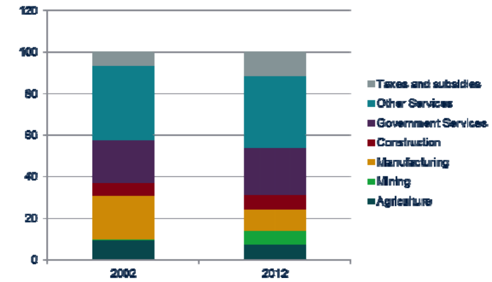
[15] The Metolong Dam and Water Supply Program's main objective is to supply treated water for domestic and industrial use to Maseru and the neighboring towns of Roma, Mazenod, Morija, and Teyateyaneng.

Figure 38: Consumption and investment are driving the economy



Source: WDI and GoL.

Figure 39: The economic structure changed over the past decade



Source: WDI and GoL.

Public spending cannot drive the economy forever

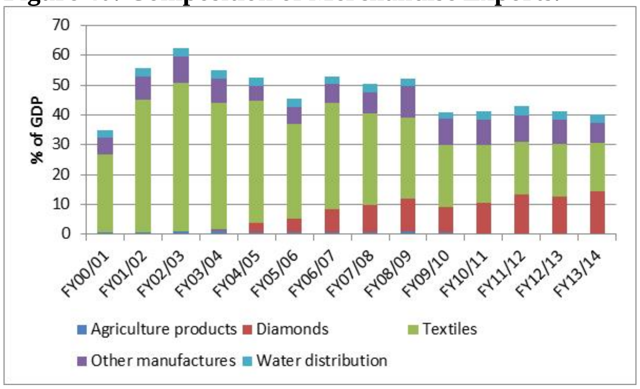
49. GDP growth since the crisis has been robust, averaging 5 percent between 2008 and 2013—almost twice the global average. The existing growth model's main problems center on sustainability and inclusiveness. Public spending cannot remain at its current level without posing a threat to macroeconomic stability. This issue will be discussed in more detail in Chapter 5. In this chapter, the focus will be on the current growth model's inability to generate the necessary jobs to eradicate extreme poverty and improve shared prosperity. Government is already the formal economy's largest employer, with a payroll of more than 50,000 persons. Mining is one of the fastest growing sectors of the economy, but it is a capital intensive sector that provides only about 2,000 jobs. To understand where growth will come from, we need to examine what happened to net exports over the past decade.

Why did net exports decline?

50. Over the past decade, net exports declined significantly. From a peak of 62 percent of GDP in FY2002/03, exports have fallen below 50 percent since FY2009/10 (Figure 40). Imports show a similar pattern, declining from a peak of 108 percent of GDP in FY2002/03 to 84 percent of GDP in FY2013/14.

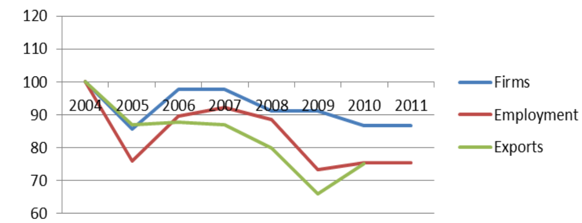
51. During 2000-10, textile exports drove the decline in exports. They dropped from a peak of 49.6 percent of GDP in FY2002/03 to 16 percent of GDP in FY2013/14. Water exports remained at about 2.8 percent of GDP over this period and agriculture products at about 0.6 percent of GDP. Diamonds exports increased from 3.3 percent of GDP in FY2004/05 to 14 percent of GDP in FY2013/2014. Other manufacturing exports fluctuated between 6 percent and 10 percent of GDP over this period.

Figure 40: Composition of Merchandise Exports.



Source: GoL.

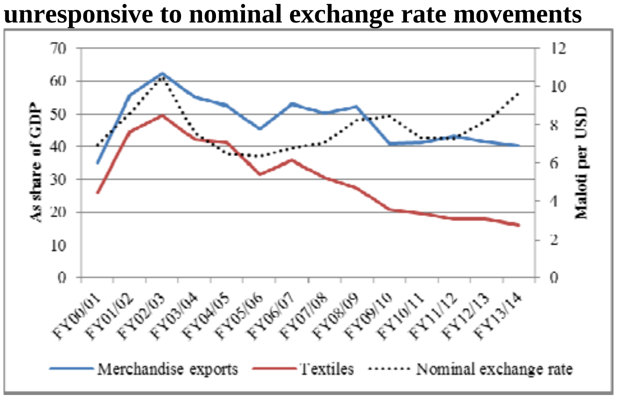
Figure 41: Index of performance in apparel sector: firms, employment, and exports (2004=100)



Source: Lesotho Textile Exporters Association, CBL 2010, Bennett 2006, Lall, 2000, Morris and Sedowski 2006, field work March 2012; includes apparel, textile and finishing (embroidery, screen printing and laundry).

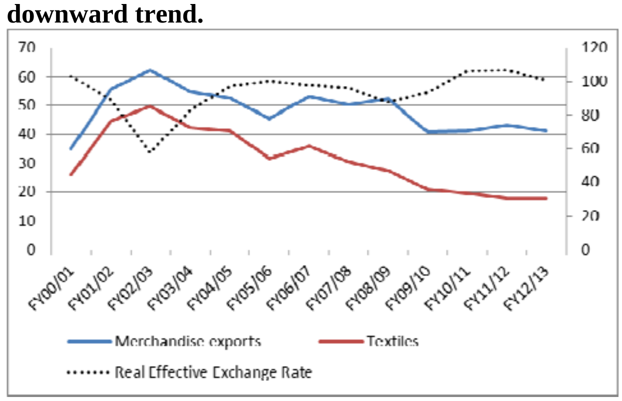
52. **Textile and clothing exports have been decreasing steadily.** Exports, employment, and the number of firms in the apparel sector reached their highest levels in 2004. After that, the phase-out of the Multifiber Arrangement (MFA) resulted in a major decline in US apparel imports from the whole of sub-Saharan Africa, including Lesotho (Kaplinsky and Morris, 2008). The decline was aggravated by other factors, including lack of clarity over the extension of the third country fabric (TCF) derogation[16] under AGOA in 2004 and the rapid appreciation of the rand[17] (Morris and Sedowski 2006, Figure 42). Figure 43 shows that the real exchange rate moved back to parity after 2004, and textile exports continued their downward trend, suggesting that other factors were instrumental in the industry's deterioration. According to Lall (2005), Lesotho's labor productivity is low, ranging from 30 percent to 70 percent of East Asia's. According to the World Bank (2012), internal factors such as relatively low productivity in Lesotho's firms and infrastructural challenges, particularly related to water supply and treatment, transport, logistics and customs, played a role in the sector's decline after 2004.

Figure 42: After 2004, textiles exports have been unresponsive to nominal exchange rate movements



Source: WDI.

Figure 43: After 2004, REER appreciated and moved back to parity and textile exports continued its downward trend.



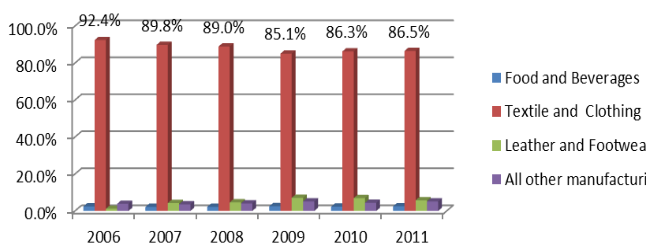
Source: WDI.

[16] The TCF under AGOA allows selected countries to source fabric from anywhere in the world and still maintain the AGOA trade preference. In the absence of TCF, countries are required to source fabric from within the region in order to qualify for the AGOA preference.

[17] Between mid-2003 and 2006, the rand strengthened from R12 per US$1 to R6 to US$1. The maloti is pegged 1:1 against the rand.

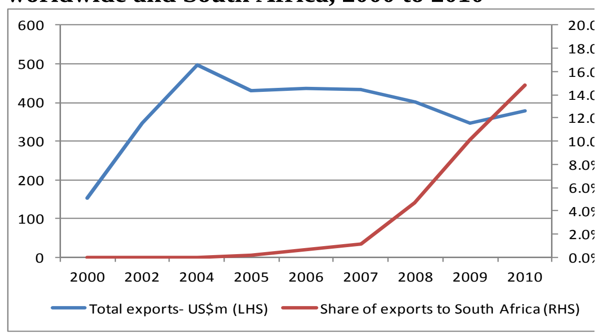
53. Lesotho managed to avoid a collapse of exports, partly through external events, including extension of AGOA TCF derogation through 2015 and the Duty Credit Certificate Scheme (DCCS) in the context of SACU,[18] and partly through government initiatives, including a reduction in the corporate tax rates (from 15 percent to 0 percent for export firms outside SACU and 10 percent for firms producing for the SACU market) and several multi-stakeholder lobbying efforts in the US. But exports to the US dropped off considerably once again after 2008 as a result of the ending of the China safeguards and, more important, the global economic crisis (Figure 41). Exports to the US decreased by 11 percent in 2008 and 18 percent in 2009. While textile and clothing employment had stabilized in the range of 45,000 to 47,000 workers in the late 2000s, it fell to 38,880 in the third quarter of 2011, still accounting for 86.5 percent of total employment in the manufacturing sector (Figure 44).

Figure 44: Share of manufacturing employment by subsector (%)



Source: Performance of the Manufacturing Sector in Lesotho—Third Quarter 2011, BoS, Lesotho, March 2012.

Figure 45: Development of apparel exports worldwide and South Africa, 2000 to 2010



Source: World Bank (2012).

54. According to the World Bank (2012), a key factor preventing further decline in the apparel sector has been significant growth in investment and exports targeting the South African market. This has occurred through the relocation of South African manufacturing activities to Lesotho, mainly to take advantage of cheaper labor. Between 2006 and 2010, apparel exports from Lesotho to South Africa increased 20-fold to US$46 million. Exports to South Africa now represent close to 15 percent of Lesotho's total textile exports (Figure 45), highlighting the significant scope for Lesotho's sales to South Africa to continue growing considerably. Notwithstanding these positive developments, Lesotho's apparel export industry remains vulnerable in the context of increased competitive pressures—most notably from Bangladesh, Cambodia, and Vietnam—in both the US and the South African markets. Lesotho has deficiencies with regard to productivity and skills at the firm level. The sustainability of the apparel sector seems to be at risk, creating a need to diversify the export basket. The textile industry's backward linkages to the local economy were limited.

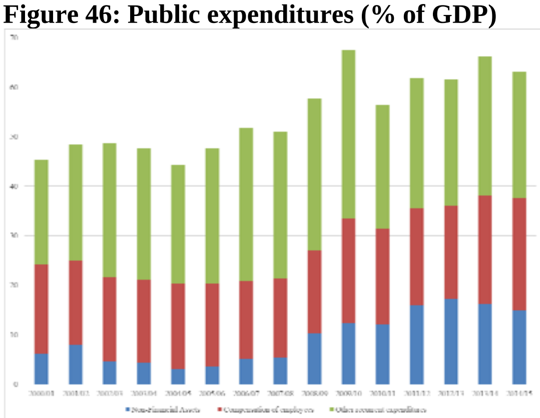
Why haven't exports picked up since the global crisis?

55. The policy of maintaining a high level of public spending seems to be negatively affecting the private sector's competitiveness. Over the past few years, the large inflows from volatile SACU receipts were absorbed mostly by government consumption, particularly

[18] Many firms indicated in firm-level interviews that the DCCS was crucial for their survival after the MFA ended.

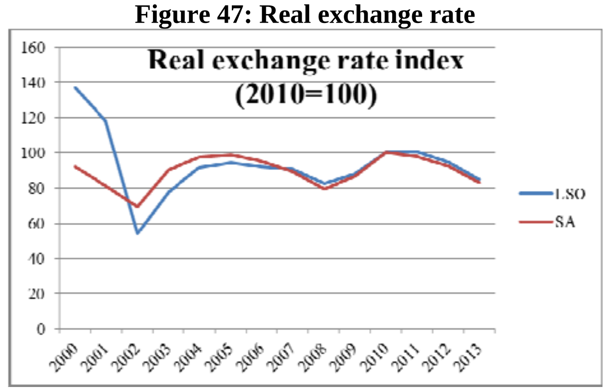
compensation of public employees (Figure 46). The maloti is pegged to movements in the South African currency, and real effective exchange rates are largely driven by rand, which has caused nominal effective rates to depreciate in recent years (Figure 47). For Lesotho, the spending of these inflows by the government has led to a rise of the relative price of non-tradables to tradables (Figure 48). As a result, the private sector's share of total investment has declined (Figure 49).

Figure 46: Public expenditures (% of GDP)



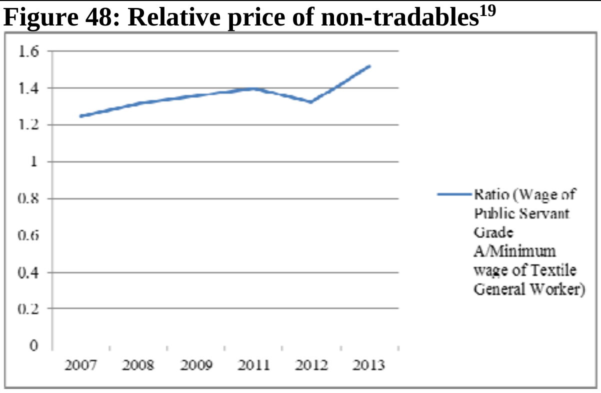
Source: GoL.

Figure 47: Real exchange rate



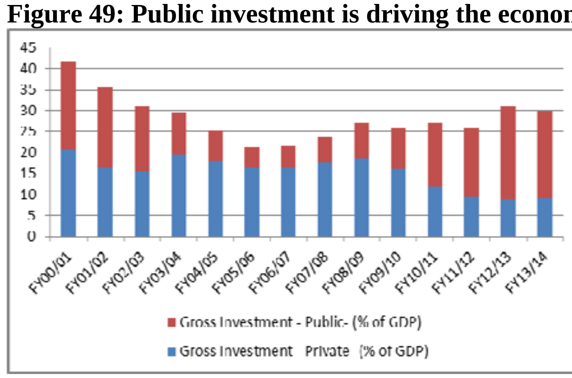
Source: WBI.

Figure 48: Relative price of non-tradables[19]



Source: GoL.

Figure 49: Public investment is driving the economy



Source: GoL.

56. Changing the existing growth model will require a strong political consensus within the system. From a political economy point of view, the winners of the existing growth model are public employees, politicians, and domestic businesses focused on local non-tradables and government contracts. Changing the model requires redefining the role of the state. This process not only entails reducing the size of the public sector but also changing the composition of public spending and its interventions with the private sector (discussed in the subsequent sections of the report).

[19] Producer Price Index data is not available. The largest formal employer of the non-tradable sector is the government and the largest employer of the trabable sector is the textile industry. Wages are used as proxy for the price of output of both the tradable and non-tradable sectors.

Lesotho can grow faster by improving total factor productivity

57. Improving the prospects for high levels of sustained and broad-based growth in Lesotho will require greater productivity and investment. Using a Cobb-Douglas production function, growth can be decomposed into capital accumulation, labor force growth, and TFP increases.[20] TFP averaged 1.1 percent during 2001-10, but then it declined to 0.7 percent in 2011-13 (Figure 50). Over the past decade, Lesotho's public and private investment have been relatively high by international standards, averaging 28 percent of GDP. Keeping labor force growth at the historical rate of 1.1 percent a year, Table 4 shows a number of scenarios of how investment and TFP generate given GDP growth rates. With investment of 30 percent of GDP and a labor force growth of 1.1 percent a year, achieving economic growth at the NSDP target of 7 percent a year will require annual TFP increases of 4.9 percent. Over a sustained period, such a TFP growth rate is high by international standards.

58. Historically, investment productivity has been low, but it has been increasing recently. The incremental capital-output ratio (ICOR) was a relatively high 13.3 for 1980-2010.[21] It was 7.9 in 2001-10 and 6.3 in 2004-10, suggesting productivity improvement was picking up speed toward the end of the decade. Most of public capital investment was largely donor-financed and administered. However, Lesotho's ICOR still trailed other small states and developing countries in sub-Saharan Africa. Government processes for project selection, appraisal, and monitoring are relatively weak.

59. Education and HIV/AIDS are important factors shaping the marginal productivity of labor and thus economic growth. Figure 51 shows how education has been positively contributing to the marginal productivity of labor over the past five decades. At the same time, HIV/AIDS has been a negative. It will be important to improve the skills of the labor force and reduce the high HIV/AIDS prevalence rates. Weak TFP appears to reflect inefficient inter-sectoral allocations, with labor concentrated in the economy's lowest productivity sectors (Table 5).

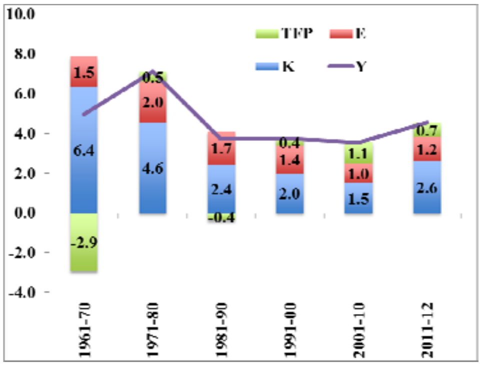
[20] $Y = A\,K^{\alpha}\,L^{1-\alpha}$

$\Delta Y/Y = \alpha(\Delta K/K) + (1-\alpha)(\Delta L/L) + \Delta A/A$

Human capital has been incorporated as part of labor force growth.

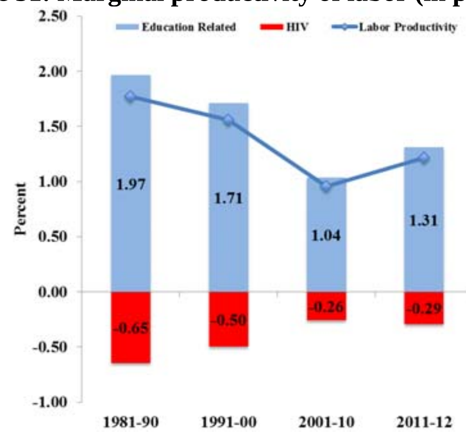
[21] In most countries, the ICOR is in the neighborhood of 3.

Figure 50: TFP grew when manufacturing was driving the economy; as the drivers changed, TFP declined



Note: E= Effective Labor Units
Source: Staff estimates.

Figure 51: Marginal productivity of labor (in percent)



Source: Staff estimates.

Table 4: Growth scenarios

Lesotho: Growth Scenarios 2013-2017

Real GDP Growth (%)	Investment (%GDP)	TFP Growth (%)
3.0	25.0	1.4
3.0	30.0	1.1
3.0	35.0	0.8
3.0	40.0	0.5
5.0	25.0	3.3
5.0	30.0	3.0
5.0	35.0	2.7
5.0	40.0	2.4
7.0	25.0	5.2
7.0	30.0	4.9
7.0	35.0	4.6
7.0	40.0	4.3
9.0	25.0	7.1
9.0	30.0	6.8
9.0	35.0	6.4
9.0	40.0	6.1

Source: Staff Estimates.

Table 5: Low productivity in largest employers sectors

Sector	Employed	Share of labor	Value added per worker (USD)
Agriculture, Hunting, Fishing and Forestry	44,039	7.1	2,713.6
Mining and Quarrying	42,933	7.0	3,214.0
Manufacturing	65,472	10.6	4,325.4
Electricity, Gas and Water	2,181	0.4	28,194.5
Construction	41,263	6.7	1,796.0
Wholesale and retail trade	44,420	7.2	2,758.6
Hotels and Restaurants	4,212	0.7	4,659.9
Transport storage and communications	12,126	2.0	7,524.8
Financial Intermediation	2,438	0.4	40,445.2
Real estate	1,230	0.2	157,376.6
Public Administration and defense	23,765	3.8	6,865.9
Education	21,931	3.6	5,521.5
Health and social work	7,527	1.2	3,282.3
Other community, social and personal serv.	7,897	1.3	2,049.5
Private households with employed persons	39,419	6.4	
Extra-territorial organizations	655	0.1	
Subsistence farming	253,999	41.1	
Not stated	2,224	0.4	
Total	**617,731**	**100.0**	**2,419.4**
Formal	230,000	37.2	
Informal	387,731	62.8	

Source: BoS (2008).
Note: Only about 3,000 people work in the mines in Lesotho. The rest work in South Africa.

3.2 IDENTIFYING THE CONSTRAINTS FOR BROAD BASED GROWTH

60. By using the Inclusive Growth Diagnostic Framework, we identified that the main factors limiting returns to labor and jobs in Lesotho: a lack of skills, high burden of disease (discussed in chapter 4), poor investment climate, and a lack of key infrastructure. Cross-country evidence has shown that these factors usually impact economic performance (World Bank (2014)).

Low skills

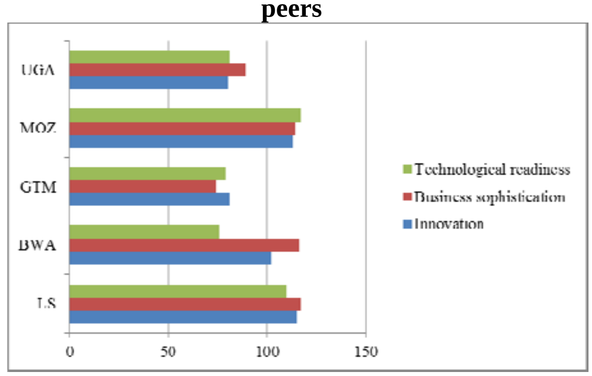
61. Low skills levels seem to be a constraint on existing industry and on investing in new areas. According to the *Investing for Changing Economy: Skill Development with Equity in Lesotho Report* (World Bank 2013), a survey conducted in 2010-11 found that employers can easily recruit plant and machine operators, craft and trade workers, skilled agricultural, forestry, and fishery workers, service and sales workers, and clerical workers. However, managers, professionals, and technicians are difficult to find. Once hired, employees still required substantial on-the-job training. Low skills have also led to low levels of technology adoption. Lesotho ranks very poorly on global measures of technological readiness and innovation. At the heart of this issue are low levels of technological use and overall business sophistication. Globally, economic growth is becoming increasingly knowledge and technology driven; upgraded skills will be necessary over the medium term for Lesotho to adjust to these changes, absorb new technologies, and better integrate into the world economy.

Table 6: Employer rankings of relative difficulty of recruiting by occupation and category, 2010

Occupation	Personal Characteristics	Core Skills	Job-related Skills	Weighted Average	Score
Managers	3	3	3	3	-60
Professionals	1	2	2	1	28
Technicians and assistant professionals	2	1	1	2	16
Clerical support workers	4	4	6	4	-128
Service and sales workers	4	6	5	5	-129
Skilled agricultural, forestry, and fishery workers	9	7	9	9	-220
Craft and related trades workers	6	8	4	7	-143
Plant and machine operators, and assemblers	7	5	6	6	-134
Elementary occupations	8	9	8	8	-218

Source: World Bank (2013).

Figure 52: Global competitiveness rankings for technology and innovation (2014)—Lesotho vs. peers



Source: Global Competitiveness Report (2014).

Knowledge Gap: Skills premium/New labor force survey

A better measure of skill shortage is the skills premium employers are will to offer in specific industries. To do such a analysis a strong labor force survey is needed. The last labor force survey in Lesotho was done in 2008. A new comprehensive labor force survey is needed to do a more profound analysis of the labor market.

Weak overall business environment

62. A number of constraints arise at each step of the process of establishing and running a business. They include:

63. The process of obtaining a construction permit is cumbersome (Box 2). According to the World Bank’s Doing Business for 2015, constructions permits in Lesotho require 10 procedures and take 179 days. These hurdles have been lowered in recent years, but they remain well above sub-Saharan Africa averages. Of the 179 days, it takes 65 days to obtain a building permit from the Maseru City Council (MCC). A series of bottlenecks starts from obtaining the environmental assessment and continues through getting an occupancy permit. The two most important bottlenecks are getting an environmental assessment for construction of more than 550 square meters and getting consent from the utility companies to issue a building permit. The government is working to address these issues, with support from the World Bank.

64. The process of starting a business in Lesotho can be further streamlined. According to the 2015 Doing Business, starting a business requires seven procedures, takes 29 days, and costs 9.4 percent of per capita income. Over the past few years, the government has taken important steps to reduce the number of days to start a business; however, it is still high compared to other countries. Enactment of the Companies Act was a step forward in reducing the number of procedures to register a new firm. However, its implementation needs to be fully rolled out in the districts. The Trading Enterprises Regulations (1999) were amended in December 2011 to make it easier to obtain a trade license by establishing a One-Stop Business Facilitation Center (OBFC) and replacing pre-inspection with post inspection for businesses with low health and environmental risks. In 2014, Parliament approved the Industrial Licensing Act of 2014. Its purpose is to facilitate and promote industrial development and micro, small, and medium enterprises (MSMEs) through a new regulatory regime that is simple, short, and cost effective. The act reduces the time it takes to obtain a license from five days to one day. This reform and others are not yet reflected in the Doing Business 2015 indicators; next year the data will be revised. Subsequently, the Ministry of Trade and Industry will submit to Parliament a bill to improve registration of sole proprietorships and partnerships. This measure will reduce the time to issue traders licenses from 15 days to one day. A reduction in the number of procedures required to start a business is typically associated with an increase in the creation of new firms. Entry reforms also have a direct positive effect on employment and productivity because increased competition from new firms encourages incumbents to become more efficient (see next sub-section).

Box 2: Process of obtaining a construction permit

To get a construction permit in Lesotho, an investor had to (i) acquire a land lease; (ii) undertake an Environment Impact Assessment (which can take up to 30 days); and (iii) submit architectural drawings with the environmental statement to the Maseru City Council (MCC). The MCC reviews the documents and, if things are in order, submits the drawings to the Lesotho Electric Company (LEC), Water and Sewerage Company (WASCO), the Road Directory, and the Lesotho Land Survey and Physical Planning office for site inspection and approval. In some cases, the site also had to be inspected by the Health Department within the MCC. These agencies take about a month to provide their clearances. They undertake site inspection at no charge, while the MCC charges a nominal fee of 0.001 percent of the structure's cost.

The main bottlenecks identified were:

- Manual delivery of hard copies of documents and drawings to LEC, WASCO, and the Physical Planning office, delaying in the process;
- Absence of GPS coordinates (geo-referencing) for the utilities, making it difficult for these agencies to locate connections and power/pipelines;
- The utility companies undertake inspections for free, so they have no incentive to speed up the process.

Once the utility companies and Physical Planning office have approved the drawings, the documents went an internal review process in the MCC.

- First, a non-technical Internal Committee within MCC, which met once a month, approved the construction permit applications.
- Then, the MCC Planning Unit issued a planning permit.
- The application was then sent to the MCC's Building Control Unit—the biggest bottleneck. In this unit, a single person handled the process, and it could take months to review an application package. Increased staffing of this unit is needed to reduce the number of days to obtain a construction permit.

65. **Trading across borders has improved, but further reforms outside the customs area are needed.** Time to import has been reduced from 49 days in 2007 to 33 days in 2013, and the number of procedures has been cut from eight in 2007 to seven in 2012. Meanwhile, costs to

import a standard shipping container rose from US$1,210 in 2007 to US$2,045 in 2014.[22] Time to export has been reduced from 44 days in 2007 to 31 days in 2013. Despite the improvements, Basotho producers and consumers still pay high trade transactions costs. To improve cross-border trading, the government has drafted a Customs Modernization Strategy. It provides a longer-term framework for coordinating and aligning customs-related activities, including the introduction of an integrated border management approach to align numerous border agencies. However, some export and import delays are not in the custom process; rather, they arise in the preparation of documents, ports and document handling, and inland transportation. Finally, cargo-handling is an issue.

66. **Weak contract enforcement and corruption impede the effective protection of investor rights.** Lesotho's contract enforcement system is inefficient and unreliable. Doing Business (2014) ranks Lesotho 115th out of 189 countries on contract enforcement. According to the report, it took an average of 615 days and cost 31.3 percent of a claim's value to enforce a commercial contract.[23] Evidence from around the world suggests that better contract enforcement shapes the business climate in two key ways. First, it is important for attracting investors. Second, it makes it easier for businesses to effectively operate and expand their networks and markets by engaging new customers and borrowers. Lesotho has made some reforms in this area, launching a specialized commercial court in 2011. Corruption is also a big issue. According to the 2009 Enterprise Survey, corruption is the second biggest obstacle to business in Lesotho. In addition, according to the survey, 72 percent of the large manufacturers reported that they were expected to give gifts to public officials "to get things done." Corruption was most commonly reported when trying to obtain construction permits; it was less common in securing government services, such as getting operating licenses or import licenses, or when dealing with tax authorities.[24]

67. **Access to finance is limited.** Credit use is increasing, but it is still low compared to other countries. The ratio of private-sector credit to GDP—a key indicator of financial sector performance—has grown from 12.3 percent at the end of FY2010/11 to 17.3 percent at the end of FY 2012/13, with private sector credit growing 42.2 percent in nominal terms. However, this level remains significantly below the sub-Saharan Africa average of 58 percent of GDP. The financial system is characterized by excess liquidity. Instead of lending domestically, banks invest this excess liquidity in government securities or export it to South Africa. Credit is split almost evenly between households and businesses. The corporate sector has adequate credit to fund their investment needs. Lending is limited not by supply but by demand because many of Lesotho's corporations can fund investment projects through retained earnings. Many

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[22] To make the data comparable across economies, Doing Business indicators use several assumptions about business and traded goods. The business: (i) is of medium size and employs 60 people; (ii) is located in the periurban area of the economy's largest business city; and (iii) is a private, limited liability company, domestically owned, formally registered, and operating under commercial laws and regulations of the economy. The traded goods: (i) are not hazardous and do not include military items; (ii) do not require refrigeration or any other special environment; (iii) do not require any special phytosanitary or environmental safety standards other than accepted international standards; (iv) are one of the economy's leading export or import products; and (v) are transported in a full 20-foot dry-cargo container load.

[23] http://www.doingbusiness.org.

[24] Enterprise Surveys (http://www.enterprisesurveys.org), The World Bank.

corporations are part of international firms, with access to South African and international financial markets.

68. SMEs' access to finance has been poor, but it is now improving because of important changes in the lending environment that reduce risk for banks. Ongoing land administration reform has greatly increased the availability of leasehold titles and streamlined the process of registering mortgage securities, leading to rapid growth in mortgage lending. Civil law reform, including establishment of commercial courts and streamlined small-claims procedures, have improved the climate for both SME and household lending. These reforms have been bolstered by moral suasion to encourage banks to invest more of Lesotho's savings domestically. At the same time, continued low interest rates have encouraged banks to seek higher returns by growing their loan portfolios. All these factors have contributed to a sharp increase in the banking system's domestic loan-to-deposit ratio and a corresponding decrease in the portion of bank assets invested abroad, primarily in South Africa. The government adopted a Financial Sector Development Strategy in 2013.

Infrastructure gaps

69. High-quality infrastructure is a pre-requisite to attracting investment and thus necessary for growth and job creation. In 2014, Lesotho ranked No. 133 on the logistics performance index. In particular, Lesotho scored 2.35 out of 5 in terms of infrastructure. According to the 2011 Lesotho review, inland transportation costs five times more than transportation by sea. High transport costs seem to derive from poor domestic road infrastructure and high fuel costs.

70. A poor-quality and unevenly distributed domestic road network is a constraint on growth. Most of Lesotho's road network is concentrated in the lowlands, which constitute only 25 percent of the country's total area. Arterial roads connect all districts in Lesotho, but relatively fewer rural roads connect villages and towns within mountain districts of Thaba Tseka, Mokhotlong, Qacha's Nek, and Quthing that include the remaining 75 percent of Lesotho's land area and about a quarter of its population. The network connects to the South African road system through a total of 14 border posts along the Lesotho-South African border, with border posts at Caledonspoort, Ficksburg, and Maseru open 24 hours a day. Only 22 percent of Lesotho's whole road network is paved, and the rest is gravel and earth roads. Of the paved roads about 50 percent are in good condition, while about 99.5 percent of the gravel roads are in fair or poor condition. The mining and tourism sectors in the Mokhotlong district offer Lesotho's best economic potential, but are constrained by the very poor condition of district's road infrastructure, although a few bridges have been built recently. The poor condition of roads leading to the district capitals of Mokhotlong and Thaba-Tseka also constrains the access to urban markets. As a result, the 25 percent of Lesotho's population living in the mountain districts are isolated with poor access to basic services and commodities as well as market and business opportunities. Limited access through the mountain zones also prevents communication within the country, notwithstanding continuous access to ports beyond the country's surrounding borders with South Africa.

71. Limited air and railroad transportation hinder growth potential of tourism and trade. The country has scheduled international air transport service between Maseru and

Johannesburg, but no scheduled domestic air service Air transport infrastructure consists of the Moshoeshoe I International Airport, and 29 regional aerodromes and airstrips, which are sometimes used by the private aircrafts. Maintenance of the airstrips has been a challenge due to heavy rains and as a result they have deteriorated and are in urgent need of resurfacing. The only rail service available on a regular basis is a freight line from the Maseru Railway station to Bloemfontein, a railhead for the country's 2.5 kilometers of narrow-gauge rail line. Two freight trains run every day, carrying mainly cement, maize, fuel, and freight containers, making up about one-third of Lesotho's international trade in bulk goods. There has been no regular passenger service since 1989. The Maseru Container Terminal (Mascon) is a large-scale freight hub connected to Lesotho network of main roads via Moshoeshoe Road in the industrial area of Maseru. Providing a customs clearing facility for goods, the terminal has significantly improved the cost efficiency of imports and exports.

72. Electricity is a constraint on growth. About 44.3 percent of Lesotho's firms in the 2009 Enterprise Survey identified electricity as a major constraint, compared to 49.3 percent in sub-Saharan Africa. However, the number of reported outages was small in Lesotho. According to the World Bank's Doing Business 2014, it takes 125 days to get electricity in Lesotho and costs 1,991.9 percent of per capita income. In OECD countries, it takes 89 days and costs 79.1 percent of per capita income. The Lesotho Electricity Company (LEC) is presently the country's monopoly transmitter, distributor, and supplier of electricity. The Lesotho Highlands Development Authority (LHDA) is the main electricity generator through its Muela Hydropower Station. Muela generates 72 megawatts (MW), and Lesotho requires about 140 MW (winter, 2011). As a result, Lesotho has to import about 68 MW—40 MW from Mozambique and 28 MW from South Africa. In the mining sector, only Letseng has access to electricity from LEC, while other mines use fuel power plants. The power line supplying electricity to the mining area has a capacity of 88 KVA (1,000 volt amps), while supplying the other mines would need more than 130 KVA. The electricity supplied in this area is imported mostly from South Africa, which at the moment doesn't have the capacity to export more. Fuel prices have increased by almost 50 percent in the past three years. As a result, some mining companies are struggling to stay open, and others have already closed down. In addition, the mining sector is located in the highlands area district of Mokhotlong, where winter access is a challenge due to snow and poor road conditions. Winter fuel storage is also challenging in the highlands. As a result of poor road conditions and weather, it is sometimes unreliable to generate electricity using fuel. For the textile sector in particular, power surges (not outages) are often very problematic, and dips in electricity can entail enormous costs and sometimes damage equipment, resulting in productivity losses. If no indication is provided regarding when electricity will be restored, workers are sent home, causing firms sometimes to miss deadlines. These power surges have damaged equipment in some footwear manufacturing firms as well.

73. Lesotho has multiple options to develop its renewable energy resources, including hydro, wind, and solar. Though the relative costs of these energy sources are likely to be higher than the current default supply (imports from South Africa) over the next five years, other factors will need to be considered in the longer term: (i) supply security; (ii) long-term tariff predictability; (iii) employment and income generation; (iv) income sources from countries willing to promote renewable energy in Lesotho; (v) the mutual commitment made by all SADC member-states to explore potential sources of domestic generation; and (vi) environmental considerations. So far, Lesotho has struggled to exploit its renewable energy resources due to a number of policy and legal framework gaps. They include the lack of: (i) an adequate policy that guides the electricity industry in relation to choices between supply security and cost; (ii) an institution that has a clear responsibility for ensuring supply security and determining a supply security target; (iii) an established tender process for the purchase of electricity; and (iv) a least-cost generation integrated resource plan.

Knowledge Gap: Energy

Lesotho has a good understanding of its power needs but relatively limited information at the moment on how to address this issue. Currently, a feasibility study is being conducted on a power generation plant linked to the Lesotho Highlands Water Project Phase 2. However, there are no feasibility studies on solar generation plants.

74. **According to World Bank (2012), lack of availability of factory shells and serviced industrial sites is a major constraint to investors.** Foreigners can rent factory shells from the Lesotho National Development Corporation (LNDC). However, LNDC has a shortage of serviced factory shells, and building new factory shells requires additional resources to invest in key infrastructure, such as roads, water, sewage, and electricity. In addition, adding to the supply of factory shells/production space for investors is exceptionally slow, with delays sometimes exceeding one year. Subleasing from the private sector is now possible under the Land Act of 2010. However, current subsidized LNDC factory rental rates don't give private developers a chance to earn an economic return on their investments. According to the World Bank 2012, current rents for LNDC industrial tenants run between M7 and M10 per square meter; however, an economic return to cover the initial capital costs and ongoing maintenance is estimated at M30 to M35 per square meter. While the reason for this low rent policy stems from wanting to remain competitive vis-à-vis Botswana, Swaziland and other rival destinations in the region , it will be necessary to revise it to encourage the private sector to play a larger role in supplying factory shells.

3.3 SECTORAL OVERVIEWS

75. **In the preceding section, we discussed the four binding constraints for broad-based growth.** In this section, we will focus on sector-specific constraints.

Agriculture

76. **Agriculture is a relatively small part of Lesotho's economy.** More than 70 percent of the population lives in rural areas, where three out of every four people are engaged in farming, herding, or both. Because labor is much less productive in agriculture than in other sectors, the economic contribution of agriculture is small, despite the large number of agricultural workers. An International Food Policy and Research Institute (IFPRI) study found that Lesotho was one of only seven African countries in which TFP in agriculture has actually declined. Agriculture's contribution to GDP has declined significantly over the past three decades—from 21.4 percent in 1982 to 7.5 percent in 2013. The sector is losing competitiveness, and the value of agricultural exports has declined over the past four decades. Over the same period, a large structural food deficit has emerged, with domestic cereal production now covering only about 30 percent of annual consumption requirements of an estimated 360,000 tons. As a result, Lesotho is heavily reliant on food imports, which has led the government to focus on production of food staples to

address its concerns regarding food security.[25] This in turn is one factor behind heavy public spending on input subsidies at the expense of other potentially more productive expenditures. In fact, Lesotho has as SADC neighbors some globally competitive cereal producers, and reducing trade barriers and costs is likely to be a more effective than trying to expand local production of staples as a way to improve food security. Production also has relatively low correlation across the SADC countries, implying a lot of potential for regional trade to stabilize local prices if markets are well integrated.

77. Lesotho's resource endowments and agro-climatic conditions limit many areas' production potential. One basic constraint is the scarcity of high-quality land. Almost 70 percent of the country's land area is classified as agricultural, but only about 10 percent is suitable for crop cultivation. The rest is low-quality land suitable only for extensive livestock grazing. A second constraint is weather. Many parts of the country are subject to extreme temperature fluctuations and highly variable rainfall, making rainfed crop cultivation and even livestock production extremely risky. Ironically, given Lesotho's position as a major exporter of water, irrigation potential in the country seems to be under-exploited.

78. Sectoral policies comprise a second set of constraints that has contributed to the poor performance of Lesotho's agricultural sector. Lesotho's "agriculture policy costs" ranking in the global competiveness index has improved a bit from 131st of 134 countries in 2009 to 100th of 148 countries in 2012, but it is worse than all but eight African countries. Traditional land tenure systems do not ensure long-term security of access and, therefore, discourage investment in land improvements; e.g., irrigation infrastructure, soil and water conservation measures, and tree planting. As a consequence, many farmers and herders have engaged in unsustainable land-management practices that have led to declining soil fertility and severe soil erosion. Because the institutions charged with agricultural research and extension have been ineffective, very few farmers have adopted improved production technologies, so productivity remains low. There also needs to be a rethink of the appropriate role of the state in supporting agriculture. As a consequence of all these constraints, high risk and a lack of resources at the farm level limit investments and make many potential farmers decide not to cultivate, leading to a high ratio of fallow land. According to the Crop Forecasting Surveys, the share of fallow land was 29 percent in FY2009/10 and 30 percent in FY2010/11.

79. Public expenditure in agriculture is both low and of low quality. Lesotho is far behind most countries in aligning its policies with the Comprehensive African Agricultural Development Program (CAADP), including the CAADP goals on public expenditure (PE). [26] Agriculture's share of the government's budget is less than half its GDP share. Per capita agricultural PE fell from US$40 to US$15 between 1995 and 2008; PE as a share of agricultural

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[25] A major problem faced by poor households is limited food availability, particularly in rural areas. At the same time, the urban poor are faced with limited purchasing power due to lack of employment and high food prices. Stunting is an indicator of long-term malnutrition that is sensitive to long-term food insecurity or poverty; it has increased from 33 percent in 1992 to about 39 percent in 2009. In addition, the country is confronted with high prevalence of anemia—at 47 percent among children 6 to 59 months, with mountain districts showing prevalence above the national average. Chronic malnutrition, including iron-deficiency anemia, is caused by a number of factors, such as poor feeding practices for the very young.

[26] The CAADP goal, according to the Maputo Declaration, is to raise agricultural spending to 10 percent of total public expenditure.

GDP fell from 37 percent to 25 percent in the same period, and the share of agriculture in total PE fell from 12 percent to 3 percent. Development partners have likewise been reluctant to support agricultural development, with the sector receiving only about 2 percent of official development assistance, half the level of the SADC as a whole and sub-Saharan Africa overall. Furthermore, a very large part of the budget goes to subsidies and staff salaries and benefits. The main beneficiaries of current subsidies and incentives are capital-intensive, high-input farmers. PE reforms should aim for down-sized, better targeted, and "smarter" agricultural support programs, with more focus on providing public goods (rural roads, research, extension, effective land administration) and less on subsidies.

80. These constraints notwithstanding, Lesotho's agriculture sector can play a role in poverty reduction. It has the potential to raise incomes but has limited potential for job creation. Global evidence indicates that agricultural growth is much more effective than growth in other sectors in reducing poverty. The challenge facing the government is to find the right combination of policy reforms, institutional changes, and supporting investments to overcome these constraints.

Knowledge Gap: Agriculture

At the heart of agriculture's inability to make a strong contribution to poverty reduction and shared prosperity is the very low rate of productivity growth in the sector, one of the lowest in Africa. It is clear that this is due to many factors, including low uptake of modern production technologies (embodied in inputs), low labor productivity, low irrigation use, land degradation, and others. But what is lacking is good analysis of what conditions and policies underlie these factors, and clear recommendations on how these could be addressed. One tool for helping to fill this gap would be an agricultural public expenditure review, which would identify whether current spending patterns correspond to the major problems. While most of these problems will ultimately need to be addressed by on-farm private investment, smart public spending is needed to create the enabling environment. Another important knowledge gap is what are the real opportunity costs (e.g., in terms of loss of net foreign exchange) of the strong policy focus on encouraging production of staple food crops at the expense of other products in which Lesotho may have a comparative advantage. This gap could be filled by a good analytical study of domestic resource costs of production of different products. Both of these kinds of studies would produce information that would be key to deciding on spending and policy priorities.

Manufacturing

81. The manufacturing sector's relative contribution to GDP declined from 20.1 percent in 2004 to 10.8 percent in 2013. The decline resulted from stagnation in the textile and apparel sector due to the global economic crisis, competition from low-cost Asian producers, rising labor costs, and the rapid growth in other sectors, notably mining.[27] The apparel sector still dominates the country's exports, accounting for about 40 percent of the total. It is also one of the economy's largest employers, providing more than 48,000 jobs in 2014. It has been particularly important in creating job opportunities for women. While the sector is by no means collapsing, it has been stagnant in recent years. Sustainability remains a major concern because the AGOA will be phased out, and major buyers are consolidating their global supply chains. A major factor preventing the collapse of the sector has been the relocation of South African manufacturing activities to Lesotho to take advantage of cheaper labor. FDI from South Africa increased from US$269 million in 2007 to US$757 million in 2010. Despite this positive development,

[27] GoL, 2011.

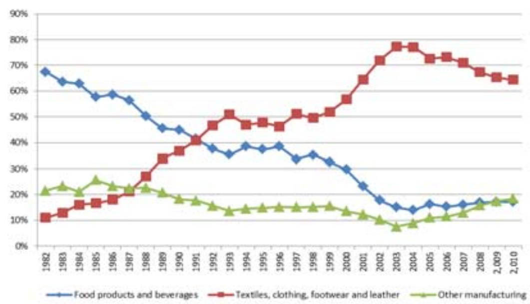
Lesotho's apparel export industry remains vulnerable to increased competitive pressures from Cambodia, Bangladesh, Vietnam and other suppliers in both the US and South African markets.

82. The manufacturing sector has the potential to raise incomes and generate jobs, but it must overcome some important constraints. We have already covered some of them, such as the weak investment climate, lack of infrastructure, high burden of disease, and lack of skills. The World Bank (2012) identified these additional constraints:

- *Uncertainties regarding labor regulations:* Several investors cited concerns over unclear policies regarding work permits. For instance, there was no guideline available to investors that specified the ratio of domestic to foreign workers required in a firm in a given sector—and, in fact, firms in the same sector were quoted different ratios. This created significant uncertainty over hiring and work-permit renewals for expatriate labor.

- *Insufficient aftercare of factory shells*: Concerns were raised over the lack of aftercare of factory shells (in Maseru, Maputsoe, and even Thetsane) and the lack of adequate fire and emergency exits. LNDC was cited as being very helpful during the initial setting up of factories. However, the feedback from firms suggests that LNDC undertakes regular surveys, but follow up was lacking in terms of maintenance and upkeep.

Figure 53: Diversification within the sector is needed
GDP contribution of manufacturing subsectors
(as a share of total manufacturing output)



Source: World Bank (2012)

Mining

83. Since industrial mining of diamonds resumed in 2004, the mining sector has emerged as the economy's fastest growing sector. Diamond production is becoming an important source of growth in Lesotho, accounting for nearly 7 percent of GDP in FY2010/11, up from 0.5 percent in the early 2000s.[28] The sector contributes significantly to tax revenues and export earnings. However, the industry is very capital intensive, and its 2,000 workers do not contribute significantly to total employment. Mining operations have some backward linkages to the rest of the economy through demand for goods and services and the use of utilities. Forward linkages are weak because diamonds are exported (by air) to foreign cutting and polishing

[28] IMF Staff Report for 2012 Article IV consultations.

centers. However, construction minerals are mainly used in Lesotho for brick-making, road construction, or processing into building materials.

84. A number of constraints hinder Lesotho's development as a mineral producer. These include (i) the general operating environment in which mineral operations take place, with notable infrastructure deficiencies, such as roads and power and (ii) regulatory and institutional arrangements that are severely stretched in terms of capacity, which can pose direct risks both to investments and to the mining sector's beneficial impacts on Lesotho's development.

Water

85. Water is one of Lesotho's most important renewable assets.[29] The combination of high altitude, abundance of water, and geographic proximity to major demand centers in southern Africa makes water central to long-term economic growth. Within this context, the water sector contributes roughly 4 percent to overall GDP, a large portion of it derived from revenues associated with the Lesotho Highlands Water Project (LHWP), one of the world's most ambitious water-transfer projects. The LHWP has brought significant development gains to Lesotho, allowing the country to transform water resources into export revenues for poverty reduction and economic stabilization. In addition, it helps South Africa develop the lowest cost water supply for the dry Gauteng region. This is achieved through the transfer water from the water-rich Lesotho highlands to the Gauteng region through a series of dams, transfer tunnels, and associated infrastructure. In addition, the project includes development of hydropower resources to supply electricity in Lesotho.

86. LHWP revenues contribute about 3 percent of GDP to the government through royalties, water transfers, and electricity sales. The benefits are likely to increase over the medium term. From 1994 to 2006, LHWP Phase 1 expenditures and revenues totaled M12.785 billion, or about three times Lesotho's total GDP of M4.175 billion in 2002. LHWP benefits are split between Lesotho (56 percent) and South Africa (44 percent), with South Africa saving on the project's lower cost compared to domestic alternatives and Lesotho benefitting from royalties, ancillary developments, and hydropower. Royalties are based on a fixed portion paid over 50 years, reflecting the lower capital cost compared to the alternative Orange-Vaal Transfer Scheme for full delivery of 70 cubic meters per second. In addition, a variable portion reflects the lower operating, maintenance, and electricity costs based on the volume of water delivered. Currently, water transfers are 18 cubic meters per second under Phase 1A and 12 cubic meters per second under Phase 1B. Since November 1996, total revenues from water sales amounted to more than US$400 million, with an additional US$90 million in electricity sales to the Lesotho Electricity Company and another US$1 million in sales to Eskom. This will increase with development of LHWP's Phase 2, which will involve construction of the Polihali Dam, associated water transfer infrastructure, and the Kobong Pump Storage Scheme.

87. Construction of LHWP2 is expected to see investment of around M3.2 billion (2010 prices) through FY2016/17 and subsequently another M3.9 billion. The Agreement on LHWP2 was signed on August 12, 2011, and it was ratified by Lesotho in 2013. The project was officially launched on March 27, 2014. The agreement includes provisions for: (i) augmenting

[29] Given the key role of water in Lesotho and dependency on hydropower, there is a need to strengthen availability of meteorological and hydrological data and to implement early warning systems.

water transfer to South Africa through construction of a new dam and transfer tunnel and (ii) the development of hydropower resources to generate electricity to benefit of Lesotho. The water transfer assets are physically located in Lesotho but financed through a South African special purpose financing vehicle (TCTA). Lesotho will finance the pump storage scheme, principally through the export price differential between peak and lower-cost off-peak energy sources. In addition, Botswana has confirmed an interest in the possibility of transferring water from the Lesotho Highlands to the arid southern parts of its country. Together, these projects will contribute approximately 11,000 jobs annually as main construction takes place through 2020. Approximately half of these jobs will be in construction, with the rest in such indirect activities as agriculture, transport, and services. However, the majority of these jobs will be temporary, and the challenge will be to transfer skills and leverage income for sustainable employment once major civil works are completed. Delays in implementing the LHWP could also risk undermining the economic benefits of the project and limiting the development benefits that accrue to Lesotho.

Transport

88. The rugged highland areas covering three-quarters of Lesotho's land area continue to challenge the expansion of road infrastructure and the maintenance of the existing network. The domestic road infrastructure has improved markedly since independence (1966), when horseback was the primary mode of transport between villages over a network of gravel roads and bridle paths. Over the past 10 years, considerable investments have been made to improve the quality of roads, expand the urban and rural road networks, and rehabilitating existing roads. According to latest statistics from the Roads Directorate (RD), an arm of the Ministry of Public Works and Transport (MoPWT), Lesotho's road network totals 7,542 kilometers—1,629 kilometers of paved roads, 3,508 kilometers of gravel roads, 2,273 kilometers of earth roads, and 132 kilometers of other roads. Maintenance of the road network, including both routine and periodic work, is financed from the government budget's Road Fund. According to the Lesotho Road Management System (LRMS), the budget includes a rolling three-year priority investment program for the core road network to eliminate the backlog of deferred periodic maintenance, avoid further deterioration of poor roads, and preserve existing road assets. Despite increased user charges in 2005, current resources are considerably less than needs. The majority of Lesotho's unpaved road network remains in poor condition, and the road sub-sector continues to experience constraints due to inadequate funding for maintenance and institutional capacity limits.

89. Transport service provision is dominated by private taxi and bus operators; however, the isolated areas depend on inland water transport at river crossings. Transport services in Lesotho are dominated by road transport, operated mostly by the private sector. Other modes are ferry services at river crossings, animal transport, and pedestrian travel, especially in the less developed and sparsely populated mountainous areas. Road passenger services are predominantly provided by private operators of taxis and buses. The Lesotho Freight and Bus Services Corporation is the only state-owned company, which operates a small percentage of road passenger transport services, mainly in areas where volumes are low and the private sector is unable to provide profitable service. Air transport is provided on a charter basis within the country; the only scheduled international flight is provided by South African Airways. Rail transport is limited to a short stretch from South Africa to Maseru, carrying freight with no passenger service. The ferry services for river crossings play an indispensable role in remote mountain areas with no road connections and no bridges across the river. The highland areas have a total of 39 inland river crossings. At present, inland water transport services are mainly provided through publicly and privately owned aluminum row-boat river ferries, with an average capacity of eight people. The Ministry of Public Works and Transport owns and operates 44 ferries.

90. Lesotho's geographic terrain presents a challenge in road safety. Due to winding roads and particularly challenging driving conditions in the mountainous terrain, the country has a high incidence of road accidents. The National Road Safety Council (NRSC) has prioritized safety issues, including driver training, use of seat belts, and enhanced emergency and rescue services. Since road safety is not prioritized by the police and is not yet in schools curriculums, the current enforcement of traffic laws is inadequate. The development and improvement of road infrastructure must be accompanied by proper road-safety measures to mitigate any potential road accident risks due to increased traffic and/or speeds. These include better road-safety infrastructure, such as road signs, improved regulations, and enforcement of speed limits and driving under the influence.

Services

91. Services have been the biggest contributor to GDP and employment growth in recent years. Services represent close to 60 percent of GDP and employ about one-third of the economically active Basotho. Government services represents close to one-third of the services sector. Government services and construction have recently become the drivers of the economy and employment.

92. Tourism has the potential to drive inclusive growth because of its labor-intensive nature and capacity to generate income in rural areas. According to the WTTC's 2013 Travel & Tourism Economic Impact Report, Lesotho's travel and tourism accounted for 4.6 percent of GDP and employed 20,500 workers in 2012.[30] Lesotho has the potential to develop a viable and strong tourism industry. However, growth is limited by serious weaknesses in competitiveness. Lesotho ranks at 135th out of 140 countries in the World Economic Forum's Travel and Tourism Competitiveness Index (TTCI), well behind its peers (Figure 54). Among the main issues are:

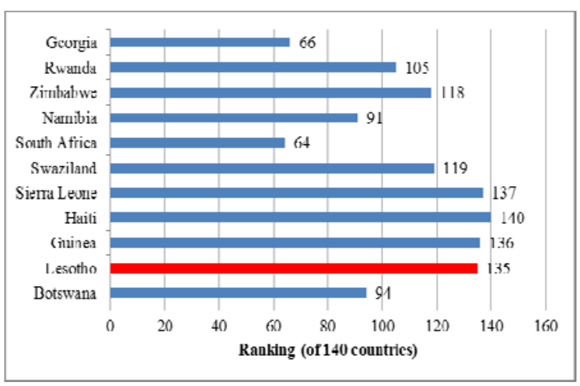
- *Skills:* The TTCI ranks Lesotho 140th among 140 countries. While this is partly driven by HIV-related issues, it also reflects lack of specialized tourism training (rank 134) and barriers to hiring foreign labor (rank 108).
- *Infrastructure:* No direct, long-haul connections are available, and regional connections are costly (rank 140). According to the NSDP, the existing accommodation facilities and attractions are not linked, and basic infrastructure is lacking on sites that have been identified for tourism investment. The road network and its quality are poor (rank 125). ICT infrastructure is limited (rank 129).

[30] This reflects economic activity generated by such industries as hotels, travel agents, airlines, and other passenger transportation services (excluding commuter services) as well as the activities of the restaurant and leisure industries directly supported by tourists.

- *Cultural resources:* The TTCI ranks Lesotho 137th among 140 countries. According to the NSDP, protection of the rich cultural heritage from destruction is limited, especially the physical assets, which threatens their existence for future generations. Disparate efforts in packaging cultural resources (museum, craft centers and theatres) also limit their use for tourism exploitation.
- *Environmental sustainability:* The TTCI ranks Lesotho 120th among 140 countries. According to the NSDP, the main causes of environmental degradation include ploughing on steep slopes and/or marginal lands by crop farmers (54 percent of croplands are exposed to sheet erosion), overgrazing of rangelands (an estimated 50 percent over-stocking of livestock), cutting of trees for fuel and other uses, and unregulated encroachment of human settlements onto prime agricultural lands. Multiple policies and plans address the key environmental and climate change challenges. However, delivery has been weak because of institutional fragmentation, duplication of efforts, insufficient cross-sectoral coordination within the government and non-governmental sectors, and weak implementation and enforcement of policies and legislation.

93. **Other Services (outside government) have the potential to raise incomes and create jobs.** India's growth pattern suggests that a shift into high-productivity services, bypassing manufacturing, represents another path to sustainable growth (Ghani, Goswami, and Kharas 2012). According to Africa Pulse (2014), services growth in Africa has been more effective for reducing poverty than growth in industry. Modern services, such as software development, call centers, and outsourced business processes, represent high value-added activities (similar to manufactured products) that can be important drivers of growth for innovative and technology-savvy countries. Skills, good health, infrastructure, and a good investment climate will be essential to unleash this potential.

Figure 54: World Economic Forum tourism competitiveness rankings



3.4 EXPANDING TRADE AND INVESTMENT AND DEEPENING REGIONAL INTEGRATION

94. **Given the small size of Lesotho's domestic market, the private sector must look to export markets, particularly within the region, to achieve the scale required for productivity and growth.** Current policies protect local industry instead of supporting its integration with global markets. Examples of these policies include requiring government-owned food-processing industries to buy inputs from local farmers and procurement policies that favor

the goods and services of the local private sector. These efforts may have contributed negatively to the productivity, efficiency, and quality of goods and services. Lesotho needs to put greater emphasis on integrating with global markets—this is what made the country's traditional exports of textiles, water, and diamonds successful. The starting point is greater emphasis on regional trade and integration.

Regional value chain integration unexploited

95. To exploit the potential of regional trade, Lesotho should address important challenges. Despite operating within the world's oldest custom union (SACU), both tariff and non-tariff barriers increasingly restrict competitiveness and trade potential in the region. Member states, including Lesotho, use the infant-industry protection clause to block imports. Lesotho's producers face similar restrictions in trying to sell into regional markets.

Box 3. Implications of being part of SACU

SACU membership has far-reaching consequences for Lesotho's fiscal policy, macroeconomic stability, and integration into the world economy—as well as for the country's trade policy.

Fiscal Policy: Like all customs unions, goods imported from outside SACU into any member country face a common external tariff, and intra-SACU trade is free of duties, with some exceptions allowed for infant-industry protection for the smaller members. Unlike most customs unions, however, SACU members pool the customs duties and excise taxes they collect and redistribute the funds among the five member states. The revenue-sharing allocates revenue according to each member's share of intra-SACU trade, its share in total SACU GDP, and its per capita GDP relative to the SACU average. By virtue of its larger economy and seaports, South Africa collects almost all SACU revenue on its imports and its production of excisable goods (e.g., alcohol and tobacco products).[31] South Africa typically retains 45 percent to 53 percent of the common revenue pool and distributes the balance to the BLNS. This is the result of the revenue-sharing formula agreed upon in 2002, which allocates customs revenue according to each country's share of intra-SACU imports. South Africa imports little from other SACU members. There is also a development component, allocated according to the countries' GDP per capita, to assist the less-developed SACU members. SACU receipts could be considered as aid transfers from South Africa to Lesotho. Lesotho usually receives around 7 percent to 9 percent of the pool.

These transfers are large relative to Lesotho's economy. In recent years, Lesotho's receipts have averaged around 30 percent of GDP—and they have exceeded 40 percent in some years. They presently finance almost half of government spending, but it has at times been three-quarters of total expenditures. These large transfers have enabled the government to undertake spending well beyond levels consistent with domestic revenue potential, and Lesotho's public spending relative to GDP ranks among the highest in the world. Measured as a share of GDP, the capital budget is larger in Lesotho than in most other countries and, as highlighted in Chapter IV, Lesotho provides substantial social transfers to the elderly and vulnerable children. On the other hand, Lesotho's public-sector wage bill as a share of GDP is the highest in Africa and one of the highest in the world.

In addition to being large on average, SACU receipts vary considerably from year to year. Since the new formula took effect in 2004, the average annual fluctuation has been 7 percentage points of GDP. In FY2006/07, receipts increased by 16 percentage points of GDP; in FY2010/11, they fell by 25 percentage points (from 41 percent to 16 percent of GDP). SACU revenue volatility can translate into fiscal volatility in the absence of fiscal rules or similar measures. When receipts dropped precipitously in FY2010/11, so did government spending, which fell by 9 percentage points of GDP (11 percent in constant maloti). Real spending on grants, transfers, and subsidies—which

[31] According to Rob Davies, South Africa's Minister of Trade and Industry, South Africa currently pays about R48 billion to the customs union annually—around 98 percent of the common pool of customs and excise duties shared among SACU members.

includes social protection programs—fell by 20 percent that year.

Trade Policy: The 2002 SACU agreement provided for common policy-making institutions for trade. However, the BLNS have not yet established their national tariff boards, so the structure of common external tariffs continues to reflect the political and economic preferences of South Africa. Duties tend to restrict imports that compete with South African producers. A consequence is that Lesotho's producers must pay high prices for some imported inputs, making their products less competitive in world markets.

The SACU agreement allows infant-industry protection. This arguably helps politically connected firms in BLNS at the expense of consumers, and it is an expensive way to preserve or create jobs.

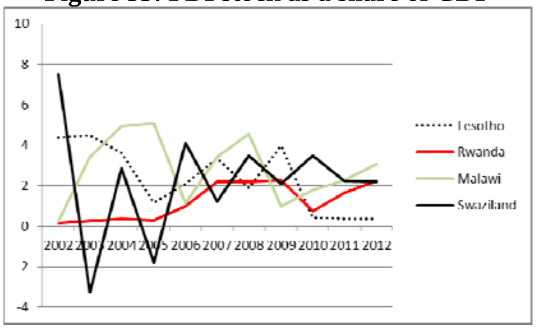
Value Chain Integration: SACU provides Lesotho with duty- and quota-free access to the large South African market, but commercial opportunities have not been exploited outside garment production. For firms in Lesotho to win buyers in South Africa or to integrate into regional production and distribution networks, improvements in Lesotho's business environment and the skills of its workforce are needed (discussed in Section III). SACU members' intention to develop a regional industrial policy may also offer local firms new opportunities.

Limited FDI

96. **Despite being landlocked, Lesotho once did well in attracting FDI to support its economic growth.** From the 1980s to 2009, investments were driven largely by construction of the Lesotho Highlands Water Project and by large inflows into the textile and apparel sector, initially from Taiwan, China and more recently from South Africa. Over this period, Lesotho was able to maintain FDI as a share of GDP comparable to other landlocked African countries (Figure 55). Since 2010, FDI has plummeted to less than one percent of GDP, one of lowest figures in the world. This decline can be explained by a large decline of FDI into the textile and apparel sector from East Asia countries. The drop would have been bigger if the country had not received the inflows from South African firms.

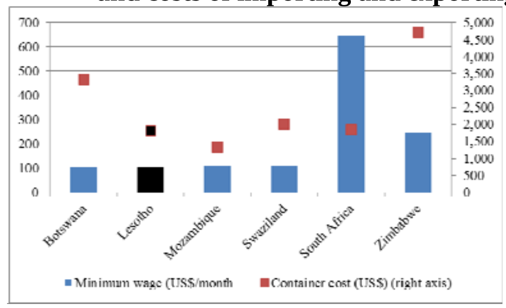
97. **In the past, some important advantages allowed Lesotho to attract significant FDI inflows in the textiles and apparel sector.** These factors included low labor costs, preferential market access (to SADC, SACU, and US markets), relatively low transport costs, and, critically, less hostile labor relations than in neighboring South Africa, reflected in fewer strikes (Figure 56). Through this FDI, Lesotho became the region's largest exporter of clothing, taking advantage of trade preferences granted in the US market under the Africa Growth and Opportunity Act (AGOA). Looking ahead, a crucial determinant of Lesotho's ability to realize new growth opportunities will be its capacity to attract and sustain foreign investments—not only from new sources such as South Africa but also in new sectors. In addition, it will be important to promote greater backward linkages to the local economy through increased spin-offs and subcontracting activities from FDI. To date, these linkages have been limited.

Figure 55: FDI stock as a share of GDP



Sources: Central Bank of Lesotho and WDI database.

Figure 56: Comparison of regional minimum wages and costs of importing and exporting



Source: World Bank, Doing Business 2014; minimum wage applies a 19-year-old worker or apprentice in US$/month; container cost takes the average for an import container and an export container (US$).

3.5 GROWTH: BRIEF SUMMARY OF MAIN MESSAGES AND KEY CHALLENGES IDENTIFIED.

98. **This chapter argues that Lesotho needs to shift its growth model from a reliance on the public sector toward a model that can deliver broad-based employment growth that will be needed to eradicate extreme poverty and improve shared prosperity.** Such a model should be built around development of strong, diversified and competitive private sector, oriented toward export markets and focused on activities where Lesotho has or can develop strong comparative advantage. In the short-to-medium term, this should be supported by a more dynamic and productive informal sector that can absorb the labor force.

99. **Building a strong, competitive, and outward-oriented private sector requires improving the absolute and relative returns to investing in such activities.** This requires: (i) reforming the role of the state and (ii) increasing returns to investment by improving the competitiveness of firms and the environment in which they operate. This chapter identified a number of issues that currently constraint the realization of this new growth model. Table 7 summarizes these issues and identifies the channels through which they impact the twin goals. This will be analyzed further in Chapter 6.

Table 7: Summary of main issues identified—Chapter 3

Area	Specific issues	Channel for impact on twin goals
Smallholder productivity	Low productivity in the agriculture sector	Raises the vulnerabilities to eradicating extreme poverty
Political	Weak political consensus to reform	Lowers private sector investment in employment-creating activities by lowering returns to investment though higher costs; lowers access to productivity enhancing spillovers
Labor supply	Skills and competency gaps	Lowers private sector investment in employment-creating activities by lowering returns to investment through lower productivity
Business red tape	Administrative and regulatory burdens	Lowers private sector investment in employment-creating activities
Competition	Policy environment, including fiscal	Lowers private sector investment in

	policy, crowds out private sector and raises inputs costs and jeopardizes quality	employment-creating activities by lowering returns to investment through higher costs; lowers access to productivity enhancing spillovers
Infrastructure	Gaps in electricity and serviced factory shells and industrial serviced sites Gaps in air connections, roads, transport services, ICT, and cross-border trade facilitation	Lowers private sector investment in employment-creating activities by raising inputs costs, limiting connectivity, limiting factory space, and lowering productivity
Access to finance	Low levels of inclusion, particularly with SMEs	Lowers private sector investment and raises vulnerabilities to eradicating extreme poverty
Technology and innovation	Low levels of technology adoption	Lowers private sector investment in employment-creating activities by lowering returns to investment through lower productivity

4. INCLUSION: BUILDING ASSETS AT THE MICRO LEVEL

Experience from around the globe has shown that growth alone is not sufficient for poverty reduction and shared prosperity. Human development is essential. Individual well-being and contributes significantly to ensuring the sustainability of economic gains. This chapter focuses on the Basotho capacity to access and build assets and to leverage those assets to contribute to growth. The government has invested substantial resources into the social sectors but has achieved poor outcomes. Lesotho could do much better within its existing budget.

4.1 HEALTH AND NUTRITION

100. Good health and access to nutrients required to remain healthy are necessary conditions for individuals to take advantage of opportunities afforded by growth and contribute to society. Over the past decade, Lesotho has seen worsening health outcomes. HIV/AIDS prevalence is among the highest in the world, coupled with a high incidence of tuberculosis (approximately 913 cases per 100,000 people) and a 74 percent HIV/TB co-infection rate. The country's HIV/TB co-epidemic is significant in that TB continues to be the first cause of death among people living with HIV/AIDS. Lesotho's Human Development Index (HDI) has worsened since 1990, dragged down a decline of more than 20 years over the past decade in average life expectancy at birth. Other indicators that are less directly affected by HIV/AIDS have also worsened and are surprisingly high for a lower middle-income country. For example, Lesotho's maternal mortality ranks in the 80th–90th percentile globally, and the country has one of the region's largest rich-poor gap in nutritional status. The government responded by allocating more resources to the sector, raising spending to more than 8 percent of GDP. However, poor budget execution has prevented full utilization of available resources. Tertiary health service has improved as a result of the establishment of the Queen Mamohato Hospital.

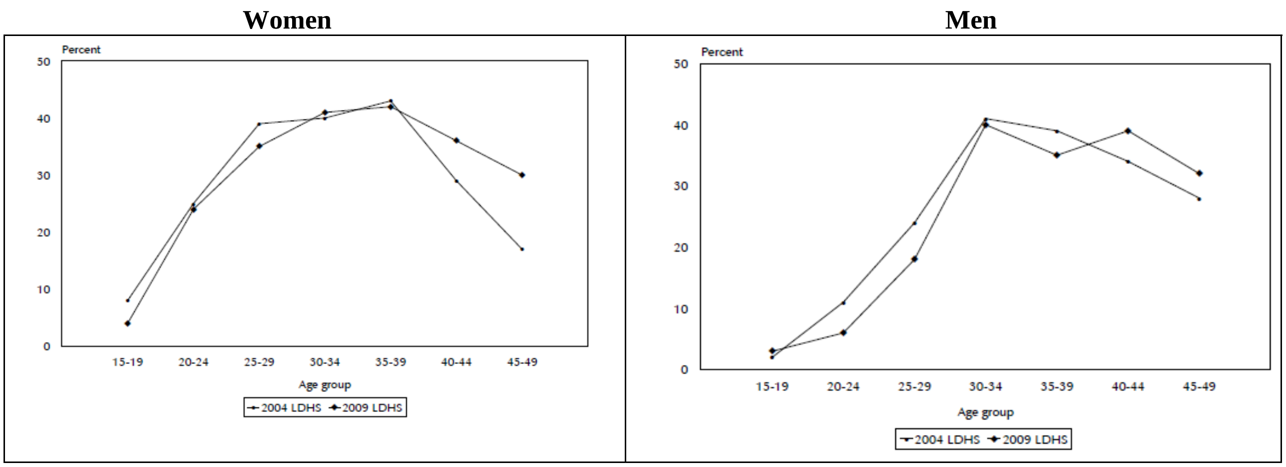
HIV/AIDS

101. HIV/AIDS is an impediment to growth and inclusion. Lesotho has the world's third-highest HIV/AIDS adult prevalence rate (23.1 percent) and a life expectancy of 49 years. Prevalence rates have remained at this level over the past decade; however, they have increased for the 40- to 49-year age cohort and decreased in the 15- to 29-year age cohort. The high HIV/AIDS rate hinders growth by undermining the stock of available labor, lowering productivity, and limiting incentives for investments in future consumption. In addition, shortened life spans resulting from HIV/AIDS may reduce demand for secondary education among poor families, who discount the value of future earnings relative to present income. In 2012, 360,000 Basotho were living with HIV (UNAIDS). According to the *Economic Diversification and the Role of FDI* (World Bank 2012), firms stated that absenteeism and high levels of sick leave are problematic and that workers are dying of AIDS-related illnesses every month. In the garment factories, HIV prevalence was estimated at approximately 33 percent in 2007. [32] Without an HIV treatment program for workers, approximately 1,500 Lesotho apparel

[32] Investing for Changing Economy: Skill Development with Equity in Lesotho (World Bank 2013).

industry employees could die from HIV-related causes each year.[33] According to the *UN Global AIDS Response Country Progress Report* (2012), the past seven years have not seen substantial changes in behavior. New infections have been increasing, particularly among women (Figure 57). This suggests behavioral modification programs have not been effective. However, coverage of HIV prevention, treatment, and care programs has expanded over the past five years, and improvements in community-related HIV prevention and control have become more visible and tangible. Finally, implementation of the current National HIV/AIDS Strategic plan has been negatively affected by an uncoordinated HIV response given the absence of a National AIDS Commission to lead and coordinate HIV prevention, treatment and mitigation efforts.

Figure 57: HIV prevalence rate, 2004 vs 2009



Source: LDHS (2009).

102. As in most countries in sub-Saharan Africa, women in Lesotho are more vulnerable to HIV/AIDS than males. The female-to-male HIV prevalence ratio of 1.4, similar to rates in Swaziland and South Africa (1.5). Of greater concern, the gender disparity in prevalence is larger among the young: the ratio for the 15-24 year age cohort is 1.8, similar to the ratio for Swaziland (1.7) but considerably lower than that for South Africa (3.3).

103. Women's greater vulnerability to HIV appears to be related to a variety of cultural and economic factors, related to the unequal power between men and women. Despite women's relatively comprehensive knowledge of HIV prevention, only 49 percent of the poorest women (and 52 percent of all women aged 15-49) believe that a woman is justified in refusing to have sex with her husband if she knows he has had sex with other women. This suggests that even with improved knowledge, women may still be in a vulnerable position unless deep-rooted social attitudes are challenged. Basotho women, especially the young, also have less access to various economic assets and are more likely to engage in transactional sex. Recent research suggests a link between these two facts: de Walque et al (2014) show that, over a four month study, non-sex worker women who experienced a negative shock to their households' food security were 36 percent more likely to test positive for a sexually transmitted infection (STI) than women who did not experience such a shock. The impact was even greater for women with the lowest social status, who have fewer alternative sources of economic support. This evidence

[33] Colcin et al (2006).

points to the importance of ensuring that women are sufficiently empowered to act as independent economic agents—for example, through the effective implementation of the legal rights provided in the Legal Capacity of Married Persons Act. This is especially important in a country where women are often separated from their husbands due to migration. In addition, a body of recent research points to the effectiveness of a range of economic incentives that target risky sexual behavior, which could be especially relevant for poor and vulnerable women (Box 4). Finally, women are not only more greatly affected by HIV in terms of higher prevalence rates, but they also because they are more likely to take on the role of primary care provider for the sick (Newman et al, 2011). Therefore, HIV exacerbates the relative time poverty that women already suffer as a result of their greater burden of domestic chores, further reducing the time they have available for market activities.

104. Increasing ART coverage combined with strengthened HIV prevention efforts will be critical for growth. According to the WHO, a potent ART regimen, particularly in early stages of the disease, results in huge reductions in rates of HIV death and suffering. Expanded ART access can also reduce HIV transmission, impact orphanhood, and preserve families. In addition, treatment reduces the risk of acquiring TB by 70 percent. Furthermore, reducing new infections is most effective, particularly when combined with other approaches, such as behavior change efforts, male circumcision, condom usage, prevention of mother to child transmission (PMTCT), and the new WHO ART regimen. Compared to Lesotho, according to the 2013 UNAIDS Progress Report on the Global Plan, "Botswana has been making strides towards eliminating new HIV infections among children (320 infections in 2012) as it maintains high levels of coverage of antiretroviral medicines (95 percent of eligible children 0-14 years old receiving ART). If progress continues, it will become one of the first countries in sub-Saharan Africa to meet this historical milestone by 2015." Lesotho had 3,700 new HIV infections among children in 2012, and three of four children are not receiving HIV treatment. In addition, ART coverage for adults stood at 66 percent. Four of 10 pregnant women living with HIV did not receive ART treatment to prevent PMTCT, and eight of 10 women or their infants did not receive ART medicines during breastfeeding to prevent PMTCT. In the medium run, eliminating new HIV infections will be critical to increasing the stock of available labor and spurring growth. Increasing ART coverage should be a government priority. Perhaps Lesotho could learn from the experiences of Botswana.[34] It has an adult prevalence rate similar to Lesotho's, but increases in ART coverage (95 percent of those eligible for treatment) raised the life expectancy of people living with the virus from 45 years in 2000 to 65 years in 2010.

Box 4. Evidence on economic incentives to reduce risky sexual behavior among women and adolescent girls

There is a growing body of evidence that points to the effectiveness of interventions that reduce risky sexual behavior among adolescent girls and women by increasing their financial independence and ability to withstand negative economic shocks.

The RESPECT program in Tanzania provided cash rewards for participants who tested negative for a range of STIs. Program participants were randomly selected to receive no reward (the control group), a small reward (US$10), or a large reward (US$20) each time they tested negative for STIs. Participants were also provided with training in sexual health and relationship skills. An impact evaluation by de Walque et al (2012) showed that after one year

[34] In Botswana, a key factor in expanding ART coverage was a social mobilization campaign that raised awareness of the availability and effectiveness of ART, which helped to reduce stigma and discrimination.

those receiving the large reward were 27 percent less likely to test positive for STIs. The authors infer that the program worked by increasing the cost of risky sex and bringing the rewards of safe sex closer to the present.

In Lesotho, the same research team is testing the impact of a pilot intervention that uses a lottery system to select a smaller number of participants to receive larger cash rewards (US$50 and US$100) for testing negative for HIV (Björkman-Nyqvist et al, 2013). Preliminary results show that HIV prevalence dropped by 22 percent across the small and large lottery groups, with a larger impact on women and those who in the larger-reward lottery. The authors suggest that the lottery model may be particularly effective at targeting the most high-risk people, making such lotteries more attractive to risk takers.

For adolescent girls, cash transfers conditional on school attendance may be an effective tool. An evaluation of a conditional cash transfer program in Malawi found that the transfers not only increased school attendance but also reduced HIV incidence (Baird et al, 2012). At follow-up, HIV prevalence was found to be 60 percent lower for those who had received the CCT than those who did not. The impact of the greater financial independence that the CCTs gave to girls is also demonstrated in results that show that CCT recipients had younger partners.

Combined vocational and life skills training programs have also shown some success in reducing risky sexual behavior among adolescent girls. In Uganda the Empowerment and Livelihood for Adolescents (ELA) program, implemented by the NGO BRAC, uses girls-only clubs to deliver vocational training (with a focus on self-employment) and life-skills training. An impact evaluation showed that the ELA not only increased girls' business skills and income generation but also reduced risky sexual behavior, with participants 44 percent less likely to have had sex against their will over the past 12 months and 25 percent more likely to report always using a condom during sexual intercourse (Bandiera et al, 2014). Moreover, the program is highly scalable; it is based on a similar intervention in Bangladesh that was successfully expanded to reach 1 million girls.

Poor efficiency and effectiveness of public spending

105. Poor budget execution has prevented full utilization of available resources. The rapid increase in allocations since 2005 has tested the MoH's implementation ability, producing low budget execution rates. In 2007-10, the average absorptive capacity was 86 percent for the recurrent budget and 69 percent for the capital budget (GoL 2010).[35] The major obstacles to improving execution rates involve deployment of human resources and procurement issues. A related issue is the perennial problem of poor coordination of capital and recurrent budget planning. Other challenges include a lack of in-year financial reporting to monitor expenditures, imperfect coordination with donors, and delayed fund releases. Steps to better absorption rates include improved management efforts, institutional development, and improved Integrated Financial Management Information System (IFMIS) utilization to monitor execution rates. Despite these challenges, this seems to be improving with 92 percent budget execution for the MoH in the 2011/12 budget.

106. Despite setbacks, access to health services has improved. For example, LDHS 2009 shows gains in indicators related to maternal care. Women delivering with assistance of a health-care professional (nurse or doctor) increased from 55.4 percent in 2004 to 61.5 percent in 2009. Women who delivered in a health facility rose from 52.4 percent in 2004 to 58.7 percent in 2009. Women who received antenatal care from a health-care professional showed slight improvement from 90.4 percent in 2004 to 91.8 percent 2009. The TB Case Detection Rate (CDR) was above 80 percent in 2008, and the Treatment Success (TS) improved from 52 percent in 2004 to 74

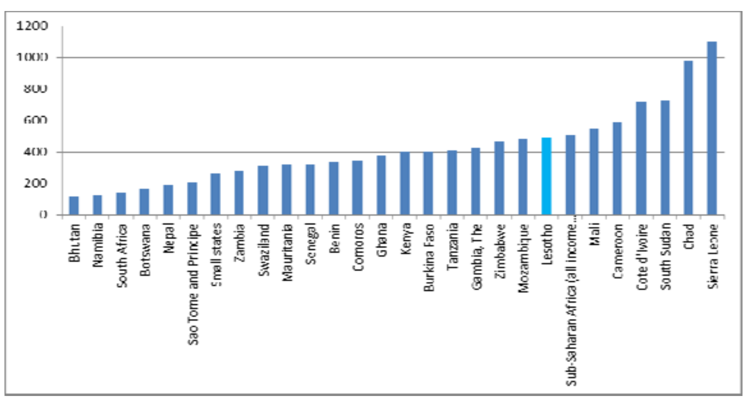
[35] Annual Joint Report, MoHSW, 2010. The absorptive capacity of the capital budget is affected by compliance to donor conditions.

percent in 2008. On the HIV/AIDS front, Lesotho showed considerable progress in expanding PMTCT. PMTCT coverage (considering mothers only) ramped up sharply from 3.1 percent in 2004 to 71 percent in 2009. The number of eligible people living with HIV/AIDS and on ART increased to 60 percent in 2010.

107. In many areas, health-care access remains an issue for the poor. LDHS 2009 showed that access to maternal care is strongly dependent on household wealth. For antenatal care, women in the lowest quintile are least likely to have seen a doctor and most likely to have seen no one. Only 35 percent of women in the poorest households took iron tablets or syrup during pregnancy, compared with 61 percent in the richest quintile. Delivering in public hospitals varied by household wealth—38.2 percent in the bottom two quintiles, compared with 75.2 in the upper two quintiles. Similarly, a large gap between rich and poor persists for measles vaccinations, ranging from 52 percent for children in the lowest quintile to 72 percent for children in the highest quintile. The percentage of children who were given vitamin A supplements to counter micronutrient deficiency in the past six months ranged from 24 percent in the lowest quintile to 44 percent in the highest quintile.

108. Low access to quality health care is reflected in a high maternal mortality rate of 490 deaths per 100,000 live births. This is an improvement from 540 in 2010. However, relative to a range of similar countries, Lesotho's performance is towards the poorer end of the spectrum (Figure 58).[36] Looking at the trend over the past 15 years, we can see that progress has not been even and that the country actually has a higher rate of maternal mortality today than it did in 1990 (Figure 59). It is clear from this trend that Lesotho will not even get close to its MDG target of 90 deaths per 100,000 live births by 2015.

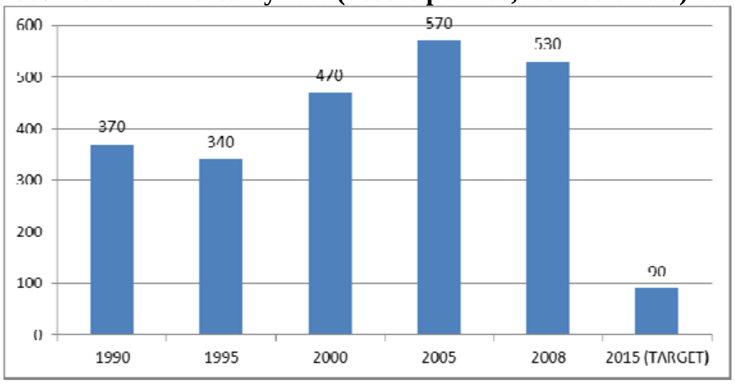
Figure 58. Maternal mortality ratio (modeled estimate, per 100,000 live births)



Source: World Bank.

[36] It should be noted that that these figures are modelled estimates from the UN and World Bank. The latest DHS figures (2009) estimate a far higher rate of 1,200 deaths per 100,000 live births. However, this represents an unusually high increase from the estimate of 762 in the 2004 DHS, leading to concern about its accuracy.

Figure 59: Maternal mortality rate (deaths per 100,000 live births) over time



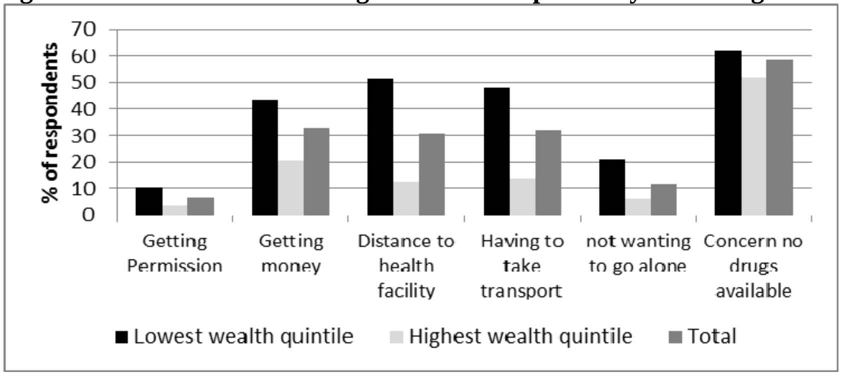
Source: UN/World Bank, 2010.

109. Low utilization of health facilities has reduced expenditures effectiveness. Data from the MoH's routine Health Management Information System (HMIS) showed 0.7 outpatient visits per capita in 2009; i.e., use of health-care facilities for a typical Basotho was less than one visit per year. This is well below the World Health Organization (WHO) norm of 3.5 visits per capita and South Africa's average of 2.3 visits per capita. Similarly, the average bed occupancy rate in 2009 was 38 percent for public hospitals and 42 percent for CHAL hospitals, compared to an optimal range of 80 percent to 85 percent (MoH AJR 2009). Low demand is hard to reconcile with the magnitude of the HIV pandemic and other pressing health-care needs. If correct, addressing the factors constraining utilization is critical to increasing the effectiveness of public-health expenditures.[37]

110. Non-availability of drugs and overall perceptions of poor quality care have emerged as significant barriers to accessing health care. LDHS 2004 had identified cost of treatment as a significant barrier to accessing health services. To address this issue, the MoH removed user charges in public and CHAL health centers and hospitals, starting in 2008. Data from the health management system, however, shows that this policy change had only limited effect on demand. LDHS 2009 also shows that "getting money for treatment" remains a serious problem in accessing health care for 33 percent of women, suggesting that costs other than user fees may be an issue. One such cost could be distance and transport, seen as access barriers in 2009 by around a third of women. Another factor could be the opportunity cost of long waiting times, reportedly one to eight hours at most facilities. According to LDHS 2009, the availability of drugs was the biggest concern in accessing health care for 58.5 percent of women (Figure 60). The response may be a proxy for a wider range of issues, reflecting service quality. This is supported by the MoH's facility-level client satisfaction surveys. The most frequently mentioned reasons for dissatisfaction were provider problems, such as lack of medicines and supplies, absent and disrespectful doctors, and long waits at facilities (GoL 2010).

[37]Reliability of administrative data may, however, be an issue, particularly on outpatient doctor's visits.

Figure 60: Problems in accessing health care reported by women age 15-49



Source: LDHS (2009).

111. **Data shortcomings prevent a deeper assessment of allocative efficiency in the health sector, but the limited data that exist suggest potential for improvement.** For example, no data have been collected on expenditures by outcome—for example, child health, maternal health, family planning, etc.—to see how this matches with the burdens of disease in these areas. HIV/AIDS is the only disease for which systematic data collection and analysis have been done. Over the FY2005/06–FY2007/08 period, an average of 42 percent of AIDS spending went to treatment and care, with 24.3 percent on impact mitigation and 21.7 percent on management coordination and support. It is particularly troubling that only 11.7 percent of AIDS spending over this period was on prevention, and for FY2007/08 the prevention share was 9.0 percent.[38] In fact, actual spending for treatment and impact mitigation tended to exceed planned expenditure by a wide margin, while allocations for prevention were usually underspent. Equally important is the high expenditure on program support, management, and coordination. A comparison of seven Southern African countries that have conducted HIV/AIDS spending assessments shows that Lesotho's expenditures on this category are among the highest. This suggests the possibility of efficiency gains through improving intra-sectoral allocations.

112. **Better information quality is necessary for understanding how to improve efficiency.** Health-facility surveys that are sample-based, nationally representative, and standardized will be an important improvement over current surveys that have limited standardization and multi-year comparability. There are also data limitations on the demand side, and household surveys on a fixed cycle are becoming the international best practice. The donor community has an important role to play in this regard, although leadership from the MoH and MoF is essential.

Knowledge Gap: Childhood Malnutrition

Childhood malnutrition is an important issue in Lesotho. Despite several government interventions, it still remains a lingering issue. Given the potential importance on long-term outcomes, further research is needed on the continuum of care approach to addressing nutrition for infants, children, adolescents as well as pregnant women.

[38] It is, however, important to note that external donors fund a large amount of activity in this area, and the limited government budget allocation does not represent the total funding for prevention.

4.2 EDUCATION AND SKILLS

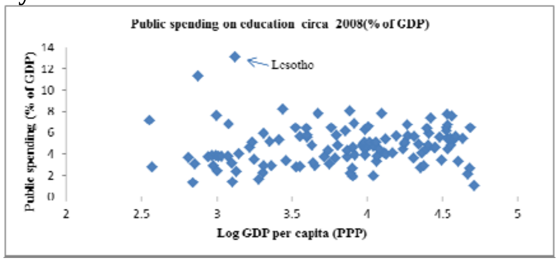
113. Access to quality education is a critical factor in inclusion because it is central to building capabilities and access to higher-paying jobs. Education is a priority in Lesotho, receiving around 20 percent of the overall budget (about 13.5 percent of GDP) in recent years. This level of spending is exceptionally high for a country with Lesotho's income level (Figure 61). Seven years of primary education are free and compulsory in Lesotho. As Lesotho's economy goes through a structural transformation, education and training can contribute to the preparation of a literate, numerate, and skilled workforce that can respond to the challenges of wage employment and self-employment. Around 70 percent of Basotho aged 25 and 34 are already employed in the formal sector, compared with 10 percent working on farms and 20 percent in the household or informal sector. If Lesotho's education and training systems are to fully contribute to human development, they still have to address fundamental challenges of quality, efficiency, and expansion of affordable and labor-market relevant post-basic education.

Barriers to inclusion

114. Improved quality, equity, and efficiency in primary education is needed as a basis for secondary education and skills development. Rapid expansion of quality basic education was critical in achieving shared growth in East Asian economies.[39] In Lesotho, the Primary Net Enrollment Rate (NER) has remained almost stagnant at 83 percent since 2000, and the Primary Completion Rate was only 62 percent. In addition, attendance for the poorest income quintile is considerably lower than for the richest income quintile; e.g., 66 percent for boys in the poorest quintile compared to 88 percent in the richest quintile. These inequalities at the basic level continue and are amplified at subsequent levels of schooling. Table 8 shows that Lesotho, at 16.8 percent of per capita GDP, has the highest per-pupil recurrent spending in primary education among southern African peer countries. The average recurrent per student spending for the similar countries is estimated at 11.3 percent of per capita GDP; this indicates that the unit cost of primary education in Lesotho is about 50 percent above the average of comparable countries. Although quality at primary level has improved slightly and quality reforms are under way, Lesotho's schools are still below the average quality for the sub-region (Table 9). Among 10 SACMEQ countries, Lesotho has the third lowest sixth-grade survival rate for students who can read, and it scored higher than only Zambia and Malawi in SACMEQ 2007 reading scores (Figure 63). Repeating grades often leads to students' dropping out. In Lesotho, the dropout rate has decreased but remained high at 19 percent in 2012, which indicates substantial system inefficiencies.

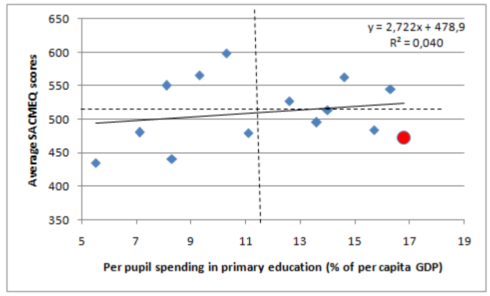
[39] Frederiksen and Tan (2008).

Figure 61: Lesotho's spending on education is high by international standards



Source: WDI.

Figure 62: Student learning and per student spending at the primary level in a sample of 14 Southern African countries



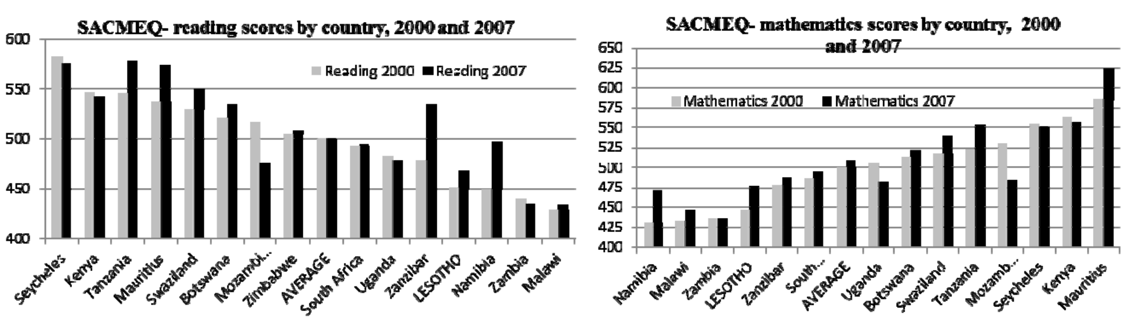
Source: Sector Diagnostic, Analysis Based on 2010 Household Budget Survey.

Table 8: Cross-country comparison of education indicators

Country	GDP per cap.	Gross Enrollment Rate At the Primary Level	Gross Enrollment Rate at Secondary Level	Gross Enrollment Rate at the Tertiary Level
	(PPP, 2009)	2009	2009	2009
The Gambia	1,221	90	57	-
Tanzania	1,237	105	27	-
Zambia	1,323	113		
Benin	1,369	122		
Lesotho	1,409	103	42	9.8
Ghana	1,410	105	57	8.6
Kenya	1,428	113	59	4.1
Cote d'Ivoire	1,549	74		
Senegal	1,650	84		8
Mauritania	1,746	104		3.8

Source: World Bank (2012).

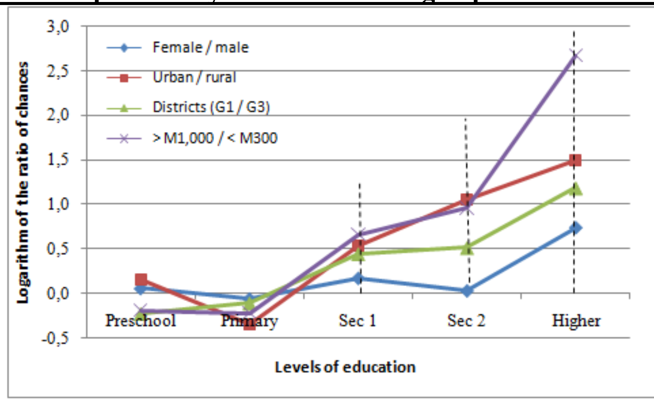
Figure 63: Despite high education spending, Lesotho still produces poor learning outcomes



Source: World Bank (2012).

Figure 64: Despite high education expenditure, access to post-basic education is characterized by inequities by gender, urban-rural location, district, income group

(Logarithm of probability ratio for accessing a specific education levels)



Source: Sector Diagnostic, Analysis Based on 2010 Household Budget Survey.

Table 9: Student learning and per student spending at the primary level in a sample of 14 Southern African countries

Countries	Global sacmeq score	Per student spending (% pc GDP)	Countries	Global sacmeq score	Per student spending (% pc GDP)
Lesotho	**472.4**	**16.8**	Zimbabwe	513.8	14.0
Zambia	434.5	5.5	Botswana	527.6	12.6
Malawi	440.5	8.3	Swaziland	545.0	16.3
Mozambique	479.9	11.1	Kenya	550.1	8.1
Uganda	480.5	7.1	Seychelles	563.0	14.6
Namibia	484.0	15.7	Tanzania	565.5	9.3
South Africa	495.0	13.6	Mauritius	598.4	10.3
			Average comp. countries	**513.7**	**11.3**

115. **Lack of education beyond the primary level is a major constraint to successful employment.** Post-primary education matters in where the Basotho work. Many post-primary graduates fill the highest-wage jobs in key sectors of the economy (Figure 65). However, post-primary education remains low for the poor (Table 10). About 85 percent of tertiary students come from families in the upper two income quintiles. According to the World Bank (2010), 81 percent of heads of households in the Rural Mountain region have no education. Therefore, the poor, especially those from rural areas, may have limited opportunities to find wage-paying jobs.

116. **Several factors combine reduce demand for secondary education among the poorest families.** Their low enrollment stems from: poor rates of completion and learning in primary schools, the secondary-level fee policies that restrict demand for education, the still-widespread lack of supply of secondary education, especially in rural areas, and the scale of absolute poverty. The poor have the lowest participation and completion rates in primary education. The

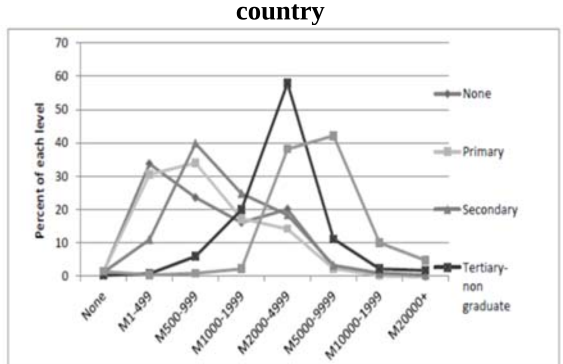
non-participation reflects the level of poverty, the distance to schools, and the condition of schools. Boys tend to drop out to engage in herding. The average household's share of education costs is the highest in sub-Saharan Africa. Lesotho's households contribute up to 49 percent of total expenditures for lower secondary education and 44 percent for upper secondary education, compared with 30 percent for primary and 22 percent for tertiary. According to the FY2010/11 household survey, secondary education costs parents between M2,600 (US$281) a year per child and M4,200 (US$545) a year per child, roughly comparable to four months' family income. Comparatively few children receive scholarships—22 percent at lower secondary and 40 percent at upper secondary, compared with 60 percent in higher education.

Table 10: Participation in secondary education a privilege to the rich

	PrimarySchool Net attendance ratio			PrimarySchool Gross attendance ratio		
Wealth Quintile	Male	Female	Total	Male	Female	Total
Lowest	87	94.3	90.5	146.2	170.2	157.6
Second	90.4	97.2	93.8	177.8	177.9	177.9
Third	94.2	96.7	95.4	172.6	175.2	173.8
Fourth	94.5	98	96.2	183.7	170.6	177.5
Highest	97.8	97	97.4	174.4	156.2	164.5
	Secondary School Net attendance ratio			Secondary School Gross attendance ratio		
Wealth Quintile	Male	Female	Total	Male	Female	Total
Lowest	6.7	14.8	10.7	11	19.1	15
Second	15.3	27.1	21	23.2	33.6	28.3
Third	24.9	38.1	31.2	33.7	46.3	39.7
Fourth	37	51.6	44.4	53.7	70.9	62.5
Highest	59.9	61.8	61	84.2	83.6	83.9

Source: LDHS (2009).

Figure 65: Wages rise with levels of education across the country



Source: LDHS (2009).

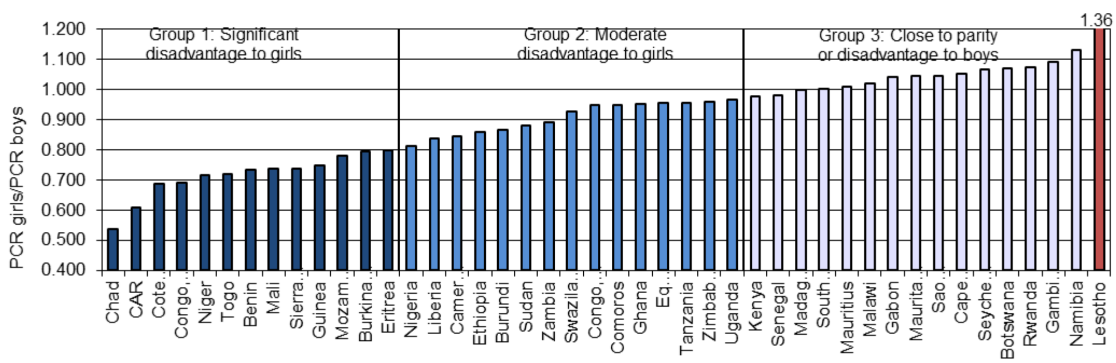
117. Higher education is expensive. The National University of Lesotho (NUL) is the country's flagship public institution, with more than 10,000 students enrolled. According to the *Investing for Changing Economy: Skill Development with Equity in Lesotho* report (World Bank 2013), public spending per NUL student as a percentage of per capita GDP is three times higher than comparable students in any other sub-Saharan Africa country. Moreover, Lesotho spends 25 times more on a university student than a secondary student, and 49 times more than on a primary student. For three-quarters of tertiary students, bursaries finance both tuition and accommodations, but repayment rates are a low 4 percent. About 85 percent of tertiary students come from families in the upper two income quintiles. Upon graduation, as many as a third of NUL students seek jobs abroad, mainly in South Africa, where they are attracted by higher salaries, better career prospects, and more favorable living conditions. Most of those that remain in the country seek jobs in the public sector. The curricula in the university have weak linkages to employer's needs. As the textile sector emerged over the past 25 years in Lesotho, for example, no academic programs have been developed to support the industry.

118. Public Technical and Vocational Education Training (TVET) in Lesotho is small, very costly, and ineffective. According to the *Investing for Changing Economy: Skill Development with Equity in Lesotho* report (World Bank 2013), TVET enrolls about 2 percent of the secondary-age cohort, costs six times more than a general secondary education, and only a third of its graduates pass skills tests. In 2007, only 166 TVET students qualified for graduation. TVET is delivered in eight institutes owned and managed by churches and civil society institutions; the government pays all salaries. The curricula in these institutes are outdated and have inadequate linkages to employers' needs; for example, the crafts curriculum is based on colonial British models. Many of the TVETs' instructors have no real-world experience.

119. Lesotho has a long tradition of educating girls, reflected in near gender parity in primary enrollment, where 50 percent of pupils were female in 2009. The girl-boy gap in primary school completion was 16.4 in 2011, compared to -0.44 for the world. In secondary and higher education, the majority of students are girls. In particular, the ratio of female to male enrollment in secondary education was 139.8 in 2012, compared to 96.45 for the world. More females than males are enrolled in secondary schools (58 percent) and at the NUL. Female adult illiteracy is less than 2 percent in the 15-24 age group. While 13.3 percent of boys aged 6–14 have never been to school, only 7 percent of girls in the age group have never been to school (2002).

120. While a larger share of women are educated, this advantage has not yet translated into enhanced economic power. One in five women is engaged in agricultural occupations. For women, the other common occupation is sales and service (21 percent). About 12 percent of women are engaged in each of three occupations: skilled manual labor, unskilled manual labor, and domestic service. By some measures, however, Lesotho's women are doing better than their counterparts in other countries. The ratio of female to male labor force participation was 0.81 in 2011, compared to 0.73 for the world. In addition, the ratio of the female to male unemployment rates was 1.22 in 2008, compared to 1.43 for the world.

Figure 66: Gender gap in the primary completion rates by sub-Saharan African country



Source: Majgaard and Mingat (2012).

121. Vested with full legal capacity and liberated from male guardianship, adult Basotho women are now, in theory, better equipped to play more productive and active roles as economic and social agents. Lesotho's Constitution provides for equality and justice to males and females. It also mandates fair wages and equal remuneration for work of equal value. The 2006 Legal Capacity of Married Persons Act (LCMPA), along with other progressive legislation, laid the groundwork for a gender-responsive legal framework that protects women's rights and provided for the repeal of all customary and civil laws giving husbands legal authority over wives or their property. The ability that this law gives women to engage in economic transactions in the absence of their husbands is particularly significant in a country in which husbands and wives are often separated due to migration.

122. However, women are yet to experience the full potential benefits of the LCMPA because of inadequate implementation, which has been complicated by the dual legal system, slow-changing social attitudes, the financial costs associated with seeking redress for violation of women's new rights, and women's lack of awareness of these rights. So far, efforts to improve women's awareness of their rights have included training and outreach events provided by the Millennium Challenge Account-Lesotho (World Bank, 2010). Awareness of the rights provided by the LCMPA needs to be built not only among women but also among men who may still be impeding women by following the discriminatory business practices of the past. For example, banks in Lesotho often still request a husband's approval before granting credit to businesswomen. Furthermore, while the LCMPA and the Land Act of 2010 brought reforms that gave married and unmarried women equal inheritance rights to their male partners, these reforms do not cover children, whose inheritance rights continue to be governed by customary law that disadvantages daughters. Despite these challenges, some measures of women's empowerment appear to be better in Lesotho than in many neighboring countries. For example, a smaller percentage of women in Lesotho report acceptance of wife beating or not being involved in key decisions on their own health care or on major household purchases.

123. Balancing the allocation of resources between education levels has the potential to generate savings and improve equity. For the past few years, more than one-third of the education budget has been allocated to tertiary education, largely to support a bursary scheme that has very limited rates of return. A similar amount of resources is spent in primary education. Only 20 percent of the budget is spent in secondary education. This makes education expenditures in Lesotho very regressive—the bulk of expenditures flow to the rich. Lesotho's allocation of resources among education sub-sectors is unusual. Comparable countries, with roughly the same share of tertiary-age population, spend half what Lesotho does on tertiary education. Lesotho's spending pattern reflects the fact that both primary and tertiary education are heavily subsidized by the government and almost free for students. The costs of secondary education are borne largely by students and their families. If the resources spent on free tertiary education for one student were redirected to secondary schooling, they could provide for 18 secondary students.

4.3 ACCESS TO BASIC SERVICES

124. Lesotho's geography is a challenge for the provision of basic services. Lesotho is the only country in the world with all its territory above 1,000 meters. Four distinct agroecological zones characterize the country, with 17 percent of the land in the lowlands, 15 percent in the foothills, 59 percent in the mountains, and 9 percent in the Senqu River Valley. Lesotho has a relative low population density, which makes the provision of services challenging and costly. Despite these obstacles, the government has made significant improvements in providing basic services.

Water and sanitation

125. By applying significant resources to providing services, Lesotho has made impressive advances in access to safe drinking water. Between 1995 and 2005, Lesotho ranked third among 24 African countries sampled in moving people from untreated surface water to higher levels of service. Approximately 77 percent of Lesotho's households have access to improved water sources (including 7.6 percent who rely on protected wells or springs), and 72 percent are less than 30 minutes from water. The government subsidizes water and structures tariffs so that prices are kept low for the poor. Sanitation remains a challenge, but it has improved significantly over the past three decades, with 25 percent of the population having improved, non-shared facilities, 39 percent having non-improved, shared facilities, and 36 percent still without facilities. Poor access to sanitation has negative impacts of health outcomes, especially among the poor.

Access to electricity

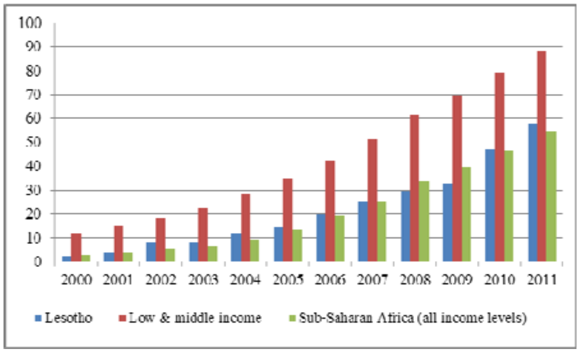
126. Access to electricity in Lesotho is very low. According to the NSDP, an estimated at 25 percent of households have access to electricity (2011); only 5 percent of them are in rural areas. About 70 percent of Basotho use biomass as the main source of energy for cooking and space heating. The cost of increasing access to a dispersed population is a significant barrier. However, the use of solar panels is proliferating in the country and could help overcome this challenge.

Communications and road infrastructure

127. Access of remote rural population to safe all season roads and affordable transportation services are a challenge for development. Large parts of Lesotho's rural areas are sparsely populated, with long distances between villages. Lesotho relies heavily on road transport given its topography, geographical location, population densities and economic activity; however, road quality and access to transport services are low. A large portion of the road network suffered severe damages due to flood from heavy rains between January and April 2011. The resulting poor market access is a constraint on the farmers' ability to sell their product and access inputs needed for efficient production. Farmers from the highlands need to travel more than 25 kilometers to Maseru to get agricultural inputs at subsidized prices. 25 percent of the country's population living in the remote mountain districts is isolated with poor access to health, education, and other basic services due to lack or poor-quality of road infrastructure and limited access to transport services. The last Public Expenditure Review (2013) reported that around a third of women had listed distance and transport as the main access barriers to health services in 2009. At present, there are more than 340 footbridges in the country and a demand for more is high.

128. Telecommunications penetration has improved over the past decade, and it is similar to the rest of the continent. Telecom and Internet services have been key drivers of investment and productivity growth around the world, and they are vital to linking up with global supply chains. According to the NSDP, about 75 percent of Lesotho's population has mobile phones; however, limited private ownership of computers restricts Internet use. According to the 2011 Lesotho Review, only 3.4 percent of the population has access to the Internet, with a little over 2,000 Internet connections. There are six Internet Service Providers (ISPs) and more than 28 Internet cafés throughout the country. Internet access using smart phones and tablets could improve the situation.

Figure 67: Fixed line and mobile subscriptions (per 100 people)



Source: WDI.

4.4 FINANCIAL ASSETS

129. **Access to financial services is still challenging for many Basotho households.** According to Global Findex, only 18 percent of the adult population has a bank account; in rural areas, it is just 14 percent (Figure 68). Only about 8 percent of the bottom 40 percent of the population has a bank account, compared to about 25 percent of the top 60 percent. The rural-urban divide is stark, with more than 36 percent of Lesotho's urban residents having bank accounts, compared with just over 20 percent in rural areas (Figure 69). Gender differences are relatively small. Lack of a collateral for the poor Basotho is an issue.

130. **Lesotho has limited banking infrastructure throughout the country.** As of June 2013, Lesotho had 44 bank branches (approximately one per 48,000 people) and 130 ATMs. Together, they represented one bank-access facility per 12,000 people. The number of ATMs is steadily increasing. So are the number of point-of-sale terminals, which have expanded 70 percent over two years, exceeding 700 as of June 2013. Many bank branches and ATMs are in Maseru; coverage elsewhere is thin. The number of physical facilities is not likely to increase much in rural areas because of low population densities, small financial markets, and mountainous terrain. Non-traditional delivery channels, such as mobile-phone banking and agency banking, are key tools for increasing financial inclusion in these areas.[40] In addition, developing the non-banking sector including MFIs and SACCOs and promoting responsible finance through consumer protection and financial literacy could also facilitate in increasing financial inclusion.

[40] The Finscope 2011 depicts serious geographical constraints to access to banking services, but a very high financial inclusion level of 81 percent because of funeral insurance. Excluding funeral insurance, it is 66 percent—and 38 percent have access to banking services. This is surprisingly high for a country with Lesotho's geographical constraints and poverty levels.

Figure 68: Share of adult population with account at a formal financial institution- vs peers, 2011

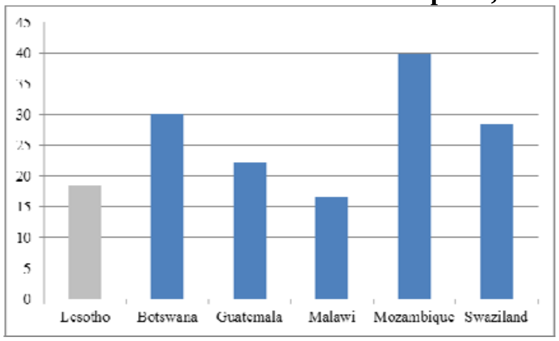
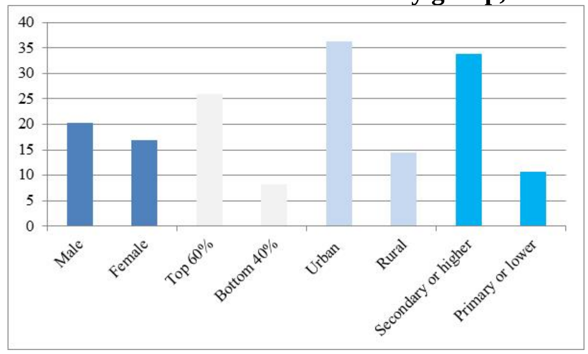


Figure 69: Share of adult population with account at a formal financial institution-by group, 2011



Source: World Bank, Global Findex Database of Financial Inclusion.

4.5 SOCIAL PROTECTION

131. **Despite adequate fiscal space, the social protection system in Lesotho does not significantly contribute to reducing poverty and inequality.** The country spends substantial resources on social transfers—about US$197 million a year, or 9 percent of GDP—but coverage of the poor is very low. Most of the money goes to the universal Old Age Pension, school feeding, and tertiary bursaries. These programs yield some positive outcomes and enjoy strong popular and political support. However, the programs are for the most part not designed to reduce poverty or vulnerability, nor promote investment and employment. The majority of the transfers go to people who are not among the poor or extreme poor (Table 12). A well-developed social protection system plays a critical role in alleviating poverty, though this is not currently the case in Lesotho.

132. **The Government recognizes such weaknesses in the social protection system, and has begun addressing them**. Most notable progress include the creation of a standalone Ministry of Social Development (MSD), the approval of a National Social Protection Strategy (NSPS), the introduction of a modern cash transfer program, (Child Grant Program-CGP) and the establishment of a National Information System for Social Assistance (NISSA). The CGP is a poverty targeted unconditional cash transfer program for children under 18 years of age introduced in 2009. It currently covers 25,000 beneficiary households – roughly one eighth of the population. A recent rigorous impact evaluation has found that it had significant positive effects on expenditure on children and food security among poor households. The NISSA, launched in tandem with the CGP, is a system that contains social-economic information of households and a targeting tool for identifying poor households based on Proxy Means Targeting formula, and that provides the basis for a unified registry of beneficiaries of all social protection programs.

133. **Much ground still remains to be covered in terms of improving targeting, administration and coordination for the social protection system to be an effective means for poverty reduction.** Like most countries, Lesotho cannot afford to waste money providing transfers to people who do not need them. Some vulnerable groups, namely children and elderly among which poverty is high, are targeted categorically. However, coverage is low and leakage is high. Programs should move towards poverty targeting at the household level. More accurate targeting mechanisms and/or scaling up programs that specifically target the poor could increase the effectiveness of social protection for poverty reduction. With the exception of the CGP,

administrative processes of cash transfers are antiquate and prone to inefficiencies. These could be improved through the adoption of reliable MIS systems, electronic payments and other modern delivery mechanisms, which could be harmonized across the different programs to reduce administrative costs. The NISSA could provide a basis for such harmonization, with program linked through the National ID system, currently being rolled out by the Ministry of Home Affairs.[41]

Table 11: Social safety net expenditures in selected African countries

Country/region	Year	(% of GDP)
Malawi	2003-2006	6.5
Lesotho	**2010/11**	**5.6-9**
Mauritius	2008/09	4.4
South Africa	2002/03	3.2
Botswana	2010	2.2
Swaziland	2010/11	2.2
Mozambique	2010	1.7
Rwanda	2010/11	1.1
Kenya	2010	0.8
Burkina Faso	2005-2009	0.6
Mali	2009	0.5
Tanzania	2010	0.3
Benin	2005-2009	0.3
Zambia	2010	0.23

Source: World Bank (2013).

Table 12: Coverage of existing programs

Program	Approximate Coverage *(2010, Beneficiaries)*	Approx. % of Population /y	Approx % of the Very Poor
Old Age Pension	83,000	4.4%	4.4%
School Feeding Program/ a	389,000	20.5%	22.5%
Child Grants Program /b	27,200	1.5%	3.9%
Public Assistance	9,500	0.5%	1.3%
OVC Bursary Scheme /b	20,000	1.1%	1.5%
Agricultural Input Fairs /c	21,600	1.1%	0.8%
National Fertilizer and Input Subsidy /d	n.a.	n.a.	n.a.
Nutrition Support Program (WFP) /e			
Child Nutrition	37,000	1.9%	3.2%
Blanket Feeding	32,000	1.7%	2.2%
EDC Feeding	30,000	1.6%	1.6%
Tertiary Bursary Scheme /f	16,200	1%	< 0.1%
Forestry Public Works Program g/	58,000-115,000	3-6%	2-4%

Source: World Bank (2013).

[41] The expansion of NISSA should be continuously monitored and evaluated to determine if it is in fact an effective way to improve coordination and targeting. Also, its expansion should be done in a cost-effective way.

4.6 Social cohesion, voice, and participation

134. Social inclusion and voice in Lesotho do not seem to be negatives for poverty reduction and shared prosperity. A coalition of the All Basotho Convention (ABC), the Lesotho Congress for Democracy (LCD), and the smaller Basotho National Party (BNP) currently governs Lesotho. The country's multiparty democracy enables members of minority parties to criticize the executive and provides relatively effective checks and balances on the incumbent. Government decisions undertaken by the prime minister are subject to public-sector auditing, which has improved in recent years. In the 2012 WBI governance index, the voice and accountability dimension was higher than the previous year but still trailed some other African countries. Lesotho scores high on control of corruption, but it rates only fair on political stability (Table 13). Freedom House's 2013 Freedom of the Press Index deems Lesotho a country with a partly free press (96th out of 196 countries). On Reporters Without Borders' World Press Freedom Index, Lesotho's ranking fell from 61st in 2012 to 81st in 2013.

135. Political instability is an issue. Lesotho has a history of difficult political transitions. In this context, the peaceful transfer of power to a coalition government following elections in May 2012 was an important milestone. However, disagreements within the coalition government have made policymaking difficult. In March 2014, Parliament was suspended for about a month and half following the opposition's submission of a no-confidence motion against the prime minister and the coalition government. In early June, 2014 the King suspended Parliament for the next nine months after the minority coalition partner withdrew its support for the prime minister and his political party. This led to political unrest. SADC intervened and reached a peaceful resolution among the various leaders of the coalition government, bringing elections forward two years. On October 17, 2014 Parliament reconvened to work on issues related to the budget and the upcoming elections. Parliament was dissolved in early December, and elections were held on February 28, 2015. A new coalition government took office on March 2018 led by Prime Minister Pakalitha Mosisili.

Table 13: Worldwide governance indicators, 2012

Percentile Rank: percentage of countries below country	**Lesotho**	Botswana	Namibia	South Africa	Swaziland
Control of Corruption	62	79	67	54	47
Government Effectiveness	42	67	59	64	32
Political Stability and Absence of Violence/Terrorism	56	89	79	44	34
Regulatory Quality	32	74	54	63	31
Rule of Law	46	70	60	58	39
Voice and Accountability	52	64	59	65	15

Source: World Bank.

4.7 Inclusion: brief summary of main messages and key challenges identified

136. This chapter argues that Lesotho spends a considerable amount of resources in the social sectors but has achieved poor outcomes. The core issue is the poor efficiency and effectiveness of public spending. In addition, social expenditures are regressive. Post-primary education is a privilege to the rich, and its skewed distribution is a major constraint to successful employment. Curricula in the vocational training and tertiary level have weak linkages with employers. Health-care access remains an issue for the poor. HIV/AIDS prevalence rates among the adult population are high, hindering growth by undermining the stock of available labor, lowering productivity, and limiting incentives for investments in future consumption. Lesotho's geography and its low population density make provision of basic services challenging and costly. Access to financial services is still difficult for many Basotho households, particularly those living in rural areas. Political stability remains an issue in Lesotho.

137. Improving human development outcomes and ensuring that individuals can more effectively contribute to the growth and competitiveness of the economy will require improving health outcomes, particularly in HIV/AIDS, maternal mortality, and child malnutrition. Social progress will also require improving both broad quality and equity in education and skills development as well as closing the gaps in access to key basic infrastructure. In addition, improvement is needed in the financial sector to ensure greater inclusion. Table 14 summarizes these issues and identifies the channels through which they impact the twin goal. This will be analyzed further in Chapter 6.

Table 14: Summary of main issues identified—Chapter 3

Area	Specific issues	Channel for impact on twin goals
HIV prevention	Continued high incidence rates and no substantial changes in behavior	Lowers human development through health impact; lowers firm and public sector productivity through poor health
Childhood malnutrition	Very high rate	Reduced cognitive potential and health impacts raises risks of sustaining poverty elimination and lowers firm productivity by lowering the capacity of skills supply
Access to health	Limited access to the poor	Lowers firm and public sector productivity through poor health
Access to sanitation	Low levels of proper sanitation	Direct impact on human development outcomes; impacts skills supply and productivity through indirect impact on health
Access to electricity	Very limited	Lowers private sector investment
Quality and equity of educational outcomes	Despite a high level of spending in education, there are poor outcomes; poor alignment of skills to jobs; low quality of education; cost of secondary education is relatively high for the poor	Lowers private sector investment in employment creating activity by lowering productivity; lowers potential for self-employment activities; impacts productivity and quality of public service delivery
Efficiency and effectiveness of social protection system	Most of the social programs do not target the poor	Limits potential to eradicate extreme poverty
Gender	Legal Capacity of Married Persons Act of 2006 has not been fully implemented	Risks sustainability of poverty elimination by reducing potential of women to build financial assets
Political stability	Is still a lingering issue	Lowers private sector investment in employment creating activities

5. IS THE GROWTH MODEL SUSTAINABLE?

Macroeconomic stability is a necessary condition for growth and poverty reduction. A growth model driven by public spending is not sustainable. This chapter will argue that fiscal prudence will be critical for sustainability, especially in the context of SACU revenue vulnerabilities. This will require fiscal consolidation of spending—in particular, a reduced wage bill. It will also require building fiscal buffers. A significant reform and modernization of the public sector will be fundamental to improving outcomes in Lesotho. Reforms will require upgrades in planning, procurement, financial management, and management processes. They will also require special attention to monitoring and evaluation. Efforts should concentrate on improving the effectiveness and efficiency of public spending. In particular, improving health and education could translate into an important yield from the demographic dividend. More effective public service, as well more informed policymaking, requires substantial upgrading of statistical capacity to ensure access to more regular, consistent, and comprehensive data. Finally, important environmental and climate change issues require attention.

5.1 FISCAL MANAGEMENT

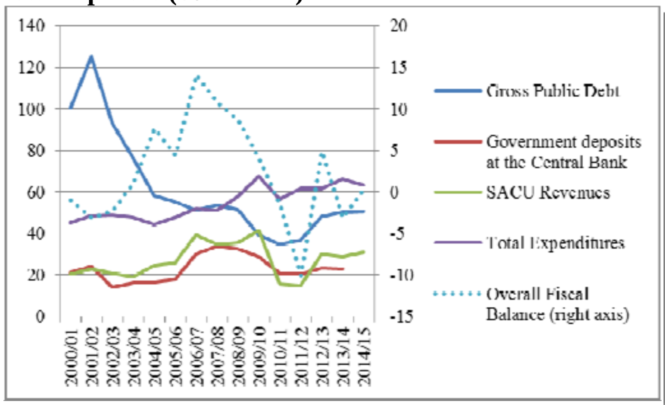
138. Fiscal and financial management is critical to all aspects of Lesotho's transformation and modernization, including delivering on key public infrastructure investments, supporting the development of the private sector, raising the level of health and educational outcomes, and improving the effectiveness of social safety nets. As mentioned previously, Lesotho has a large public sector relative to the size of its economy—in fact, one of the largest in the world at more than 60 percent of GDP, supported mostly by SACU transfers that are highly volatile. The size of public spending seems to be crowding out private investment and seems to have raised the relative price of non-tradables to tradables. Lesotho also exhibits poor effectiveness and efficiency of public spending. Finally, at least 20 percent of public spending is regressive. The current growth model is not inclusive and sustainable. From a social point of view, it may lead to more inequality and further political instability. The solution lies in strengthening fiscal and financial management.

Revenue and expenditure trends and fiscal balances

139. Government revenue rose from about 44.3 percent of GDP in FY2000/01 to about 71.7 percent of GDP in FY2009/2010, driven primarily by increases in SACU receipts. The SACU transfers' surge was driven largely by soaring imports into South Africa. The up-cycle in SACU transfers coincided with a change in the SACU revenue-sharing formula that went into effect in 2005. The new formula is the sum of three components: the customs component, the excise component, and the development component. The first component is a function of custom union duties, distributed according to each country's share of total intra-SACU imports. The second component is a function of excise-duty revenues collected within SACU—85 percent is distributed according to each country's share of SACU GDP and the remaining 15 percent, also called the development component, is divided according to the inverse of per capita GDP. The formula favors the less-developed members like Lesotho.

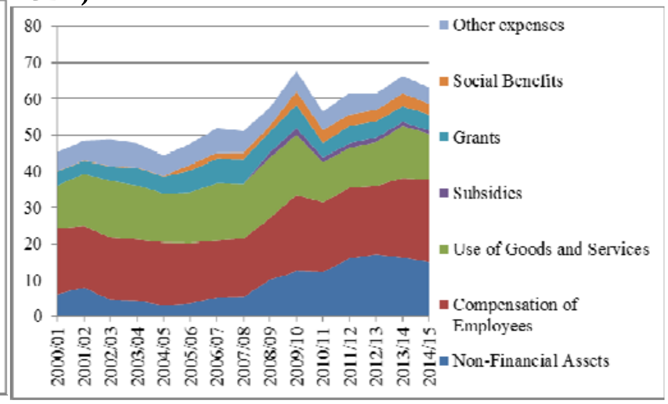
140. **Initially, the rising SACU transfers were saved, resulting in annual fiscal surpluses averaging about 7 percent of GDP between FY2003/04 and FY2008/09 (see Figure 70).** The mirror image of these savings was a buildup of Government deposits at the Central Bank, an increase in international reserves (import coverage was raised from three to four months before FY2005/06 to five to six months in FY2006/7-2009/10), and a fall of non-concessional debt (mostly related to the first Lesotho Highlands Water Project). After 2009, these savings would be critical to financing the fiscal deficit and preventing the buildup of debt.

Figure 70: Lesotho public debt, SACU revenues and total expenses (% of GDP)



Source: GoL.

Figure 71: Composition of public spending (% of GDP)



Source: GoL.

141. **After 2005, however, authorities gradually yielded and increased expenditures, even though they recognized the vulnerability from an over-reliance on the volatile SACU transfers.** This vulnerability was noted repeatedly in government documents, including the Interim National Development Framework (INDF) and the Background to the Budget FY2009/10. By FY2009/10, public expenditures had fully absorbed the historically high transfers Lesotho was receiving. The non-SACU fiscal deficit deteriorated from 17.1 percent of GDP in FY2004/05 to 37.3 percent of GDP in FY2009/10 (Figure 72).

142. **Expenditures would have risen even higher if budgets had been executed as planned.** From FY2004/05 to FY2013/14, the budget envisaged higher spending and running deficits in all but two years. The surpluses the Government actually ran were a result of larger than budgeted SACU transfers and an inability to spend quickly enough after FY2005/06, especially on the capital side. Budgeting higher than implementation capacity may have helped deflect political pressures to spend. Even so, these pressures could not be contained as actual spending trends became known. The significant gap between planned and actual budgets also weakened the budget as a tool for policy implementation.

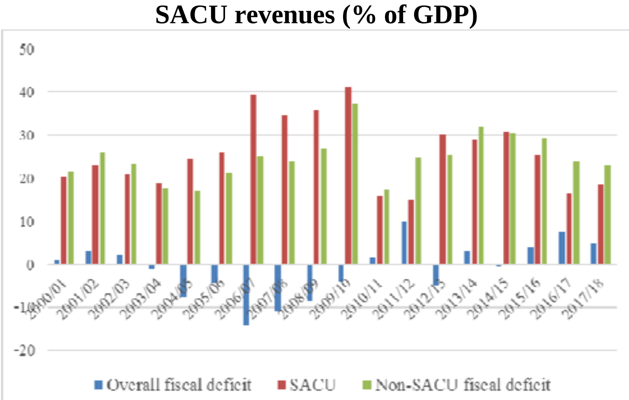
143. **Both non-financial assets and expenses increased substantially between FY2005/06 and FY2009/10 (Figure 71).** Non-financial assets increased by about 9 percent of GDP, largely driven by foreign grants. Most of the resources were allocated to construction of roads, the Metolong dam, upgrading health facilities, and the construction of the Queen Mamohato Hospital. Expenses increased by more than 11 percent of GDP during this period—and 4.5 percentage points of GDP went to increases in employee compensation. According to the World Bank Public Expenditure Review (2012), the wage bill rose more than 45 percent in real terms.

The increase was primarily the result of pay hikes that exceeded inflation between FY2007/08 and FY2009/10. By the end of FY2009/10, overall government expenses reached 55 percent of GDP, making the budget extremely rigid.

Volatile SACU revenues

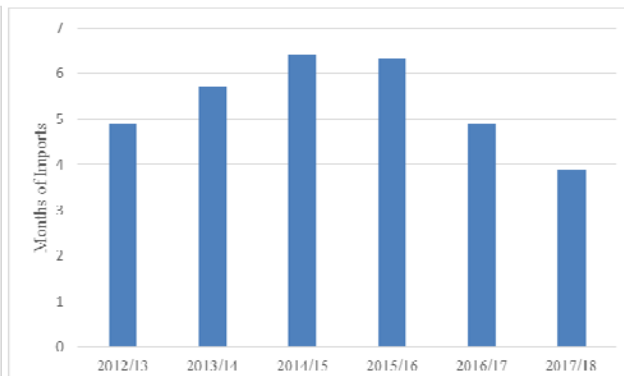
144. SACU transfers have proven volatile and difficult to manage. In the international financial crisis, SACU revenues turned volatile, plummeting from 41.3 percent of GDP in FY2009/10 to about 16 percent of GDP in FY2010/11. Despite a public-spending reduction of 10 percentage points of GDP, the overall fiscal balance fell into deficit. Since FY2011/12, public spending has remained above 60 percent of GDP, up from about 56.4 percent of GDP in FY2010/11. The country's international reserves declined from 5.3 months of imports in FY2009/10 to 3.6 months of imports in FY2010/11. During this period, international reserves remained above the minimum thresholds on the traditional metrics (three months of import, 100 percent of short-term debt, and 20 percent of broad money).

Figure 72: Fiscal balances depend heavily on volatile SACU revenues (% of GDP)



Source: GOL.

Figure 73: Declining gross international reserves



Source: GOL.

145. SACU transfers increased considerably since 2010 and public spending rose to absorb these increases, pointing to the need for more careful fiscal management and increases in domestic revenues. Other countries dealing with similar revenue fluctuations have successfully aligned public spending with credible estimates of long-term government revenue. However, weaknesses in the tax administration expose important gaps between actual and potential revenue generation. Closing them will require improvements in both policy and administration to increase domestic tax revenue, creating a more stable supplement SACU revenue. Despite some efforts to bolster tax management—such as approval of the new Tax Modernization Program and a country-wide fiscal census in 2014—the tax regime remains old and requires modernization. A strong need arises to strengthen tax collection and management, particularly in the mining, telecommunication, construction, and financial services sectors. Tax management also presents a number of opportunities for strengthening.

146. Over the past six years, Lesotho's stock of public debt has been fluctuating to a large extent on the back of exchange rate movements and increases in public spending. Lesotho's public sector debt declined from 37 percent of GDP in FY2009/10 to 34.4 percent at the end of FY2010/11, driven mainly by significant appreciation of the maloti/dollar exchange rate in 2009 and 2010. In FY2011/12, however, higher public spending led to an increase of public debt to 37.6 percent of GDP. In FY2012/13, public debt kept rising to 39.6 percent of GDP, largely because of increased financing for key infrastructure projects, such as the Metolong Dam and health clinics throughout the country. Finally, debt reached 41.9 percent of GDP as a result of higher public spending and a depreciation of the exchange rate. More than three-quarters of total debt was owed to multilateral creditors, mainly the International Development Association, the International Monetary Fund, and the African Development Fund. At present, domestic debt is relatively small, composed of Treasury bills and bonds.

Table 15. Debt Sustainability Indicators

(percent)	*2011/12*	*2012/13*	*2013/14*	*2014/2015*	*2015/16*	*2016/17*
External debt	31.5	36.5	38.9	37.8	38.3	39.1
PV of PPG external debt in percent of exports		75.1	79.1	73.2	74.2	70
PV of PPG external debt in percent of gov. revenues		58.1	61.1	54.3	54.9	57.4
Debt services to exports ratio	3.3	3.2	4.2	4.2	5.5	5
PPG debt service to government revenues ratio	3.4	2.5	3.3	3.1	4.1	4.1
Public Debt	37.6	39.7	41.9	40.5	40.7	41.3
PV of public sector debt		36.7	35.6	33.2	32.2	31.7
PV of public sector debt to revenue and grants ratio		55.5	60.5	54.9	55.4	57.5
PV of public sector debt to revenue ratio		63.7	66.5	59	59.3	61.5
Debt service to revenue ratio	4.9	3.2	3.9	3.7	4.6	4.4
Primary deficit that stabilizes the debt to GDP ratio	-22.9	-7.9	-1.5	2.4	0.1	1.4

Source: Debt Sustainability Analysis Update (June 2014). Prepared by IMF and IDA staff.

147. The macroeconomic framework faces a major shock. SACU revenues are projected to decline from 30.7 percent of GDP in FY2014/15 to 16.5 percent of GDP in FY2016/17 and then recover somewhat to 18.4 percent of GDP in FY2017/18. The Government envisions gradually tightening the fiscal stance in response to the shock on SACU revenues. It aims to reduce the non-SACU deficit from 30.3 percent of GDP in FY2014/15 to 23.1 percent of GDP in FY2017/18, a level that still exceeds the World Bank's estimate of a sustainable non-SACU deficit of 19 percent of GDP (PER 2012).[42] Adjustment relies primarily on cuts in capital spending and use of goods and services, thus, composition of spending worsens. The wage bill is projected to gradually increase from 22.7 percent of GDP in FY2014/15 to 23.8 percent of GDP in FY2017/18. While capital expenditures and use of goods and services are projected to be cut by about 6 percent of GDP. Measures that underpinned the cut have not been fully identified yet. A tax reform bill that levies alcohol and tobacco is yet to be presented to Parliament, and it is expected to yield about 1 percent of GDP.

148. Against this backdrop, Lesotho faces significant macroeconomic risks. Over the medium term, gross international reserves are expected to decline to 3.9 months of imports, down from about 6 months of imports in FY2014/15. This leaves Lesotho with inadequate buffers under its exchange rate peg. If the forecast proves correct, Lesotho's international reserves will fall below the optimal 4.3 months of imports (IMF 2014). A shock similar to the global crisis of 2008 would drop international reserves below the minimum threshold of three months of imports.

149. According to the 2014 Joint Bank-Fund debt sustainability analysis, Lesotho remains at moderate risk of debt distress. In the baseline scenario, the present value of the public debt to GDP ratio is projected to reach 56.3 percent in FY2023/24. The ratio is projected

[42] The IMF estimates the sustainable non-SACU balance at 15 percent of GDP.

to decline thereafter because the primary balance remains positive over the medium term. However, the risk of debt distress increases significantly in the event of adverse shocks to economic growth, significant exchange rate depreciation, or a fiscal balance significantly worse than expected. Results are sensitive to the assumptions concerning the financing of the hydropower plant under the second phase of the Lesotho Highlands Water Project and projections of Government's annual financing needs.

Fiscal burdens and the need to reduce the size of government

150. Achieving exchange-rate sustainability, fiscal sustainability, and rebuilding buffers will depend on reducing ongoing fiscal liabilities. Government expenditures remain above 60 percent of GDP. Fiscal consolidation efforts are challenging when the Government plays a critical role in employment and growth. An important target for achieving fiscal sustainability is reducing the Government's wage bill.

151. The wage bill has been a lingering problem in Lesotho. The country has one of the highest wage bills in Africa and the world. Over time, Government spending on salaries has been driven upward by wage settlements that were higher than inflation and by increases in the number of public servants. The Government justified past wage increases as necessary to bring civil-service salaries up to "competitive" levels, stem attrition, and encourage greater efficiency among public sector workers. Whether these objectives were achieved is questionable. First, public sector employment offers job security and other differences to compensate for lower wages. Second, Lesotho awards wage increases equally to all civil servants and across all tiers of the public service, so the raises are a very blunt instrument for stemming attrition among particular skills, such as front-line health professionals and information technology specialists. Third, wage increases by themselves are unlikely to result in improved service delivery unless accompanied by incentives to perform better and improve staff accountability.

152. In addition, a number of structural problems and irregularities are left in human-resources management (HRM). Public servants constitute about 9.4 percent of the employed population and a quarter of the people in formal wage employment. Lesotho's wage bill reaches about 21 percent of GDP, one of the highest in the world, presenting a significant challenge to fiscal consolidation efforts. In particular, teacher's salaries are among the highest in the region, and other countries have achieved similar educational outcomes with fewer resources. Given the insufficient private-sector job creation and high unemployment rates, the civil service has become a de facto social safety net. The current civil service has a bottom-heavy structure, with a high number of support staff but very few professionals or middle and senior managers. Recurrent problems include high vacancy rates and irregularities, including ghost workers and double dippers. In light of multiple structural problems and high wage bill, the civil service requires strengthening of basic functions and system, such as human resource planning, merit-based recruitment and career management, and internal control and monitoring. The current remuneration regime does not have a way to reward high-performing employees, and previous attempts to implement a Performance Management System have failed. Cleaning up and regularizing current human resources records, establishing a solid and modern HRM system, and strengthening controls will likely help reduce the wage bill. International experiences show that such initiatives can create a great deal of fiscal space. Basic payroll and establishment controls are needed as well as a system for HRM. In addition, a greater performance orientation is needed for the delivery of public services, starting with the introduction of the foundations for performance monitoring and evaluation (M&E).

153. Savings will depend on greater effectiveness and efficiency in public spending. In other words, fiscal consolidation can be achieved through downsizing or eliminating programs and projects and reducing headcounts while at the same time improving outcomes. In addition, improving the quality of public investment will be critical. A modernization of the public sector is needed to achieve this.

5.2 PUBLIC SECTOR MANAGEMENT: AT THE HEART OF LESOTHO'S CHALLENGE

The failures in the public sector reforms

154. The Government embarked on the ambitious Public Sector Improvement and Reform Program (PSIRP) in FY2002/03. The PSIRP was formulated in collaboration with development partners in response to the need to strengthen good governance as a basis for achieving accelerated growth and poverty reduction. The multidimensional PSIRP aimed at improving the effectiveness and efficiency of public service delivery and public financial management. Despite many attempts to launch the reform processes with support from donors, very little success or progress has been seen over the past decade. The poor results raise an important question: Why has the public sector reform been failed? It is critical to analyze the following: (i) the role of leadership and the commitment of stakeholders; (ii) the appetite for reforms as well as the incentives and drivers involved—in other words, who will be losers and winners and their supporters and opponents; (iii) involvement of oversight institutions, such as the Court of Account and the Parliament, and citizen engagement for checks and balance.

Weak public financial management and procurement

155. Strengthening the efficiency and effectiveness of public spending and the accountability framework is at the core of fiscal consolidation. In March 2013, the MoF approved a detailed PFM Reform Action Plan (PFMRAP) in close collaboration with development partners. The plan seeks to develop more effective PFM systems, including improvements in planning, budgeting, budget execution, procurement, accounting, reporting, audit, and oversight. In addition, the Treasury regulations of the PFM Act of 2010 have been issued. Over the medium term, sustained implementation will be critical for improved governance in Lesotho.

156. The IFMIS does not yet support sound financial controls and the production of timely and reliable quarterly budget execution reports and annual public accounts. With financial support from DFID and the EU, the Government introduced IFMIS in 2009 at the central government level. Due to a number of technical and adaptive challenges, the system does not support daily operations effectively, and the timely production of reliable in-year and annual financial information is not yet possible. Some of the core PFM functions (requisitions, orders, commitment control, and payments) were initially not performed through the IFMIS. Budgets were not loaded. Users were not properly trained. Frequent system unavailability continues (up to two days a week) and results in bypassing of the IFMIS to maintain operations, with no controls to ensure timely capture of transactions conducted outside the IFMIS. Other PFM functions (e.g., budget preparation and asset management) are still performed manually or through parallel systems in line ministries and district sub-accountancies. Good-practice accounting disciplines, such as month-end closures and bank reconciliations, are also not yet fully functional. These deficiencies severely limit revenue and expenditure control, budget execution, reliable and timely reporting, and ultimately financial accountability. A lack of verified and accepted opening IMFIS balances as of 2009 also affects the reliability of IFMIS data.

157. **The MTEF process is still weak.** Projects and programs are not always linked to NSDP priorities. Policy discussion has taken place at the end of the preparation of the Budget Framework Papers (BFPs). The MTEF's outer-year spending plans are seldom used in preparing subsequent years' budgets, and the approach to budgeting remains largely incremental and line-item based.

158. **Although several reforms have been introduced, the public procurement system remains weak, understaffed, and poorly regulated at the ministry and district levels.** A new public-procurement regulation took effect in 2007, and it has been under review since 2010 to remove inconsistencies, provide greater clarity in its application, and introduce additional procurement methods.[43] Capacity building of procurement staff also began under the Irish Aid-supported Chartered Institute of Purchasing and Supply (CIPS) program at the Lesotho Institute of Development and Management (IDM). A Procurement Tribunal was established early in 2012, providing the private sector with the comfort of an independent complaint-handling mechanism. Despite these positive developments, several challenges stand in the way of a transparent, efficient, economic, and competitive public-procurement system that delivers value for money and fosters development of local enterprises. The challenges include: (i) a decentralized procurement system not fully staffed in almost all line ministries and districts; (ii) staff with limited (and in some cases unacceptable) academic qualifications and little experience in public procurement, coupled with a CIPS training program that appears ineffective in building public-procurement skills; (iii) weak regulatory oversight and audit and ineffective capacity-building by Procurement Policy and Advice Division (PPAD); (iv) procurement structures at national, ministry, and district levels that do not offer competitive salaries and grades to attract and retain skilled and experienced staff; (v) negative public perception of procurement as having limited competition, inadequate information, and lengthy payment arrangements that leave the process prone to corruption and betray the interests of the private sector (GoL, 2008c).

Poor public investment management

159. **In recent years, the productivity of capital spending has been reduced by the lack of complementary reforms.** High capital spending has boosted short-run growth, especially in the construction sector; ultimately, however, investment productivity has to be assessed in terms of its effects on future growth. A large part of the increase in capital spending after 2005 was directed toward recruiting new private-sector investment; so far, it is unclear whether these public investments were effective in achieving their goals. While institutional weaknesses in

[43]The 2007 regulation created the Procurement Policy and Advice Division (PPAD) to spearhead procurement reform and provide the needed regulatory function. The regulation also created procurement units in each entity.

project selection, management, and implementation may have contributed to the disappointing results, the productivity of public investment may have been compromised by slow progress in complementary reforms to improve the investment climate. For instance, the Government has spent large amounts on maintaining and improving health facilities, yet their utilization remains low because of a lack of complementary factors—most important, doctors and medicines (GoL, 2010).

160. The inefficiency of public investment is manifested in several other dimensions. These include weak capacity for project implementation, project delays, and poor procurement procedures—all contributing to Lesotho's low absorption capacity. The country has struggled to expend the funds budgeted for specific projects, leading to relatively low execution rates. For example, the country spent just 56 percent of budgeted funds in FY2006/07 and 61 percent in FY2007/08. In recent years, however, implementation of the capital budget has improved to more than 80 percent. No central guidelines control project implementation. A general lack of transparency affects implementation of projects and programs. On the procurement side, too, tendering procedures are lax, adding to perceptions of a lack of transparency.

161. According to the World Bank's Public Investment Management Efficiency Review (2012), the implementation capacity of capital spending across the ministries varies considerably. In September 2010, the MoF submitted *A Comprehensive Review of All Ongoing Capital Projects* to the Cabinet. The report analyzes the implementation of Lesotho's capital budget and specific projects' performance. Two key issues emerge. First, absorption rates vary significantly across sectors. In FY2009/10, for example, the Ministry of Forestry and Land Reclamation spent 100 percent of its allocated budget, while the Ministry of Natural Resources managed about 40 percent. Second, absorption rates differ significantly for Government funds and development partners' funds. Gaps between amounts budgeted and actually spent have ranged from 7 percent to 32 percent of the total budget. The data on allocations and spending show a long-standing execution deficit. The pattern, however, is different when comparing government-funded and donor-funded projects with spending across ministries.

162. Strengthening the PIM cycle is therefore critical to increasing average returns on public investment projects. Before 2009, the Cabinet decided which projects were funded through the capital budget. The projects selected were not always closely linked to national priorities. Some progress was made following the PIM Efficiency Review (2012)—for example, introduction of a new public investment project appraisal system and the restructuring the Projects Approval Committee (PAS) as the Public Sector Investment Committee (PSIC). Despite the positive signs, the PIM cycle from planning/designing to implementation and M&E remains weak. Currently, project proposals are submitted to the project cycle management unit at the MoDP and PSIC in an ad-hoc way as needs arise within sectoral ministries. Many projects, even large-scale ones, still do not go through a rigorous appraisal process. Even when they do, limited capacity for project appraisal hinders both MDP and line ministries. In practice, rigorous cost-benefit analysis—indeed, any cost-effective analysis at all—is rarely done for any budget-funded project or program. Not surprisingly, many projects are poorly designed and fail to deliver assets at least worth the investment cost (GoL, 2009). In addition, a robust M&E program is greatly needed to strengthen the capacity to produce and use information from assessments of public investment impacts. It is also not clear whether projects with the greatest potential impact make it through the appraisal process.

163. Project proposals often do not set defined physical scopes and hard ceilings on financial resources. Once a project's financing is approved, it is important to budget and manage against an estimate of total cost. Any substantial budget increases should be subject to further approval. Such procedures are not well established in Lesotho. As a result, it is common for projects to continue beyond their original completion dates and become a source of what is in effect recurrent financing. Since almost 90 percent of the capital budget is allocated to ongoing projects, strengthening procedures for monitoring project implementation and undertaking periodic reviews should play a central role in Public Sector Improvement Reform Program (PSIRP) management.

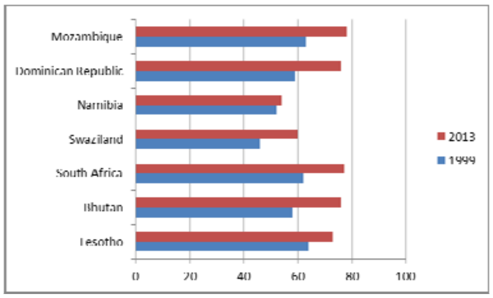
164. Weak capacity to implement projects and programs is a serious issue in Lesotho. In the 2012 governance indicators, Lesotho ranked very low (42 percent) in terms of government effectiveness. The Public Investment Management Review (2012) found important delays in project and program implementation. At the same time, the report notes weaknesses in project and program monitoring during the implementation phase. On the one hand, there seem to be capacity constraints due to the lack of necessary skills. On the other hand, there seem to be political economy issues. At the moment, no performance management system is in place, and previous attempts to establish one have failed. A strong political consensus to reform the public service will be necessary to address this issue.

Monitoring and evaluation and statistical capacity

165. The lack of an across-the-board M&E system and capacity handicaps policy and programming planning and decision-making, making it difficult for the Government to determine whether expenditures are meeting their objectives and, if not, why. There are growing concerns about poor fiscal management and weak service-delivery outcomes. The key issues are inefficiencies in strategic planning, budgeting, and M&E, a lack of coordination, capacity challenges, statistical weaknesses and public investment management. In the context of the NSDP, Lesotho seeks to develop a government-wide performance M&E system to enhance the effectiveness, efficiency, transparency, and accountability of public-sector management and develop a culture of evidence-based results management. This would help monitor and evaluate the implementation of the NSDP and key government policies, programs, and projects, with a view of enhancing capacity of managers to make informed and timely decisions.

166. Lesotho lags its regional and international peers in statistical capacity, hindering evidence-based policymaking and undermining the potential to monitor the performance and impact of government policies and programs (Figure 74). The country needs to strengthen data development, analysis, and use to support effective planning, budgeting, and M&E policies, programs and projects. The Lesotho Bureau of Statistics (BoS), an autonomous agency, has made significant progress producing key economic and social statistics—NPI, CPI, demographics, agricultural production, household budgets, employment, security and gender-related subjects. The BoS has spearheaded publication of these data through the use of web-based open formats. However, delays of up to three years are common on the availability on the national account and sector data. Data from household surveys, ministries, public service delivery units, and public-sector spending reports are sporadic and vary in quality, imposing constraints on the ability of decision-makers to assess alternative policies and make informed decisions. As a result, decisions regarding the allocation of scarce resources and options for reforming and improving public services often lack sound analytical foundations, and program evaluation is at best difficult. At both BoS and line ministries, the objective is clear—to strengthen systems, tools, and capacities and to develop the necessary IT infrastructure and software to support further statistical capacity-building throughout the government.

Figure 74: Weak statistical capacity raises risks in development and monitoring of policies and programs



Overall score (out of 100)

Source: World Bank, Bulletin of Statistical capacity.

Transparency and accountability in the public resource management

167. Transparency and accountability are serious challenges in Lesotho, reaching perceived levels of state capture in some cases. Important oversight challenges persist despite the establishment of key oversight bodies, such as Independent Electoral Commission (IEC), the Office of the Auditor General, the Directorate on Corruption and Economic Offences (DCEO), the office of the Ombudsman, the Human Rights Commission, and the Police Complaints Authority. The issues include unclear legal mandates and capacities and the lack of an effective incentives framework and political consensus to make these bodies effective accountability institutions.

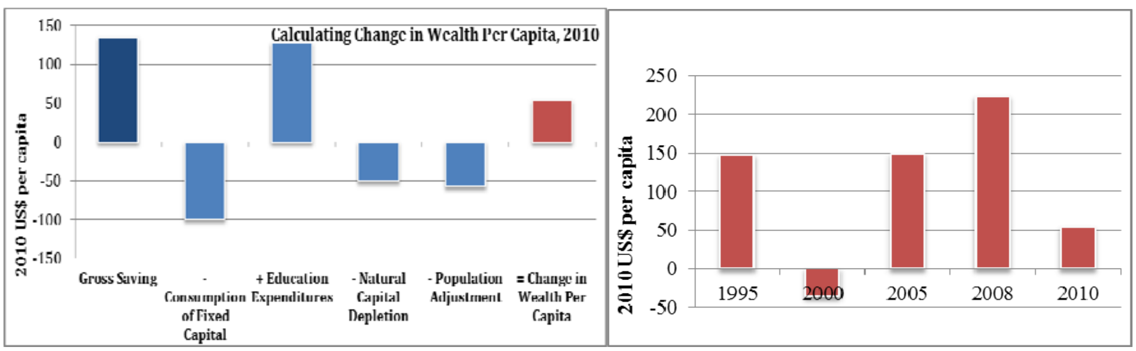
168. Despite some efforts to promote think tanks and grass-roots organizations, civil society appears to be fragmented and weak, with limited influence. Trust in government and civil society are limited—at the same time. With regard to citizens' access to government information, a historical legacy of military rule and restrictions has inhibited popular demand for good governance. The government generally respects freedom of speech and the press in Lesotho. With recent efforts to tackle corruption, Lesotho ranks currently 55th among 174 countries in the 2014 Transparency international Corruption Perceptions Index. Greater citizen engagement would enhance accountability. Steps in that direction could include (i) citizen engagement tools to facilitate greater citizen engagement in policymaking; (ii) citizen-based monitoring tools to support the M&E system, such as service-delivery satisfaction tools, including the use of mobile technology, and service delivery oversight tools, such as procurement watch; and (iii) support to media strengthening, such as grants for investigative journalism on select topics.

5.3 NATURAL CAPITAL AND WEALTH CONVERSION

169. **Wealth accumulation is fundamental to ensuring sustainable growth and development.** Wealth can take the form of natural capital, produced capital, human capital, and social capital. Growth that simply runs down assets is less sustainable than growth associated with maintaining and building assets. Because it is nonrenewable, natural capital is most critical in the assessment.

170. **Lesotho has experienced a positive change in wealth per capita since 2005.** Gross savings have been relatively high (Figure 75). In addition, education expenditures in Lesotho (used as a proxy for investments in human capital) is high compared to most sub-Saharan Africa countries, contributing positively to the change in wealth per capita. By contrast, natural capital depletion, depreciation of fixed capital, and population adjustments contributed negatively to wealth per capita. Compared to other developing countries in sub-Saharan Africa, Lesotho is in a better position because of its positive balance in wealth per capita (Table 16). Lesotho's natural capital depletion can be explained by loss of forest resources. Compared to other African countries and the average for other developing countries, depletion in natural capital per capita has been relatively smaller in Lesotho (Table 17).

Figure 75: Changes in wealth per capita in Lesotho



Source: World Bank, Change in Wealth Per Capita Database.

Table 16: Change in wealth per capita, 1995-2010

Change in Wealth Per Capita	1995	2000	2005	2008	2010
Lesotho	**147**	**-36**	**149**	**223**	**53**
Average sub-Saharan Africa	-220	-163	-229	-276	-221
Average Developing Countries	84	108	268	367	479

Source: World Bank, Change in Wealth Per Capita Database.

Table 17. Depletion of natural capital, 1995-2010

Depletion of Natural Capital (US$ per capita)	1995	2000	2005	2008	2010
Lesotho	29	27	28	61	50
Average sub-Saharan Africa	98	102	165	218	171
Average Developing Countries	61	88	173	256	184

Source: World Bank, Change in Wealth Per Capita Database.

Other environmental issues

171. **The country suffers from severe land degradation.** Despite numerous attempts and extensive but fragmented technical knowledge, barriers continue to obstruct efforts to develop or implement effective sustainable land management (SLM) models. As a result, land degradation continues to diminish local livelihoods and impose broader environmental costs on the region beyond Lesotho's borders (UNDP, 2008). The threats to Lesotho's land can be classified along two major production systems: cultivated lands and the range resource complex.

172. **Cultivated lands are threatened because of inadequate adoption of soil and water conservation (SWC) structures.** The problems include water and wind erosion, declining soil fertility, sediment deposits on and outside cultivated areas, increasingly variability in stream flows, and lower water tables (UNEP, 2008). The root cause is inadequate adoption of SWC structures because most land managers have little knowledge of appropriate methods and insufficient incentives for maintaining the structures. SWC methods have been used in Lesotho since colonial times, are widely known among researchers, and examples of successful adoption exist; however, they are not appropriately reflected in extension services, and many land managers in the highlands do not know about them.

173. **Two-thirds of Lesotho's land area is rangeland, and grazing is the principal land use (WB, 2011).** Lesotho's rural economy depends predominantly on livestock herding's productivity for income and employment generation. Livestock are mainly cattle, goats, and sheep, and they are herded on rangelands throughout most of the year. Large-scale wind and water erosion have caused rangeland degradation, leading to shrinking grazing resources and declines in grazing areas and their productivity.

174. **The range complex is threatened by reduced ground cover due to overgrazing and fuel collection; soil erosion by wind and water; declining soil fertility that affects pasture productivity, woody biomass, and biodiversity; and hydrological instability leading to variable stream flows and off-site sediment deposits within and beyond Lesotho (UNDP, 2008).** Due to overgrazing, the shrub vegetation and grassland that should dominate the Foothill and Mountain Regions is now very sparse. When combined with Lesotho's characteristically steep slopes and semi-arid climate, this loss of vegetation worsens the water and wind erosion that plays a significant role in land degradation. Vegetative cover, soil fragility, and type and duration of rainfall are among the most significant factors responsible for soil erosion—the most serious form of land degradation in Lesotho (IFAD 2014). Fertility has been reduced over time by "soil mining," exacerbated by the fact that many farmers live (with their livestock) far from their plots and have no cost-effective way to transport manure to the fields (PRS).

175. **The root cause of the degradation of the range resource complex is poor governance, rendering current management practices unsustainable.** Effective governance is often lacking, so that power struggles over resources are not controlled. The legal framework is not clear enough and does not sufficiently clarify responsibilities and boundaries. Furthermore, the institutions for management of rangelands (Community Councils) have legal authority but lack resources to operate at the local level. In addition, the rangelands face increasing pressure to meet the rising demand for wood fuel, driven by lack of affordable alternative fuels and affordable, accessible, efficient heating and cooking technologies. Supplies are met from wood

resources that are not effectively managed, and the invasion of alien species is causing widespread rangeland degradation (UNDP, 2008). In South Africa and Lesotho together, alien plants cover about 10 million hectares, or more than 8 percent of total land area, and they are spreading at 5 percent a year (FAO, 2011). Incentives for investment in sustainable land-management practices are lacking because of land-tenure insecurity, and knowledge is lacking because information on these production technologies is not disseminated through research and extension. Recently, the Land Act of 2010 and Land Administration Authority Act of 2010 have overhauled the land administration system, with the objective of regularizing titles and strengthening tenure security. However, this is aimed mainly at urban and peri-urban areas, and a communal system remains in place in rural areas. The impact of the new system on investments in sustainable land-management practices is, therefore, likely to be limited.

5.4 VULNERABILITY TO NATURAL DISASTERS AND CLIMATE CHANGE

176. Under the United Nations Framework Convention on Climate Change (UNFCCC), Lesotho is categorized as one of the countries highly vulnerable to the impact of climate change. The country has a temperate climate with subalpine characteristics, including four distinct seasons. Temperature and rainfall vary significantly from season to season, with Lesotho experiencing hot summers and relatively cold winters (WB, 2014c).[44] The country experiences droughts, floods, frosts, heavy snowfalls, strong winds, hailstorms, and tornadoes. Frequent droughts result in poor harvests and large livestock losses. Dry spells also create food shortages, famine, disease epidemics, invasions by exotic plants and destructive insects, dust bowls, and down-cutting by rivers.[45] These adverse climatic conditions undermine the country's economic development and the well-being of the nation (UNEP, website report and ALM Lesotho profile).

177. Lesotho's vulnerability to climate change and climate variability arises from several factors: erratic rainfall, fragile soils, and worsening land degradation in the face of a growing population. All are exacerbated by poor land-management practices, particularly in the livestock sector. In addition, Lesotho is highly vulnerable to climate-related challenges due to over-reliance on rain-fed agriculture for food production. Climate change forecasts point to detrimental impacts on the agricultural and livestock sectors in a country already ravaged by cycles of drought and intense rainfall that combine to create massive soil erosion and gully formation, resulting in loss of Lesotho's very limited agricultural land (IFAD, 2014).

178. Lesotho is expected to experience changes in temperature and precipitation patterns, becoming drier and hotter. The mean annual temperature in Lesotho already increased by 0.76° C between 1970 and 2001,[46] and inter-seasonal (between seasons) and intra-

[44] Winter occurs during June-August, and mean temperatures vary from 0.1° C to 17.3° C. Significant amounts of snowfall occur during this season in high-lying areas and every three years on average in the low-lying regions. Summer lasts from December to February, with a mean temperature of around 25° C. Around 85 percent of rainfall occurs during the summer months. The main rainy season begins in October and lasts through April, bringing between 400-1,200 mm of rainfall per year. Lesotho's northern region experiences the most rainfall (800-1,200 mm) and the Senqu River Valley and southern lowland districts experience the least rainfall (400-600 mm) (GoL, 2013).
[45] The occurrence of dry spells has been found to be correlated to the El Niño phenomenon—an abnormal increase in surface sea temperatures—while wet spells are related to La Niña conditions (ALM website).
[46] Projected mean annual temperature increases: 1.78-2.23° C by 2060 and 2.48-4.50° C by 2100 (GoL, 2013).

seasonal (within a season) precipitation has become more variable (GoL, 2013).[47] In addition, the intensity and frequency of floods, droughts, and other extreme weather events have increased, especially in the western and northern lowlands. Droughts have become more frequent in recent years,[48] and recurrent droughts[49] have resulted in a steep reduction in the production of cereals and other staple crops (GOL, 2013). In the past 50 years, Lesotho has gone from a position of virtual self-sufficiency in grain production to being highly dependent on imports.[50] Foreigners currently supply 50 percent to 60 percent of Lesotho's annual grain requirements. The main reason for the dramatic decline in grain production has been the extreme variability of Lesotho's rainfall, particularly the severity and length of drought periods (IFAD, 2014). In addition, Lesotho is experiencing desertification in the southern lowlands and across the Senqu River Valley (GoL, 2013). Increases in the frequency and intensity of extreme events and natural disasters have also been observed in recent years (Table 18).

Table 18. Natural disasters from 1980-2010

No. of events:	15
No. of people killed:	97
Average killed per year:	3
No. of people affected:	1,996,947
Average affected per year:	64,418
Economic Damage (US$ X 1,000):	0
Economic Damage per year (US$ X 1,000):	0

Source: http://www.preventionweb.net/english/countries/statistics/?cid=97.

179. The impacts of climate change in Lesotho will vary from sector to sector. Water resources will be affected negatively by reductions of precipitation and increases in temperature. This will result in greater evaporation losses and decreases in runoff and groundwater recharge. Rangeland conditions may deteriorate—and ultimately be destroyed—by climate changes, leading to declines in the quality of livestock and livestock products. The present indigenous forests may change into semi-arid types, while agricultural production will decline, resulting in food shortages (ALM, website).

180. In terms of impacts on health, Lesotho has few recorded occurrences of tropical vector-borne diseases, but it has been affected by meningococcal meningitis, which was one of the top five causes for adult mortality in 2010. Meningitis is related to climate and environmental factors, particularly drought, which may affect its spatial distribution, intensity, and seasonality. In addition, falling agricultural output due to drought may lead to reduced dietary diversity and lead to micronutrient deficiencies. Strategies that will reduce the risks posed by climate change include: development of early warning systems that forecast health-related weather events; strengthening institutional capacity; promotion and development of better infrastructure; and integration of climate change into health policies (GoL, 2013).

[47] Mean annual precipitation is projected to increase slightly by middle (2046-2065) and late 21st century (2081-2100) under low, medium, and high emissions scenarios (GoL, 2013).
[48] Between April 1991 and October 1995, Lesotho experienced the longest drought in almost 200 years (GoL, 2013).
[49] Devastating floods in December 2010 and February 2011 resulted in severe economic losses, equivalent to 3.2 percent of Lesotho's GDP.
[50] Cereal yields in 2010 were 909 kilograms per hectare, compared with the sub-Saharan Africa average of 1,400 kilograms per hectare (WB climate change portal).

Knowledge Gap: Climate change

Currently, Lesotho has no climate change strategy. Understanding of how climate change may affect vulnerable rural communities is limited, along with the implications this may have on migration and urbanization.

5.5 SUSTAINABILITY: BRIEF SUMMARY OF MAIN MESSAGES AND KEY CHALLENGES IDENTIFIED

181. This chapter argues that Lesotho's growth model is not sustainable. Lesotho's macro-fiscal situation threatens the sustainability of the exchange-rate peg. In addition, as mentioned in Chapter 3, the current level of public spending could be crowding out private-sector investment. Addressing this issue will require the Government to make hard choices on fiscal consolidation and rebuild its buffers to manage fiscal and external risks. This is likely to require a fundamental rethinking of the government's scope and in the economy. It will also require the Government to change its mindset and adopt more modern, efficiency-driven, and accountable approaches to service delivery. Finally, important environmental issues, such as land degradation, need to be addressed. Table 19 summarizes these issues and identifies the channels through which they impact the twin goals. This is analyzed further in Chapter 6.

Table 19: Summary of main issues identified—Chapter 5

Area	Specific issues	Channel for impact on twin goals
Revenue management	Key revenue source (SACU receipts) highly volatile	Risks to sustainability of growth through fiscal vulnerability
Consolidation of public sector	Government spending as share of GDP extremely high and rebuilding buffers will require achieving even greater savings; high wage bill and other recurrent costs persistent	Risks to fiscal sustainability as well as to the sustainability to the currency peg (but consolidation risks lowering growth)
Public investment management	Ineffective planning and project implementation linked to capacity and management	Cross-cutting risk to efficiency and effectiveness of service delivery
Capacity to implement projects and programs	Lack of skills; weak political consensus.	Cross-cutting risk to efficiency and effectiveness of service delivery
Public financial management and Procurement	Weak public financial management and procurement	Cross-cutting risk to efficiency and effectiveness of service delivery
M&E and accountability	Weak monitoring and evaluation and accountability systems	Cross-cutting risk to efficiency and effectiveness of service delivery
Statistical capacity	Insufficient frequency, scope, quality of data collection	Cross-cutting risk to efficiency and effectiveness of service delivery and policies targeting poverty and growth by undermining potential for evidence-based policymaking
Sustainable natural resource management	Land degradation	Risks to sustainability of poverty reduction by depleting important resources for agriculture and tourism
Climate change	Vulnerability of key resources in the context of climate change	Risks to sustainability of growth and poverty reduction

6. PRIORITIZING THE CHALLENGES

Lesotho faces many constraints to achieving the goals of eradicating extreme poverty and improving shared prosperity, stimulating jobs-intensive and private sector-driven growth, and ensuring that all Basotho can contribute to and share in the gains from growth. Prioritization these constraints is challenging, but by assessing potential impact, complementarities, and sequencing, a set of five broadly defined priorities are identified for implementation. They are: (i) reducing the size of the state, rebuilding buffers, and improving service delivery by achieving fiscal consolidation and modernizing the public sector; (ii) facilitating a competitive export-oriented private sector by aligning incentives and developing key infrastructure; (iii) increasing the returns to self-employment by raising smallholders' productivity; (iv) improving health and education outcomes by reducing the disease burden and raising and aligning skills; and (v) reforming social protection to reduce fragmentation and improve targeting, efficiency, and effectiveness.

6.1 INTRODUCTION AND SUMMARY OF THE CHALLENGES

182. **For Lesotho, the analysis presented in this report shows an adequate level of growth that has not been inclusive.** Both poverty and inequality are among the highest in the world. Fundamentally, this is because Lesotho's growth has not been conducive to reducing poverty and inequality. At the heart of the country's challenge, therefore, is the need to develop a more inclusive and sustainable growth model, one that ensures the drivers of growth and inclusion are interrelated.

183. **As Chapters 3-5 of this report have described in detail, Lesotho faces a broad range of constraints to achieving the transition to this new growth model and subsequently to making continued, rapid progress toward the twin goals.** Table 20 summarizes the 26 broad challenges identified in these report. They are organized along three pathways:

- Redefining the role of the state
- Promoting private sector-led jobs-intensive growth;
- Strengthening individual and group assets.

Table 20: Summary of main issues identified

Pathway	Broad challenge identified	Specific Constraints
Redefining the role of the state	**1. Revenue management**	Key revenue source (SACU receipts) highly volatile
	2. Consolidation of public sector	Government spending as share of GDP extremely high and rebuilding buffers will require achieving greater savings High wage bill and other recurrent costs persist
	3. Public investment management	Ineffective planning and project implementation linked to capacity and management
	4. Capacity to implement projects and programs	Lack of skills Weak political consensus
	5. Public financial management and Procurement	Weak public financial management and procurement
	6. M&E and accountability	Weak monitoring and evaluation and accountability systems
	7. Statistical capacity	Insufficient frequency, scope, quality of data collection
	8. Sustainable natural resource management	Land degradation

	9. Climate change	Vulnerability of key resources in the context of climate change
Promoting private-sector led jobs-intensive growth	**10. Smallholder productivity**	Low productivity in the agriculture sector
	11. Politics	Weak political consensus to reform
	12. Labor supply	Skills and competency gaps
	13. Business red tape	Administrative and regulatory burdens
	14. Competition	Policy environment, including fiscal policy, crowds out private sector and raises inputs costs and jeopardizes quality
	15. Infrastructure	Gaps in electricity and serviced factory shells and industrial serviced sites Gaps in air connections, roads, transport services, ICT, and cross-border trade facilitation
	16. Access to finance	Low levels of inclusion, in particular with SMEs
	17. Technology and innovation	Low levels of technology adoption
Strengthening individual and community assets	**18. HIV prevention**	Continued high incidence rates and no substantial changes in behavior
	19. Childhood malnutrition	Very high rate
	20. Access to health	Limited access to the poor
	21. Access to sanitation	Low levels of proper sanitation
	22. Access to electricity	Very limited
	23. Quality and equity of educational outcomes	Education outcomes are poor despite high level of spending Poor alignment of skills and jobs Low quality of education Cost of secondary education is relatively high for the poor
	24. Efficiency and effectiveness of social protection system	Most social programs do not target the poor
	25. Gender	Legal Capacity of Married Persons Act of 2006 has not been fully implemented
	26. Political instability	Still a lingering issue

6.2 DESCRIPTION OF PRIORITIZATION PROCESS

184. Each of the challenges in Table 20 where assessed within a "theory of change" framework, shown in Annex 3 (Table 24). The assessment identifies (i) the desired results that would hopefully be achieved by removing these constraints and (ii) logical links that show how removal of the constraints would ultimately impact the twin goals of eradicating extreme poverty and improving shared prosperity via the three broad pathways. By mapping the pathway, this approach helps highlight key complementarities across the challenges as well as the degree to which addressing certain challenges may be pre-requisites to unlocking others.

185. To identify priorities, each challenge was then assessed against a set of criteria, as outlined in Box 5. A quantitative score was given for each, with the assessment of the impact on achieving the twin goals weighted heaviest. See Annex 3 for a detailed description of the quantitative assessment process; results are shown in Table 24 of Annex 3.

Box 5: Criteria for prioritization

The criteria used in scoring as part of the prioritization exercise were:

- *Impact on twin goals*: To what degree would resolving the constraint (or exploiting the opportunity) have a direct impact on eradicating extreme poverty? To what degree would resolving the constraint (or exploiting the opportunity) have a direct impact on supporting sustainable incomes and livelihoods among those in the bottom 40 percent of the population? The emphasis is on job-creating growth.

- *Time horizon of impacts*: Over what timeframe will the impact be realized?
- *Complementarities*: To what degree does the issue have influence across different domains (growth, inequality, sustainability) and/or would magnify the positive impact of addressing other constraints?
- *Evidence base*: Given the quality of the evidence, how confident are we in identifying the issue as a priority? In many cases, Lesotho's evidence base—through statistics, strategies, and reports—is relatively solid, despite the fact that data is often weak. However, much of the evidence in several cases remains anectotal. In these cases, issues were rated as having a less solid evidence base to support the assessment.
- *Adequacy of existing interventions:*[51] The intention of the SCD is not to identify issues that have somehow been completely passed over by policymakers. This is unrealistic, and it would indeed be concerning if such issues were identified. In fact, the Government is addressing all of the challenges identified in this report to some extent. This criterion aims to identify areas where significant additional public intervention is warranted.[52]

186. Overall, the desk analysis resulted in identifying 14 of the 26 challenges as "highest" and "high" priority (see *Annex 3, Table 24 and Table 25*). Other identified challenges did not rank among the top 14 for a variety of reasons. Most common, it was either: (i) they had a long pathway to eliminating poverty and increasing shared prosperity and/or (ii) there was already a fairly effective intervention in place to address the challenge.

187. To complement and enrich the desk assessment, consultations were held with key stakeholders. This included a workshop within the World Bank, which solicited input from across the global technical practices, and five workshops in Lesotho with representatives of government, the private sector, civil society, and development partners. Annex 4 presents details on the consultations conducted throughout the SCD process. During the sessions, the analysis from Chapters 3-5 was presented, along with the logic leading to the identification of challenges and priorities. This was followed by discussion of the analysis and identification of priorities. Overall, the consultations underlined broad support for the analysis and priorities identified, and the consultations impacted the prioritization process in several ways:

- *Recognizing the limitations of quantitative rankings*: As expected, individuals and organizations with vested interests in certain sectoral and technical areas not identified as priorities often made forceful arguments to the contrary. Bolstered by strong technical expertise, these arguments were, of course, fairly effective. This underlined the contestability of quantitative ratings and the importance of leaving scope for flexibility in the CPF process by grouping some identified priorities into broader categories.

- *Highlighting the critical role of improving efficiency and effectiveness of public spending*: The consultations, particularly those in Lesotho, put strong emphasis on the priority of addressing issues related to improving the efficiency and effectiveness of public spending.

[51] Used as a criteria in the Botswana Systematic Country Diagnostic (2015).

[52] This criterion takes into consideration only those interventions that ongoing. For Bank-related projects, it was based on the BTORs and Aide Memoires. In addition, key development partners informed us about the status of existing information during the consultations. Based on this information, a score of 3 was given to weak adequacy of existing interventions, while a score of 1 was given to strong adequacy of existing interventions.

- *Highlighting the critical pre-condition of political consensus and stability*. Sessions with government officials showed they are well-aware of the key challenges identified in the diagnostic, but the Government's ability to implement major reforms/corrective actions has been impaired by the lack of political consensus and resistance from political and business special interests.

- *Identifying linkages and complementarities*: The sessions were particularly helpful in further identifying the linkages and complementarities across challenges, which again supports the idea of grouping some identified priorities into broader categories.

- *Describing the status of ongoing interventions*: The consultations were particularly helpful in providing additional details on the nature and status of existing interventions (by government, development partners, etc.) to address many of the challenges identified.

6.3 PRIORITIZATION: FINAL RESULTS

188. Pulling together the results from the prioritization exercise, Figure 76 provides an overview of the challenges and priority interventions identified. These are shown with their links to the three pathways highlighted in this note and, ultimately, to the twin goals. It is important to note that prioritization of some challenges does not suggest ignoring others. All the issues discussed in this report are important to ensuring sustainable, inclusive growth and poverty reduction in Lesotho. And to some degree, the Government will need to put time and resources into all of them. The purpose of the SCD prioritization is to identify those challenges that are likely to have the greatest bearing on eliminating absolute poverty and on improving the welfare of the less-well-off in the medium term. In short, we are proposing an emphasis rather than a sole focus.

189. The final priorities are discussed in further detail below:

190. None of the priority interventions outlined below will deliver rapid and sustainable progress on the twin goals without addressing the fundamental challenge—the need to **redefine the role of the state:**

- *Fiscal consolidation.* The sheer size of the state, coupled with misaligned expenditures, including a high wage bill, is one of the fundamental obstacles to the sustainability of inclusive growth, more diversified growth itself, and building assets among the poor. Fiscal consolidation can be achieved through downsizing or eliminating programs and projects and through headcount reductions, while at the same time improving outcomes. In addition, strengthening management of SACU receipts will be essential for macroeconomic stability. Other countries dealing with similar revenue fluctuations have successfully aligned public spending through credible estimates of long-term government revenue. Strengthening domestic revenue could be an alternative that would reduce dependency on SACU revenues. With other revenue sources in place, SACU windfalls could be used to restore buffers and to invest in key infrastructure to boost private-sector development.

- *Public sector modernization for effectiveness and efficiency*: Fundamental to addressing the challenges are: regularizing human resource management and establishing a Performance Management System; improving the effectiveness and efficiency of public spending; adopting systems and processes to improve public investment management, project management, procurement, and program delivery; and putting in place systematic and meaningful processes for monitoring and accountability. Finally, a skilled and effective civil service is needed.

191. As discussed throughout this report, eliminating poverty and improving the welfare of the bottom 40 percent of the population will require a fundamental shift to a new growth model, one that gives inclusion a central role and creates sufficient, broad-based employment. This will require the **development of a competitive and export-oriented private sector:**

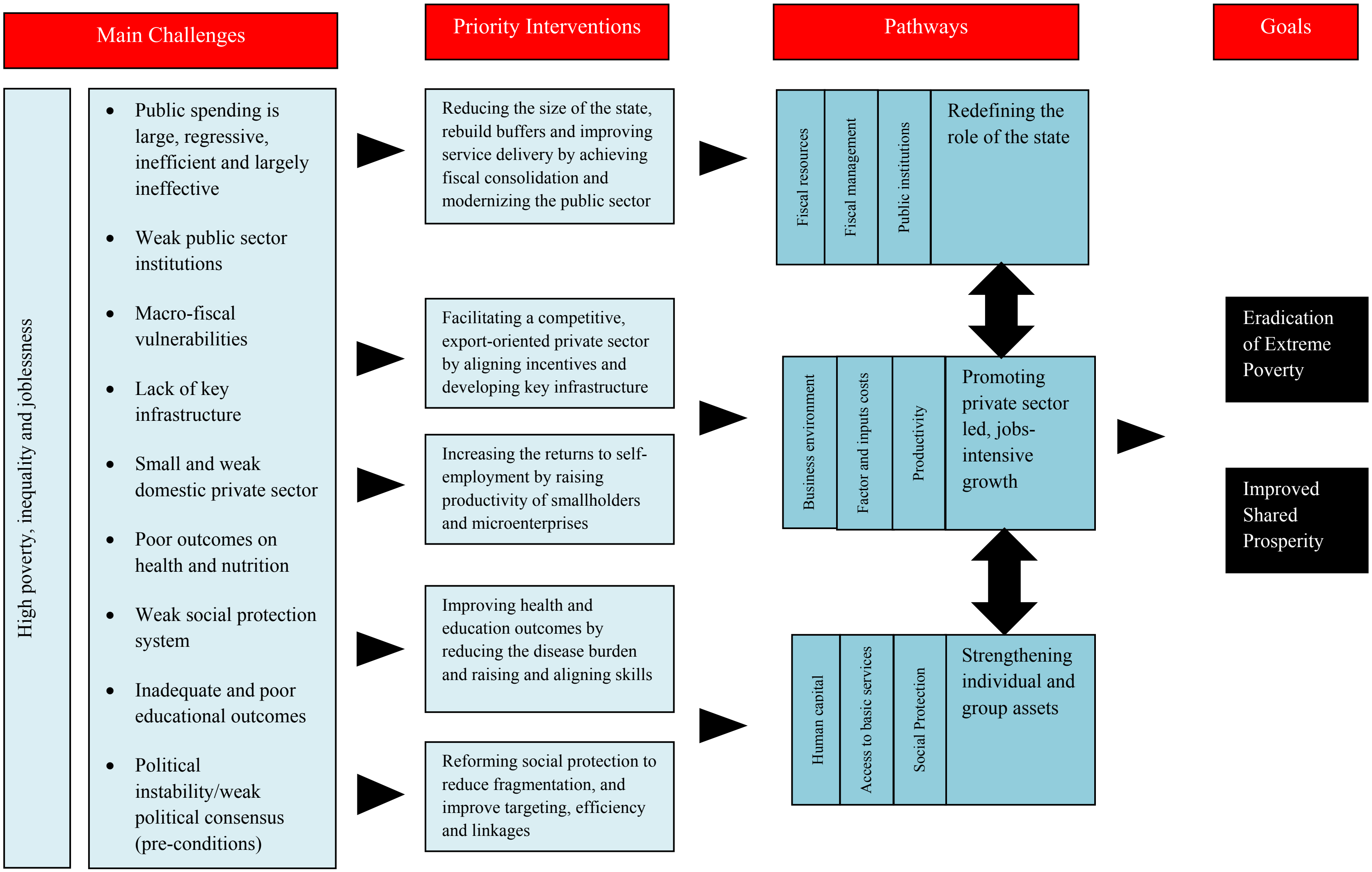
i. *Establishing incentives to support an outward-oriented private sector,* including trade, competition, and business-regulation policies that ensure access to competitively priced inputs and skills and improve incentives to compete in tradable sectors. Skilled and talented Basotho have long faced an environment in which the most attractive career choices have been to join the public sector or to migrate to South Africa. For those looking to become entrepreneurs, the easiest and highest returns could be found by focusing on domestic non-tradables and government contracts. With such a small domestic market, Lesotho needs build competitive, productive export-oriented firms capable of generating significant employment. It will require redefining the role of the state by moving away from areas that should be undertaken by the private sector (for example, provisioning factory shells), cutting the red tape in business regulation, and abandoning policies to promote national champions.

ii. *Developing key infrastructure:* The returns to export-oriented activities in Lesotho are relatively low due to a variety of factors--some structural, others policy-related. While high input costs can be partly addressed through the incentive framework discussed above and productivity addressed through improvements in human capital discussed below, building key infrastructure is critical to competitiveness. This will require a focus on improving: (i) trade facilitation, (ii) access to electricity, (iii) sustainable and safe road connectivity, and (iv) the speed, quality, and cost effectiveness of ICT infrastructure.

Knowledge Gap: Analysis of the private sector

Identifying the incentives to develop the private sector will require a much deeper analysis. How big is it? How is it structured (firm size, sectors, formal/informal)? How much is it dependent on government contracts? This analysis will help identify specific opportunities that may be available given Lesotho's location and endowments.

Figure 76: Overview of identified priorities to eliminate extreme poverty and promote shared prosperity



192. Developing a competitive private sector capable of generating broad-based employment will take time. Such a structural change will require from 15 to 20 years. During this time, a large share of the population, particularly those in rural areas, will still rely on farming. Many of the poor and "near poor" that fall outside the formal labor market will continue to face risks of falling back into poverty. For this reason, Lesotho needs to focus on increasing the opportunities and returns to self-employment by **raising productivity of smallholders and microenterprises**:

- *Raising productivity of smallholder and microenterprises:* Improving productivity and increasing agricultural incomes is key to developing a more vibrant rural economy, which will in turn create non-farm employment opportunities. The agenda for raising smallholder productivity will focus on establishing the right incentives for adopting more appropriate technologies and production methods to improve yields and mitigate risks. This will require strengthening the extension system. In addition, seeking new opportunities, such as developing horticulture for regional markets will be important. Outside agriculture, interventions will promote a more dynamic microenterprise sector, both in rural and urban areas, with a focus not only on entry into self-employment and the SMME sector but also on improving productivity within the sector through capacity-building and access to services. Given the sector's existing limits, a starting point will be deepening the knowledge base to ensure that interventions are built on a strong evidence base.

Knowledge Gap: Gender constraints to agricultural productivity

Given the importance of improving smallholder productivity, it will be particularly critical to know whether there are any gender-specific constraints that prevent female farmers from being as productive as their male counterparts. The recent World Bank/One Foundation "Levelling the Field" (2014) report carried out analysis using LSMS-ISA data and found that in many countries women suffer from lower agricultural productivity caused by restricted access to various productive inputs and structural factors that reduce women's returns on various inputs. Currently, available data are not sufficient to undertake a similar study for Lesotho. The analysis would require gender disaggregated data on farmers' use of various productive inputs and on their agricultural yields.

193. Developing a new growth model will also require large gains in firm-level productivity, which will depend on substantial improvements in **human capital:**

- *Human capital for employment, productivity, and human development*: Lesotho's private sector requires a workforce with better and more appropriate skills; this will be key to improving firm-level productivity and driving competitiveness in diversified sectors. But it also requires a much-improved health environment to ensure that all individuals have the capacity to contribute to productivity and enjoy adequate human development outcomes. This will require a specific focus on elements of both education and health:

    i. *Education*: Raising the quality of education, with a specific focus on aligning skills with labor market needs, will equip Basotho, especially the youth, to participate productively in the economy, whether through formal employment or microenterprises. The focus will be on improving the relevance of skills, primary education quality, primary completion rates, vocational training, and access to post-primary education for the poor.

ii. *Health*: Improving health care will focus on: (i) health barriers to skills acquisition and labor-market participation, particularly infant and child malnutrition and the impact of disease (especially HIV) on female participation in income-earning activities and (ii) efforts to improve access to reproductive health services. Intensifying efforts to improve outcomes in HIV prevention is likely to be critical over the medium term. Life expectancy and incidence of disease are critical elements for Lesotho's future.

194. Achieving a transformation in the drivers of growth will take time. In the short term, it will be necessary to **strengthen the social-protection system**:

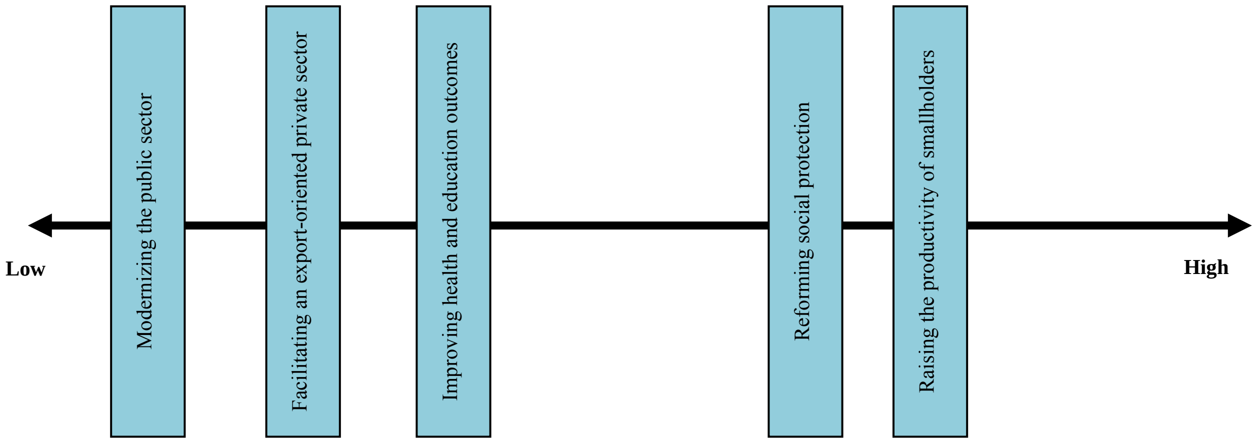
- *Reforming social protection*: A social protection reform is needed because of the magnitude and depth of poverty in Lesotho, stagnation in the labor market, and the urgency to arrest the rise of inequality in the short run. The priorities for the reform include improving targeting accuracy and coverage of targeted programs, improving administration systems, and harmonizing fragmented programs.

6.4 IMPLEMENTATION OF THE PRIORITY INTERVENTIONS

195. Most of the issues raised in the report have been identified by the National Strategic Development Plan and previous poverty-reduction strategic papers. In addition, some sectorial strategies and specific programs address these issues. But the fact that strategies, policies, and programs have been in place to address what are still identified as priority challenges suggests they have not been fully effective and raises some questions on implementation potential. Despite the low capacity of public services, it is possible to implement the package of priority interventions outlined in this report.

196. Figure 77 provides a broad assessment of implementation potential across the six priority areas—it considers both capacity and political consensus. Overall, reforming social protection and raising the productivity of smallholders have the best potential for implementation in the short run. By contrast, public-sector modernization and interventions to support an export-oriented private sector have the lowest implementation potential. This reflects capacity and political consensus. In areas like human capital development, some political consensus exists to support priority interventions, but achieving results can be difficult and some capacity limitations will need to be overcome.

Figure 77: Summary assessment of implementation



ANNEX 1: NON-INCOME DIMENSIONS OF POVERTY IN LESOTHO—VALIDATION EXERCISE

197. **Estimates suggest that poverty has been stagnant in Lesotho, and inequality has increased.** However, lack of comparable and reliable data on consumption and income creates a need to verify these findings by examining non-income dimensions of poverty. This section examines a number of non-monetary measures of well-being to look for corroborating evidence of the poverty trends found in the observed consumption aggregate in FY2002/03 and the imputed consumption aggregate in FY2010/11. Specifically, we analyzed household asset ownership, access to education, and basic services.

Asset ownership

198. **The data do not show gains in ownership of traditional assets across the population, supporting the possible stagnation in poverty.** Ownership of durable goods is often a proxy for households' welfare. We construct a simple indicator summarizing durables ownership by adding up a number of dummy variables (27) for whether a household owns each comparable item listed in the two surveys. Figure 78 illustrates a large improvement in asset ownership along the entire distribution of the asset index. To a large extent, however, the durable goods that showed the largest increase over time are expensive electronics—TVs, video players, satellite dishes, electric stoves, solar systems, etc. Cheap durable goods—fans, bikes, irons, sewing machines, etc.—remain the same or even show small declines. One important exception is represented by cell phones: the share of households reporting owning at least one cell phone increased fivefold from 12.8 percent to more than 71 percent. As Allwine et al. (2013) argue, there was a substantial decline in cell phones charges because of a rapid expansion of cell phone networks. If a cell phone was a luxury good in 2003, it certainly was not seven years later. Breaking down the set of durable goods into sub-groups of "traditional" and "high-tech" assets, the gains observed in the global index show up only in the "high-tech" index, not in the "traditional" one. In other words, the welfare improvement suggested by the global index appears to be mainly driven by access to expensive "high-tech" goods, mostly cell phones.

199. **Along the same lines, Figure 79 shows the distribution of a farm assets indicator, which includes ownership of livestock (cattle, poultry, horse, pigs) and farm implements (tractor, plough, wheel barrow, scotch cart, etc.).** Among households running a farm,[53] ownership of farm assets deteriorated between FY2002/03 and FY2010/11, particularly among households in the middle of the distribution—between the 20th and the 80th percentile.

[53] Households are defined as farm households if they report having some portion of land.

Figure 78: Assets index, Fy2002/03 and FY2010/11

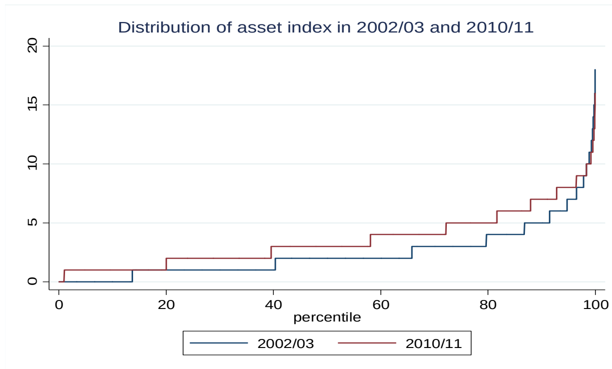
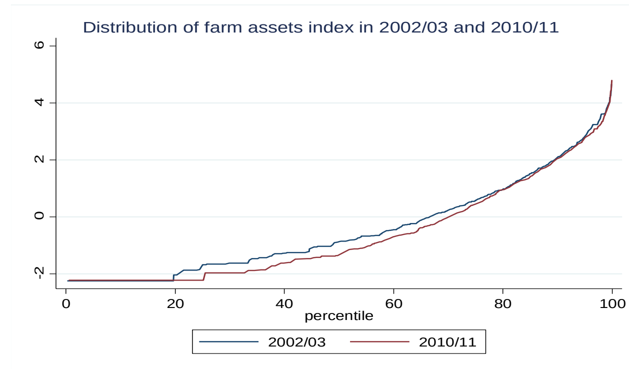


Figure 79: Farm assets index, FY2002/03 and FY2010/11



Source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

Access to Education

200. Access to basic education has improved, but access to the higher education did not change. Measured by the literacy rate among the population aged 15 and over, access to basic education improved between FY2002/3 and FY 2010/11, and it did so along the entire distribution of consumption, especially among the poor and in rural areas (Figure 80). Due to the introduction of free primary education in 2000, the share of individuals aged 15 and over with no education decreased and those who completed primary education increased. However, those with a secondary education fell 2 percentage points, and the upper part of the education distribution showed no major changes (Figure 81).

Figure 80: Literacy rate—population aged 15 and over, FY2002/03 and FY2010/11

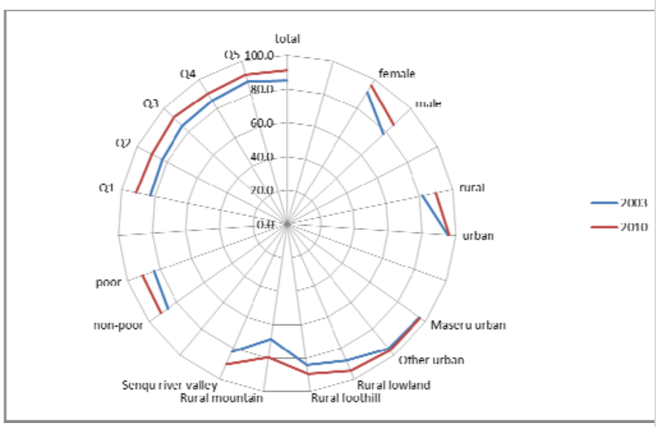
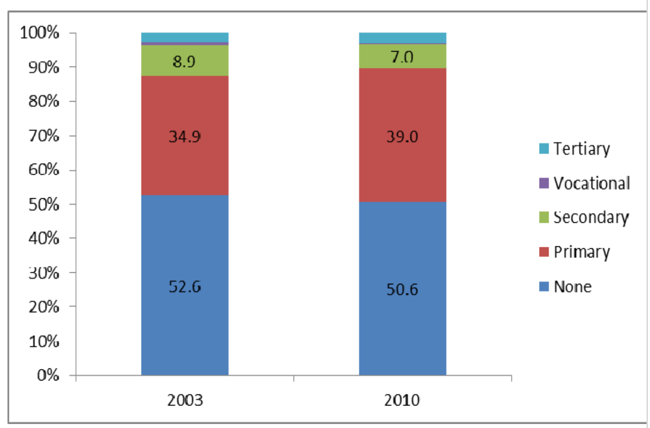


Figure 81: Highest educational level completed—population aged 15 and over, FY2002/03 and FY2010/11



Source: Staff estimates from HBS (FY2002/03) and CMS/HBS (FY2010/11).

Access to services

201. Access to electricity has somewhat improved, but overcrowding has deteriorated. A second set of indicators concerns access to services and the number of persons per occupied room, a measure of overcrowding. In Lesotho, the percentage of households reporting access to electricity is still very low—but it did improve after FY2002/03 (Figure 82). In FY2010/11, about 14 percent of the households had access to electricity—about 50 percent in urban areas and 20 percent among the non-poor. Although the major improvements were observed among the poor and in rural areas, these groups still lagged.

202. The number of persons per occupied room can foster the spread of infectious diseases, produce negative psychological effects like frustration and anxiety, and lead to more violence due, for example, to increased physical contact and lack of sleep. On average, there were more than 2 persons per occupied room in 2003, and conditions deteriorated over the next seven years, reaching an average of 3.7 persons per room (Figure 83).

Figure 82: Access to electricity, FY2002/03 and FY2010/11

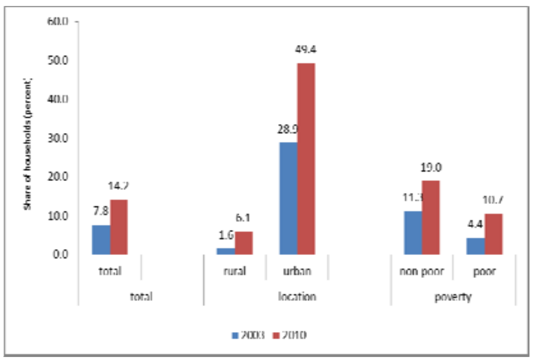
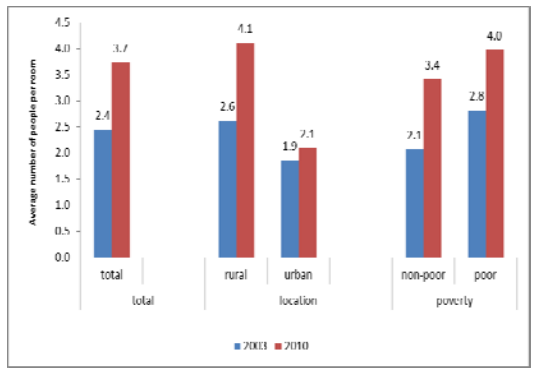


Figure 83: Room overcrowding indicator, FY2002/03 and FY2010/11



Data source: Lesotho Bureau of Statistics (2014) comprising HBS (FY2002/03) and CMS/HBS (FY2010/11).

203. Conclusion: Non-income analysis generally does not contradict the partly imputed income analysis. Assets ownership remained the same between FY2002/03 and FY2010/11, with an exception of the introduction of cell phones. Access has improved for basic education and electricity. However, access has not changed for secondary and higher education; rates of housing and overcrowding have increased. There were some improvements in labor market indicators, but lack of income data means we cannot validate improvements in productivity.

204. We analyze the poverty and associated distributional changes using the economic growth projections in Table 21. The projections suggest further deterioration in manufacturing, contrasted with the boom in trade and other services.

Baseline macro and demographic scenario—main assumptions
Table 21: GDP by sector, baseline scenario

	Compounded Growth Rates			Average Growth rates		
	2010-2014	2010-2016	2010-2020	2010-2014	2010-2016	2010-2020
Agriculture	3.3	10.4	25.6	0.8	1.7	2.3
Mining and quarrying	51.2	58.0	76.5	10.9	7.9	5.8
Manufacturing	-15.4	-14.0	-11.6	-4.1	-2.5	-1.2
Electricity and water	13.2	27.3	61.9	3.2	4.1	4.9
Construction	44.5	50.6	73.1	9.6	7.1	5.6
Wholesale and retail trade, repairs	31.0	61.6	131.9	7.0	8.3	8.8
Hotels and restaurants	13.4	20.3	35.3	3.2	3.1	3.1
Transport and communication	38.3	58.4	107.7	8.4	8.0	7.6
Financial intermediation	93.3	141.6	276.5	17.9	15.8	14.2
Real estate and business services	12.6	28.8	64.0	3.0	4.3	5.1
Public administration	11.7	18.4	36.5	2.8	2.9	3.2
Education	8.7	15.4	33.3	2.1	2.4	2.9
Health and social work	126.8	144.0	195.9	22.7	16.0	11.5
Community, social and personal services	10.2	13.7	21.2	2.5	2.2	1.9
Total Economy	20.5	33.3	63.4	4.8	4.9	5.0

Source: Staff estimates. The information on sectoral economic growth comes from the World Bank's Lesotho economic projections.

205. **The macroeconomic projections are augmented with assumptions on demographic changes and a better educated workforce.** Specifically, we use demographic forecasts from the UN World Population Prospects (UN, 2012), applying them to the working-age population (Table 22).

Table 22: Demographic assumptions of baseline scenario

Year	Population in thousands					Composition			
	Total	0-14	15-24	25-64	65+	0-14	15-24	25-64	65+
2010	2,009	756	470	697	86	37.6	23.4	34.7	4.3
2015	2,120	755	487	789	88	35.6	23.0	37.2	4.2
2020	2,226	773	481	877	94	34.7	21.6	39.4	4.2
2025	2,325	786	471	971	97	33.8	20.3	41.8	4.2
2030	2,419	778	487	1,059	95	32.2	20.1	43.8	3.9

Source: Staff estimates based on UN (2012).

206. **For schooling among the working-age population, we extrapolate (assuming a reduced pace of expansion) the observed changes between FY2002/03 and FY2010/11 in completed primary, lower, upper, and post-secondary education.** We assume that the share of the working-age population with no or only primary schooling falls by 8 percentage points, with the share of individuals with upper and post-secondary education expanding accordingly (Table 23).

Table 23: Educational expansion assumptions of baseline scenario

	None	Primary	Secondary	Vocational and Tertiary
2002	52.6	34.9	8.9	3.6
2010	50.6	39.0	7.0	3.4
2016	48.6	36.9	9.5	5.0
2020	46.6	37.4	10.0	6.0

Source: Staff estimates based on the Lesotho HBS (FY2002/3) and CMS (FY2010/11 data). Author's extrapolation for the later years.

207. During the 2000s, households' consumption showed significantly lower growth rates than GDP. In simulations, we assume the similar pattern will continue. However, the exact elasticity between GDP and private consumption is unclear. We assume three very different elasticities of 0.4, 0.6, and 0.8 to estimate the ranges for poverty changes in the baseline scenario. Thus, changes in poverty are dependent on consumption growth rates.

ANNEX 2: GENDER

I. Legal Rights

208. Vested with full legal capacity and liberated from male guardianship, adult Basotho women are now, in theory, better equipped to play more productive and active roles as economic and social agents. Lesotho's Constitution provides for equality and justice to males and females. It also mandates fair wages and equal remuneration for work of equal value—in particular; women are guaranteed conditions of work, including pension or retirement benefits that are not inferior to those given to men. The current law on land matters is gender neutral in its provisions. The 2006 Legal Capacity of Married Persons (LCMP) Act, along with other progressive legislation, laid the groundwork for a gender-responsive legal framework that protects women's rights and provided for the repeal of all customary and civil laws giving a husband legal authority over his wife or her property. The ability that this law gives women to engage in economic transactions in the absence of their husbands is particularly significant in a country where husbands and wives are often separated due to migration.

209. However, women have yet to experience the full potential LCMP benefits because of inadequate implementation, which has been complicated by the dual legal system, slow-changing social attitudes, the financial costs associated with seeking redress for violation of women's new rights, and women's lack of awareness of these rights. So far, efforts to improve women's awareness of their rights have included training and outreach events provided by the Millennium Challenge Account-Lesotho (World Bank, 2010). This effort has also worked to create a federation of Lesotho women entrepreneurs, allowing women to come together and share experiences. Awareness of the LCMP rights needs to be built not only amongst women themselves but also amongst other actors who may still be impeding women by following the discriminatory business practices of the past. For example, it is thought that Banks in Lesotho often still request a husband's approval before granting credit to businesswomen. The issue of implementation is complicated by the fact that the LCMP Act resulted from a top-down legislative process, which has taken place in a cultural environment still not entirely supportive of women's empowerment (World Bank, 2010). While this is true, it should be noted that some measures of women's empowerment appear to be better in Lesotho than in many neighboring countries. For example, compared to most peer countries, a smaller percentage of women in Lesotho report acceptance of wife beating or not being involved in key decisions on their own health care or on major household purchases.

II. HIV

Overview:

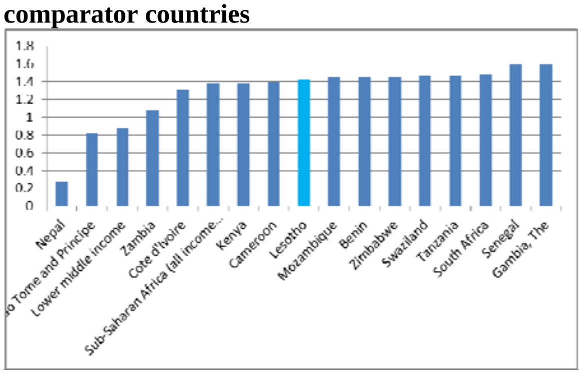
- Lesotho has the 2nd highest HIV prevalence in the world.
- One of the key channels of transmission of HIV in Lesotho is multiple and concurrent partnerships (MCPs), which are much more common in Lesotho than in sub-Saharan Africa as a whole.
- Women are more likely to be infected, but the gender gap is comparable to many similar countries in sub-Saharan Africa.

- Women are more likely to take on caring responsibilities for HIV patients in their families.
- Women's lower social status and access to economic opportunities may play a role in their greater vulnerability to HIV, giving them a less than equal say in sexual decision-making and making them economically dependent on men, including not only their husbands but also the non-spousal sexual partners that are common due to their own and their husbands' migration.
- Condom use is low in MCPs, especially for women.

A closer look

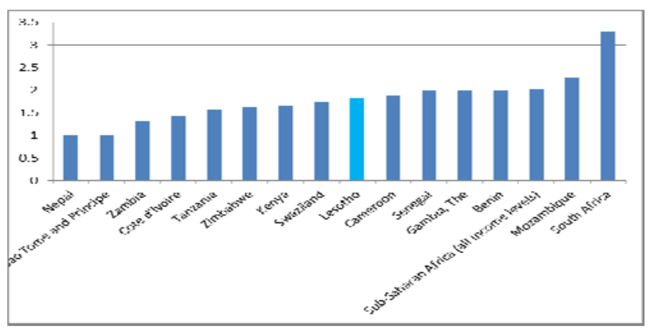
210. The HIV/AIDS pandemic has been declared a national disaster by the Government and is the leading cause of morbidity and mortality in Lesotho (AFDB, 2005). In 2013, Lesotho's prevalence rate of 23 percent was the second highest in the world (after Swaziland). In Lesotho as in most countries in sub-Saharan Africa, women are more vulnerable than men to HIV/AIDS (Figure 84). Of greater concern, the gender disparity in prevalence is even larger among young people (Figure 85). However, the male to female prevalence ratios in Lesotho are similar to those of many comparable countries. As in other countries, women's greater vulnerability to HIV appears to be related to a variety of cultural and economic factors, underpinned by unequal power relations between men and women, with women (especially young women) having less access to various economic assets and being more likely to engage in transactional sex and to experience sexual violence.

Figure 84: The ratio of adult female to male HIV prevalence in Lesotho and a selection of comparator countries



Source: WDI.

Figure 85: Ratio of female to male HIV prevalence amongst those aged 15-24



Source: WDI.

211. The unequal status of women in Lesotho is illustrated by the fact that 37 percent of women (and 55 percent of the poorest women) responded that a husband is justified in beating his wife for at least one of five reasons listed in the 2009 DHS survey. However, this is lower than for many similar countries (Figure 86) and represents a sharp reduction from 48 percent in 2004.[54] In addition, only 49 percent of the poorest women (and 52 percent of all women aged 15-49) believe that a woman is justified in refusing to have sex with her husband if she knows he has sex with other women.

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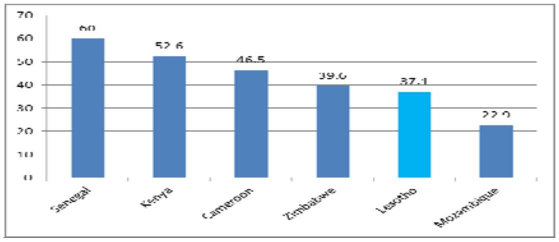
[54] The five reasons included in the DHS are: she burns the food; she argues with her husband; she goes out without telling her husband; she neglects the children; or she refuses to have sexual intercourse with her husband.

Figure 86: Percentage of women who agree with at least one of five reasons for justifying wife-beating



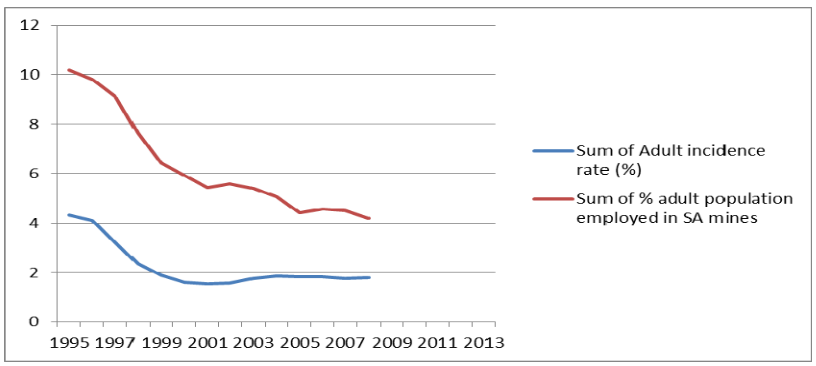
Source: LDHS (2009).

212. The gaps in HIV knowledge appear to be much greater between rich and poor than between women and men, but social attitudes clearly place women in a vulnerable position in relationships and restrict the degree to which they can put their knowledge into practice. Overall, 81 percent of women and 72 percent of men know that using condoms and limiting sexual intercourse to one uninfected partner can prevent HIV. This moderate gender gap disappears for younger age cohorts: 74 percent of women compared to 76 percent of men aged 15-19. There are larger differences among wealth quintiles, with only 68 percent of the poorest women, compared to 87 percent of the richest, knowing that using condoms and limiting sexual intercourse to one uninfected partner can prevent HIV. Knowledge of mother to child transmission (MTCT) of HIV appears to be slightly lower. Only 61 percent of the poorest women, compared to 78 percent of the richest women, know that HIV can be transmitted by breastfeeding and that the risk of MTCT can be reduced by the mother taking special drugs during pregnancy (ICF Macro, 2010). Despite women's knowledge of HIV prevention, only 49 percent of the poorest women (and 52 percent of all women aged 15-49) believe that a woman is justified in refusing to have sex with her husband if she knows he has sex with other women. This suggests that even with improved knowledge, women may still be in a more vulnerable position because of deep-rooted social attitudes. In another example of the inadequacy of knowledge by itself as a protective mechanism, one study of garment factory workers in Lesotho showed that greater knowledge of HIV did not translate into safer sexual practices, except for condom use (Khobotlo at al, 2009).

213. There is a relationship between women's level of economic empowerment and their vulnerability to HIV and sexually transmitted infections (STIs). Research suggests that women are more likely to engage in risky sex (transactional sex, or multiple and concurrent partnerships) when they lack economic opportunities or experience a negative economic shock. For example, a four-month study by de Walque et al (2014) shows that non-sex worker women who experienced a negative shock to their households' food security were 36 percent more likely to test positive for an STI than those women who did not experience such a shock. The impact on the risk of testing positive for an STI was even greater for women with the lowest social status, who have fewer alternative sources of economic support. This evidence points to the importance of ensuring that women are sufficiently empowered to act as independent economic agents—for example, through effective implementation of the legal rights provided in the LCMP Act. This is especially important in a country where women are often separated from their husbands due to migration.

214. Migration has played a key role in the spread of HIV in Lesotho, and the way this has played out has an explicit gender angle. Migration of a single partner breaks up the household and increases the risk of either partner having multiple and concurrent partnerships (MCPs). Indeed, 24 percent of people in Lesotho are estimated to be involved in MCPs (compared to an average of 10 percent for the region) and multiple sexual relationships before and during marriage are thought to be a key factor in the high prevalence of HIV in Lesotho (Khobotlo at al, 2009). Condom use for people with multiple partners is only 38 percent for women and 51 percent for men (ICF Macro, 2010). Before the end of the 1990s, the migration of large numbers of men to work in South African mines was thought to play a significant role in the spread of HIV in Lesotho. Interestingly, we see a steep fall in the HIV incidence rate with the decreasing labor intensiveness of the mines and consequent rapid drop in the proportion of Lesotho's adult population employed by South Africa's mines (Figure 87). The small increase in incidence that we see in the early 2000s may be related to changes in employee regulations, which allowed miners to return home more frequently. This could have aided to spread of the disease if either the miners or their spouses had MCPs (Khobotlo at al., 2009).

Figure 87: Adult incidence rate (%) and percentage of Lesotho's adult population employed in South African mines



Sources: GoL and World Bank.

215. In more recent years, migration has caused partners to be separated again as women migrate to urban areas to work in garment factories. In 2008, around 75 percent of the employees in Lesotho's garment factories were estimated to be migrant workers (Khobotlo at al, 2009). However, it is thought that the most at risk group among garment factory workers are single females aged between 25 and 39. Overall, 44 percent of female and 36 percent of male garment workers tested positive for HIV in 2007, higher than the overall rates for all females and all males (Khobotlo at al, 2009).

216. Finally, women are not only disproportionately affected in terms of being infected with HIV, but are also more likely to take on the role of primary care provider for the sick (Newman et al, 2011).

III. Maternal Health

Overview:

- The latest estimates suggest that maternal mortality is even more critical in Lesotho than in many peer countries.
- Lesotho's progress on maternal mortality appears uneven and actually reversed since the early 1990s.
- Access to quality medical care appears to be the main constraint to women's maternal health, with large gaps in access between the rich and poor.
- The main factors impeding access are concerns about the quality of care, the availability of drugs and costs, including those associated with transport and distance to the nearest health facility.
- Total and adolescent fertility rates do not appear to be as critical an issue as they are in peer countries. As with most indicators in Lesotho, significant gaps exist between rich and poor.

A closer look

217. **The need to improve women's access to quality health care is evident in a very high maternal mortality rate.** The latest modelled estimates from the World Bank and the UN suggest a maternal mortality rate of 490 deaths per 100,000 live births, an improvement from 540 in 2010. However, charting Lesotho along with a range of peer countries shows that its performance is toward the poorer end of the spectrum (Figure 88).[55] Moreover, looking at the trend over the last 15 years, we can see that progress has not been even and that the country actually has a higher rate of maternal mortality today than it did in 1990 (Figure 89). It is clear from this trend that Lesotho will not even get close to its MDG target of 90 deaths per 100,000 live births by 2015.

Figure 88: Maternal mortality ratio (modeled estimate, per 100,000 live births)

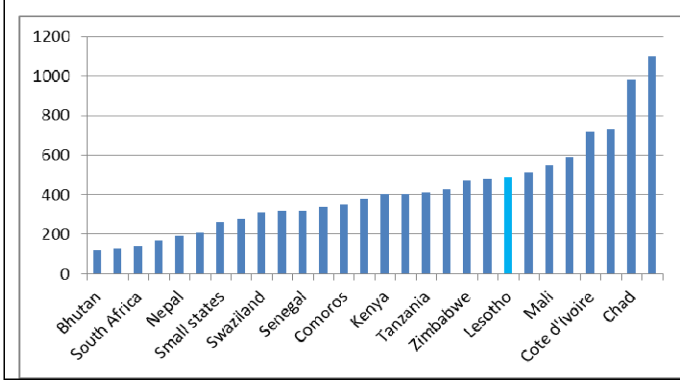
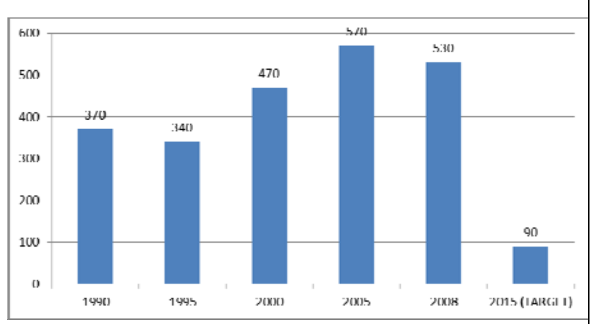


Figure 89: Maternal mortality rate (deaths per 100,000 live births) in Lesotho, actual and MDG target



Source: UN/World Bank, 2010.

[55] It should be noted that these figures are modelled estimates from the UN and World Bank. The latest DHS figures (2009) estimate a far higher rate of 1,200 deaths per 100,000 live births. However, this represents an unusually large increase from the estimate of 762 in the 2004 DHS, causing us to question the figures' accuracy.

218. Prenatal care appears to be fairly universal, yet the quality appears to be lacking for the poorest women (Figure 90). Around 92 percent of all women and 87 percent of the poorest women received at least one session before pregnancy. However, only 35 percent of the poorest women took an iron tablet during their last pregnancy (compared to 61 percent of the richest): overall, 31 percent of pregnant women were classified as anemic (ICF Macro, 2010). In addition, only 54 percent of the poorest women reported having had urine samples taken during their prenatal sessions, compared to 82 percent of the richest women (ICF Macro, 2010). Finally, only 48 percent of the poorest women (compared to 70 of the richest) received at least two tetanus toxoid injections during their last pregnancy (ICF Macro, 2010).

Figure 90: Quality of antenatal care, comparisons across wealth quintile (1= poorest, 5= richest)

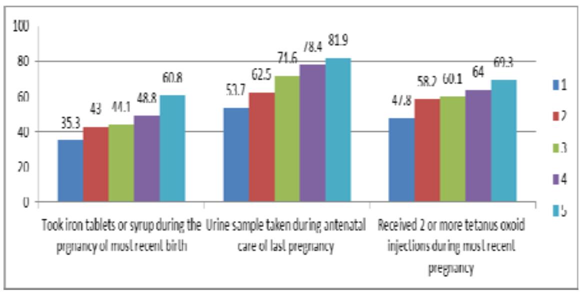
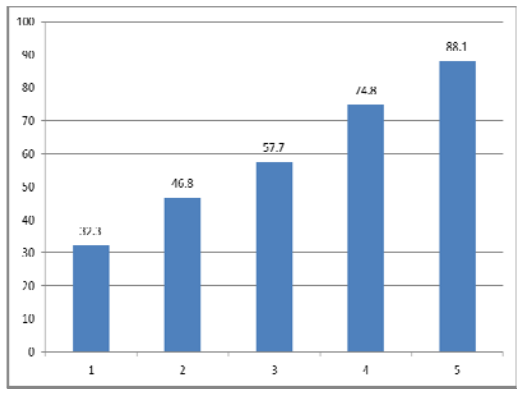


Figure 91: Percentage of births delivered at a health facility, by wealth quintile (1= poorest, 5= richest)



Source: LDHS (2009).

219. For care delivered at the time of the birth, there are even larger gaps between rich and poor women (Figure 91). While 59 percent of women delivered in a health facility, only 32 percent of the poorest women did so, with the majority of this group of women (66 percent) delivering at home. Given this information, it is not surprising that the most common person to assist the poorest women with births is a relative (39 percent), with midwives delivering only 31 percent of their births, compared to 68 percent for the richest women (ICF Macro, 2010).

220. Postnatal care is also deficient. Sixty percent of the poorest women receiving no post natal checkup at all (compared to 20 percent of the richest women) and only 2 percent receiving a checkup within the recommended period of one hour after the birth (ICF Macro, 2010).

221. In addition to inadequate access to quality health care, high maternal mortality rates are related to high fertility rates that can be traced back to low contraceptive use and traditional attitudes. Lesotho appears to be performing better in terms of fertility, adolescent fertility, and contraceptive use than many comparable countries. Therefore, the priority for improving maternal health in Lesotho may lie with improving access to quality medical care.

222. With 3.1 births per woman, the total fertility rate in Lesotho is significantly lower than the average for sub-Saharan African countries (5.1) and countries with a similar GDP per capita, such as Cameroon (4.9), Senegal (5.0), and Kenya (4.5). However, the overall figure for Lesotho masks important differences by wealth quintile. The total fertility rate for the poorest wealth quintile (5.9) is considerably higher than that for the richest quintile (2.0) (Figure 92). The figure for the poorest quintile represents an increase from the 5.2 reported in the previous DHS in 2004. The figure for the richest quintile did not change, and there was an improvement in from 3.4 to 2.5 for the second richest quintile. This suggests that more efforts need to be directed at the poorest women.

Figure 92: Total fertility (births per woman), by wealth quintile

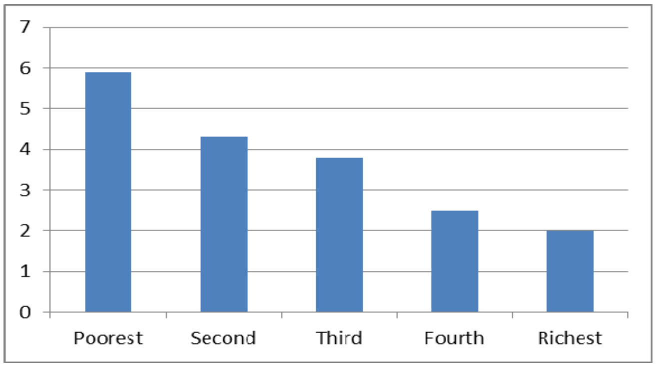
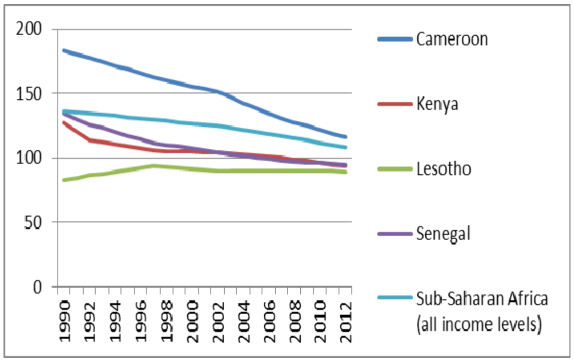


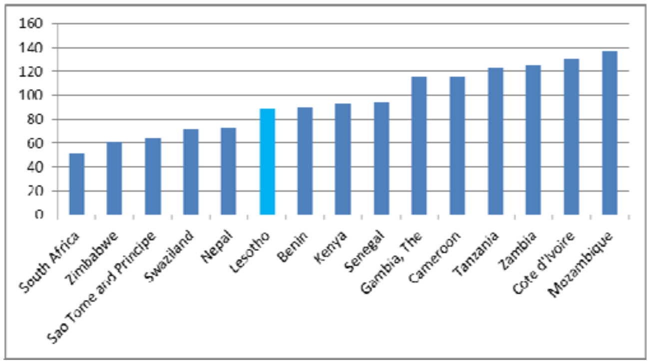
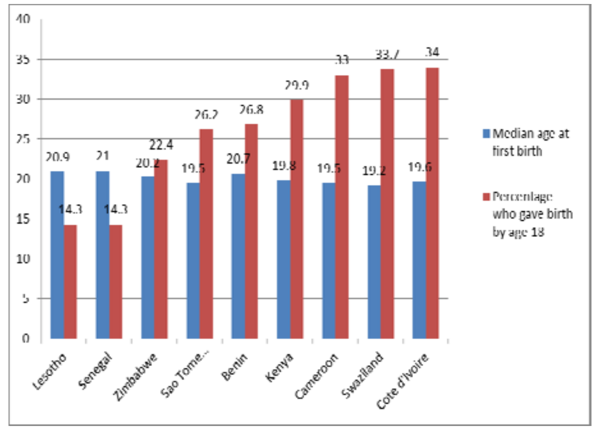
Figure 93: Adolescent fertility (births per 1,000 women ages 15-19)



Source: LDHS (2009).

223. Adolescent fertility remains stubbornly high at 89 births per 1,000 women ages 15-19; this is particularly critical because births to this age group carry a higher risk of maternal mortality.[56] While other countries have made significant inroads, Lesotho has seen no progress reducing this figure over the past 20 years (Figure 93). As with total fertility, significant differences exist by wealth quintile: 42 percent of the poorest women 20-24 years old gave birth before reaching 18, compared to only 16 percent of women in the richest quintile (ICF Macro, 2010). Moreover, early childbearing and the gap between rich and poor both appear to be increasing. However, Lesotho still has a lower adolescent fertility rate than many comparable countries (Figure 94), with a higher median age at which women first give birth and a lower proportion of 25-49 year olds who had given birth before they reached the age of 18 (Figure 95).

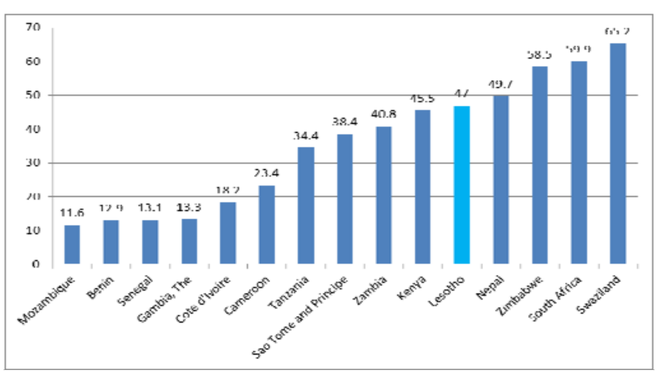
[56] World Bank. 2011. Reproductive Health at a Glance: Chad. World Bank, Washington, DC.

Figure 94 : Adolescent fertility, births per 1,000 women ages 15-19	Figure 95: Median age at first birth and percentage of women who had given birth to their first child by age 18 (25-49 year olds)
	

Source: WDI (2012).

224. Contraceptive use in Lesotho has increased markedly in recent years, yet there are significant disparities by wealth and a great deal of unmet demand. The percentage of women (ages 15-49) who used some form of modern contraception increased from 37 percent in 2005 to 47 percent in 2009. This compares to an average of around 24 percent across all sub-Saharan African countries (Figure 96). However, there are significant differences by wealth quintile, with only 19 percent of those in the poorest quintile using some method, compared to 61 percent of women in the richest quintile. Unsurprisingly, there is a very high level of unmet need for contraception among the poor, with 37 percent of the poorest women reporting an unmet need, compared to 13 percent of women in the richest quintile (ICF Macro, 2010). Overall, more than 60 percent of women ages 15-49 who were not using contraceptives at the time of the most recent DHS responded that they intended to start using them in the future. This data suggests significant room for expanding access to contraceptives in Lesotho. Unfortunately, the latest DHS survey did not ask women why they did not intend to use contraceptives. Asking this question in the future could help highlight the barriers (cultural, cost, access to supply, etc.) that are preventing those not already using contraceptives from doing so.

Figure 96: Contraceptive prevalence (% of women ages 15-49)



ANNEX 3: DETAILED DESCRIPTION AND RESULTS OF PRIORITIZATION PROCESS

225. **To define priority interventions, each of 26 challenges identified in this note was assessed against a set of five criteria shown in Box 5 of Chapter 6.** For each challenge, all the criteria were scored on a scale of 1-3—low to high in terms of importance of priority. The result was a raw score that was converted into a rank. Where two challenges received the same raw score, they were given a common ranking—this was the case across many of the challenges. Table 24 summarizes the results of the desk prioritization assessment. Overall, the analysis resulted in converting the 26 challenges to 14 ranked sets of priorities. Those that achieved a ranking among the top three were marked as "highest" priority; those ranked in the range of four to five were marked as "high" priority; and those ranked six to eight were marked as "secondary" priority.[57] Those marked 'highest' and 'high' priority are highlighted and listed in Table 25. This results in a prioritization of 14 of the 26 challenges identified.

226. **To give a sense of the reasons why other challenges were identified as among the top priorities, Table 26 provides some very brief explanations.** In most cases, it came down to particularly long pathways to impacting the twin goals (both in terms of time and the degree to which they were removed from other challenges and/or several stages downstream) and the degree to which a strong intervention to address the challenge was already in place. In addition, many of the challenges, particularly in the pathway of job-creating growth, were expected to have a limited impact on elimination of extreme poverty because the nature of the challenge often is disconnected from the extreme poor. Finally, several potentially important challenges lacked sufficiently strong supporting evidence.

227. **Finally, Table 28 maps the high priority challenges to the set of three priority interventions shown in of Chapter 6.** In some cases, challenges mapped to more than one intervention.

[57] This rating of "highest," "high," and "secondary" was chosen to highlight the fact that none of these challenges should be considered low priority. By definition, the analysis in this note was designed to identify the most important challenges facing the country in addressing the twin goals. Therefore, all the challenges identified here should be considered important.

Table 24: Summary of key challenges, desired results, and pathways to achieving twin goals

Pathway	Broad challenge identified	Desired results	Links in the pathway to poverty reduction and shared prosperity
Redefining the role of the state	**Revenue management**	Effective management of SACU receipts	Supports sustainability of growth through overcoming fiscal vulnerability
	Consolidation of public sector	Government spending as a share of GDP declines driven by reductions of recurrent expenditures, in particular the wage bill	Supports sustainability of growth through overcoming fiscal vulnerability Enables private sector development by reducing the relative price of non-tradables to tradables
	Public investment management	Effective planning and project implementation	Cross-cutting support to efficiency and effectiveness of service delivery
	Capacity to implement projects and programs	Cadre of well-trained public servants capable to implement programs and projects	Cross-cutting support to efficiency and effectiveness of service delivery
	Public financial management and procurement	Strong public financial management and procurement systems	Cross-cutting support to efficiency and effectiveness of service delivery
	M&E and accountability	Robust M&E system implemented and consistently used and updated across all projects, programs, and policies in government Accountability part of the human resources culture in government	Cross-cutting support to efficiency and effectiveness of service delivery
	Statistical capacity	Frequent, high quality data collection of households and firms, with rapid and high quality analysis and dissemination, making use of the most effective global technologies and practices	Cross-cutting support to efficiency and effectiveness of service delivery and policies targeting poverty and growth by supporting potential for evidence-based policymaking
	Sustainable natural resource management	Effective land usage	Supports sustainability of growth and poverty elimination
	Climate change	Effective policies and institutions in place to address climate change issues	Supports sustainability of growth
Promoting private sector-led, jobs-intensive growth	**Smallholder productivity**	Improved productivity of agriculture and livestock through adoption of appropriate technologies and methods and mitigation of risks	Supports sustainability of eradicating extreme poverty; raises incomes which contribute to supporting growth on the non-agricultural rural sector
	Political	Strong political consensus to reform	Enables a policy reform process to

			change the growth model, which is necessary to achieve the twin goals
	Labor supply	Alignment between labor market needs and skills of the labor force; stronger work ethic driving productivity	Raises private sector investment in employment-creating activities by increasing returns to investment through higher productivity
	Business red tape	Lesotho among the most "business-friendly" environments (as measured by Doing Business) with easy business set up and access to key inputs and services	Raises private sector investment in employment-creating activities by lowering fixed costs of entry
	Competition	Contested domestic markets with strong competition/ regulation driving quality and cost effectiveness of key input sectors Government's role in the economy redefined	Raises private sector investment in employment-creating activities by increasing returns to investment through lower costs and improved access to productivity enhancing spillovers
	Infrastructure	Private sector investment to develop factory shells and industrial serviced sites Non-structural connectivity gaps closed through quality roads, cost-effective ICT, and improved cross-border trade facilitation	Raises private sector investment in employment-creating activities by lowering input costs, improving connectivity, and increasing productivity Supports sustainability of inclusive growth
	Technology and innovation	Policies and mechanisms in place to facilitate technology transfer and licensing; firms actively seeking access to global technologies and processes	Raises private sector investment in employment-creating activities by increasing returns to investment through higher productivity
Strengthening individual and community assets	**HIV prevention**	Rapid decline in incidence rates of HIV, contributing to a sharp fall in the prevalence rates	Increases private and public sector productivity through improved health
	Childhood malnutrition	Sharp fall in childhood malnutrition rates, contributing to lower prevalence of other health problems and improved educational outcomes	Improves inclusion through improve cognitive potential and health impacts supports risks sustainability of poverty elimination and raises firm productivity by increasing the capacity of skills supply
	Access to health	Widespread access to quality health facilities, properly staff and equip and	Increases productivity through improved health

		has the necessary supplies	
	Access to sanitation	Widespread access to appropriate sanitation facilities across the country, contributing to better health outcomes	Raises productivity through indirect impact on health
	Access to electricity	Widespread availability of electricity across the country, making use of the most effective technologies, including renewables	Raises private sector investment in employment-creating activities by lowering input costs, improving connectivity, and increasing productivity Supports sustainability of inclusive growth
	Access to finance	Financial inclusion gaps closed, with broad access to credit for self-employed and SMEs through Lesotho	Raises private sector investment in employment-creating activities and lowers vulnerabilities to eradication of extreme poverty
	Quality and equity of educational outcomes	Basotho students' raise substantially their performance in international tests scores; the poor improved access to post-primary education; students given a clear path of quality educational; and vocational support, delivering a more competitive labor force	Raises private sector investment in employment-creating activities by increasing productivity Improves inclusion by increasing the probability of the poor to have a job Impacts productivity and quality of public service delivery
	Efficiency and effectiveness of social protection system	Highly efficient and effective social protection system capable of eliminating extreme poverty without raising spending System well linked to other programs.	Raises potential to eradicate extreme poverty and supports the sustainability of poverty elimination through by facilitating individual asset-building and reducing intergenerational transmission of poverty
	Gender	Equal rights between men and women	Improves inclusion
	Political stability	A mature democratic culture. Peaceful transmission of power	Supports growth sustainability

Table 25: Summary of prioritization assessment

Challenge	Impact on twin goals (small, medium, high)	Time Horizon of impact (short, medium, long)	Complementarities (weak, medium, strong)	Evidence base (weak, medium, strong)	Adequacy of existing interventions (weak, medium, strong)	Priority level (highest, high, secondary)
Redefining the role of the state						
Revenue management	Medium	Long	Strong	Strong	Medium	High
Consolidation of public sector	Medium	Medium	Strong	Strong	Medium	Highest
Public investment management	Medium	Medium	Strong	Strong	Medium	Highest
Capacity to implement projects and programs	Medium	Medium	Strong	Strong	Medium	Highest
Public financial management and procurement	Small	Long	Strong	Strong	Strong	Secondary
M&E and accountability	Medium	Long	Strong	Strong	Medium	High
Statistical capacity	Medium	Long	Medium	Strong	Medium	Secondary
Sustainable natural resource management	Small	Long	Strong	Strong	Medium	Secondary
Climate change	Small	Long	Medium	Medium	Weak	Secondary

Weighted at twice the level of other categories.

Note: score are in the range of 1 (lowest) to 3 (highest); "time horizon of impact" and "Adequacy of existing interventions" are scored in reverse to their qualitative order (e.g. strong adequacy of existing interventions scored as 1 not 3; weak adequacy of existing interventions 3 not 1).

Challenge	Impact on twin goals (small, medium, high)	Time Horizon of impact (short, medium, long)	Complementarities (weak, medium, strong)	Evidence base (weak, medium, strong)	Adequacy of existing interventions (weak, medium, strong)	Priority level (highest, high, secondary)
Promoting private sector-led, jobs-intensive growth						
Smallholder productivity	High	Medium	Medium	Medium	Weak	High
Political	High	Short	Strong	Medium	Weak	Highest
Labor supply	High	Medium	Strong	Strong	Medium	Highest
Business red tape	Small	Medium	Medium	Strong	Strong	Secondary
Competition	Medium	Medium	Medium	Medium	Medium	Secondary
Infrastructure	Medium	Medium	Medium	Strong	Medium	High
Technology and innovation	Small	Medium	Medium	Medium	Medium	Secondary

Weighted at twice the level of other categories.

Note: score are in the range of 1 (lowest) to 3 (highest); "time horizon of impact" and "Adequacy of existing interventions" are scored in reverse to their qualitative order (e.g. strong adequacy of existing interventions scored as 1 not 3; weak adequacy of existing interventions 3 not 1).

Challenge	Impact on twin goals (small, medium, high)	Time Horizon of impact (short, medium, long)	Complementarities (weak, medium, strong)	Evidence base (weak, medium, strong)	Adequacy of existing interventions (weak, medium, strong)	Priority level (highest, high, secondary)
Strengthening individual and group assets						
HIV prevention	Medium	Medium	Strong	Strong	Medium	High
Childhood malnutrition	Medium	Medium	Strong	Medium	Medium	Secondary
Access to health	Medium	Medium	Strong	Strong	Medium	High
Access to sanitation	Medium	Short	Medium	Medium	Medium	Secondary
Access to electricity	Medium	Medium	Strong	Medium	Medium	Secondary
Access to finance	Medium	Medium	Medium	Weak	Medium	Secondary
Quality and equity of educational outcomes	High	Medium	Strong	Strong	Medium	Highest
Efficiency and effectiveness of social protection system	High	Short	Strong	Strong	Medium	Highest
Gender	Small	Medium	Medium	Weak	Weak	Secondary
Political stability	High	Short	Strong	Medium	Weak	Highest

Weighted at twice the level of other categories.

Note: score are in the range of 1 (lowest) to 3 (highest); "time horizon of impact" and "Adequacy of existing interventions" are scored in reverse to their qualitative order (e.g. strong adequacy of existing interventions scored as 1 not 3; weak adequacy of existing interventions 3 not 1).

Table 26: Top 14 challenges identified through the desk prioritization

Pathway	Broad challenge
Redefining the role of the state	**Revenue management**
	Consolidation of public sector
	Public investment management
	Capacity to implement projects and programs
	M&E and accountability
Promoting private sector-led, jobs-intensive growth	**Smallholder productivity**
	Political
	Labor supply
	Infrastructure
Strengthening individual and group assets	**HIV prevention**
	Access to health
	Quality and equity of educational outcomes
	Efficiency and effectiveness of social protection system
	Political stability

Table 27: Second priority challenges

Pathway	Broad challenge	Reasons for not rating within top priorities
Redefining the role of the state	**Public financial management and Procurement**	Long pathway to twin goals; adequate interventions are in place to address the challenge over time
	Statistical capacity	Long pathway to twin goals
	Sustainable natural resource management	Long pathway to twin goals
	Climate change	Long pathway to twin goals
Promoting private sector-led, jobs-intensive growth	**Business red tape**	Long pathway to twin goals; weak impact on extreme poverty; adequate intervention in place
	Competition	Long pathway to twin goals; weak impact on extreme poverty
	Technology and Innovation	Long pathway to twin goals; lack of strong evidence base
Strengthening individual and group assets	**Childhood malnutrition**	Weak evidence base; needs further analysis
	Access to sanitation	Weak evidence base on the links to poverty reduction
	Access to electricity	Weak evidence base on the links to poverty reduction
	Access to finance	Weak evidence base
	Gender	Long pathway to twin goals; weak evidence base

Table 28: Mapping broad challenges to priority interventions

Pathway	Broad challenge	Mapped to priority
Redefining the role of the state	**Revenue management**	Reducing the size of the state, rebuild buffers and improving service delivery by achieving fiscal consolidation and modernizing the public sector
	Consolidation of public sector	Reducing the size of the state, rebuild buffers and improving service delivery by achieving fiscal consolidation and modernizing the public sector
	Public investment management	Reducing the size of the state, rebuild buffers and improving service delivery by achieving fiscal consolidation and modernizing the public sector
	Capacity to implement projects and programs	Reducing the size of the state, rebuild buffers and improving service delivery by achieving fiscal

		consolidation and modernizing the public sector
	M&E and accountability	Reducing the size of the state, rebuild buffers and improving service delivery by achieving fiscal consolidation and modernizing the public sector
Promoting private sector-led, jobs-intensive growth	**Smallholder productivity**	Facilitating a competitive, export-oriented private sector by aligning incentives and developing key infrastructure
	Political (will)	Pre-condition
	Labor supply	Facilitating a competitive, export-oriented private sector by aligning incentives and developing key infrastructure; improving health and education outcomes by reducing the disease burden, and raising and aligning skills
	Infrastructure	Facilitating a competitive, export-oriented private sector by aligning incentives and developing key infrastructure
Strengthening individual and group assets	**HIV prevention**	Improving health and education outcomes by reducing the disease burden, and raising and aligning skills
	Access to health	Improving health and education outcomes by reducing the disease burden, and raising and aligning skills
	Quality and equity of educational outcomes	Improving health and education outcomes by reducing the disease burden, and raising and aligning skills
	Efficiency and effectiveness of social protection system	Reforming social protection to reduce fragmentation, and improve targeting, efficiency and effectiveness
	Political stability	Pre-condition

ANNEX 4: SUMMARY OF CONSULTATIONS

228. **Consultation on the SCD in Lesotho were carried out over three periods (i) in development and review of the initial concept; (ii) as part of the analytical stage; and (iii) in reviewing the draft report and selecting priorities.** The table below provides an overview of the consultations carried out in Lesotho as well as internally at the World Bank in each of these stages.

Stage	In Lesotho	World Bank (internal)
Concept development and review	• *June 2014:* Meeting with Ministry of Development Planning and Millennium Challenge Corporation to coordinate scope of the diagnostics carried out by us and the MCC.	• *May 2014:* SCD brainstorming workshop.
Analysis	• *August 2014:* one-on-one meetings with development partners, and local researchers/technical experts.	• *June-October, 2014:* one-on-one meetings with Bank technical experts and global practices
Draft review and prioritization	• *November, 2014:* SCD key finding presentations and prioritization workshops with government, private sector, civil society, and development partners.	• *October, 2014:* SCD draft report and prioritization workshop with country team and global practice representatives.

229. **The table below indicates the participants in the SDC key findings presentations and workshops in Lesotho:**

Organization	Representative
Ministry of Development Planning	M. Majoro (Minister), L. Pheko (PS), L. Mofo (Chief Economist), S. Kanayan (Aid Coordination Consultant)
Office of the Prime Minister	L. Tlamane (Director)
Ministry of Finance	H. Van der Heidjden (Team Leader)
Ministry of Health	R. Koloti (EP), N. Moalosi (HR manager)
Ministry of Gender	P Tsoane (Acting PS)
Ministry of Foreign Affairs	R. Ramolefano (First Secretary)
Ministry of Mining	M. Ranoce (PS)
Ministry of Trade and Industry	P. Lepah (Chief Economic Planner)
Ministry of Social Development	M. Masasa (Director of Planning)
Ministry of Forestry	S. Mabako (Acting PS)
Lesotho National Development Corporation	S. Raleche (Manager), M. Raphuthing (Industry Analyst)
Central Bank of Lesotho	E. Molose (Economist)
Lesotho Revenue Authority	L. Tseuda (Senior Manager), R. Reletooarre (SLMPS)
Lesotho Textile Exporters Association	J. Chen (President)
Lesotho Flour Mills	M. Geyer (Director)
Computer Business Solutions	M. Sefika (Managing Director)
SMME support Network	M. Masitha (Coordinator)
Basotho Enterprises Development Corporation	T. Sebakiso (Representative)
Water and Sewerage Company of Lesotho	S. Sechonyana (Assistant to Chief Executirve

Lesotho Hotels and Hospitality Association	M. Mohapi (Vice-Chair), M. Sekhiba (Member)
Lesotho Cooperative Handicrafts	M. Lerothidi (Marketing Officer), M. Maichitla (General Manager)
Lesotho National Dairy Board	S.U. Monter (Executive Director)
Morade Crushers	B. Likate (Business Development)
Lesotho Highlands Development Authority	M. Tholcoa (Manager), T. Tente (Project Manager)
National University of Lesotho	E. Letate (Lecturer)
Lesotho Institute of Public Administration and Management	J. Dzimba (Director General)
Lesotho Electricity Company	T. Makume (Statistician)
Lesotho Darts Association	K. Korobe (Director)
Lesotho Council of NGOs	T. Kaaba (Program Coordinator)
Christian Health Association of Lesotho	M. Ngwenya (E. Planner)
Lesotho Chamber of Commerce and Industry	M. Mokolangae (Producer)
Lesotho Tourism Development Corporation	M. Morojele (Manager)
Lesotho Millennium Development Agency	S. Mohapi (CEO), K. Pekole (Public Outreach and stakeholder enagement), L. Maema, T. Aumane (Private Sector Specialist)
UNAIDS	A. Zwandor (Country Director)
UNICEF	T. Shiferau (Representative)
EU	Jyrki Torni (First Secretary)

ANNEX 5: ASSESSMENT OF KEY KNOWLEDGE GAPS

230. **Throughout the report, key knowledge gaps have been identified.** These are topics that are critical to understanding the challenges facing Lesotho but where we have limited quantitative and qualitative evidence to enable taking a clear position on the degree to which the issue is a priority and/or on the interventions required to address it. It can be viewed as a set of research priorities for the Government, development partners, academics, and research institutions over the next few years.

Knowledge gap	Description
Limited understanding of the growth-poverty link	There are important discrepancies between the income from national accounts and consumption from the household survey. Due to the poor quality of data, a deeper analysis cannot be made on the growth-poverty link. There is a need to strengthen the household survey methodology.
Skills premium/New labor force survey	A better measure of skill shortage is the skills premium employers are willing to offer in specific industries. To do such analysis a strong labor force survey is needed. The last labor force survey in Lesotho was done in 2008. A new comprehensive labor force survey is needed to do a more profound analysis of the labor market.
Energy	Lesotho has a good understanding of its power needs but relatively limited information at the moment on how to address this issue. Currently, a feasibility study is being conducted on a power generation plant linked to the Lesotho Highlands Water Project Phase 2. However, there are no feasibility studies on solar generation plants.
Agriculture sector and irrigation	The data and information on the agriculture sector as well as irrigation is dated. It would be particularly useful to have gender disaggregated data on smallholder's access to inputs (land, labor, fertilizer, extension services, etc) and agricultural yields. This would allow an analysis of gender specific constraints to agricultural productivity, in the style of the World Bank and One Foundation's Levelling the Field Report (2014). At the heart of agriculture's inability to make a strong contribution to poverty reduction and shared prosperity is the very low rate of productivity growth in the sector, one of the lowest in Africa. It is clear that this is due to many factors, including low uptake of modern production technologies (embodied in inputs), low labor productivity, low irrigation use, land degradation, and others. But what is lacking is good analysis of what conditions and policies underlie these factors, and clear recommendations on how these could be addressed. One tool for helping to fill this gap would be an agricultural public expenditure review, which would identify whether current spending patterns correspond to the major problems. While most of these problems will ultimately need to be addressed by on-farm private investment, smart public spending is needed to create the enabling environment. Another important knowledge gap is what are the real opportunity costs (e.g., in terms of loss of net foreign exchange) of the strong policy focus on encouraging production of staple food crops at the expense of other products in which Lesotho may have a comparative advantage. This gap could be filled by a good analytical study of domestic resource costs of production of different products. Both of these kinds of studies would produce information that would be key to deciding on spending and policy priorities.
Informal economy	There is very little information on the informal sector of the economy outside subsistence agriculture. Labor market data comes infrequently and only provides a very broad snapshot of this part of the economy. It will be important to analyze key issues in more detail—what is the nature of the sector, what are

	the constraints to formality, to what degree the formal and informal sector act as substitutes or complements?
Analysis of the private sector	Identifying the incentives to develop the private sector will require a much deeper analysis. How big is it? How is it structured (firm size, sectors, formal/informal)? How much is it dependent on government contracts? This analysis will help identify specific opportunities that may be available given Lesotho's location and endowments.
Childhood malnutrition	Childhood malnutrition is an important issue in Lesotho. Despite several government interventions, it still remains a lingering issue. Given the potential importance on long-term outcomes, further research on this issue is needed.
Climate change impact	Currently, there is no climate change strategy. Understanding of how climate change may affect vulnerable rural communities is limited, along with the implications this may have on migration and urbanization.
Brain drain and migration	There is very limited information on income on the household survey. Also, there is no information on migrants. A comprehensive household survey, which has an income and consumption module as well as social and economic characteristics of migrants is needed. This will allow seeing whether remittances may have created Dutch-disease type effects in the country or other effects on human capital formation. For instance, a large migrant population may also affect school decisions and the behaviour of children left behind. Also, there is only dated and anecdotal evidence on the brain drain. Further research on this issue is needed.

ANNEX 6: ASSESSMENT OF DATA AVAILABILITY AND GAPS

231. The table below provides a brief overview of data availability and quality in Lesotho, as identified during the process of carrying out the SCD analysis.

Broad area	Assessment of data availability and quality
Macroeconomic	National accounts are reported on annual basis. They have some important gaps, such as in distinguishing between public and private investment. Central Bank of Lesotho provides monthly financial data; BoS publishes quarterly reports on the performance of manufacturing with a nine-month lag; BoS publishes annual crop reports with a year lag; CBL produces monthly economic reviews with a three-month lag. The quality seems good.
Fiscal and debt	LRA publishes annual data on tax collection. MoF publishes the budget every year. Financial statements are not published. CBL publishes fiscal balances as part of its annual report. Fiscal data usually available upon request. The quality is poor.
Employment	Very weak; last labor force survey was published in 2008. Key labor data are monitored through the quarterly Continuous Multi-purpose Survey, but results have not been published since the last quarter of FY2011/12; data quality may also be an issue (e.g. unemployment figures don't match those in the labor force survey).
Poverty and social	No regular reporting—only available following major surveys (2003 and 2010). Data quality on the most recent survey is questionable, particularly in the consumption module. A survey to survey imputation method was used to restore the comparability of consumption data and poverty estimates between the FY2002/03 HBS and the FY2010/11 CMS/HBS because the questionnaire design and survey logistics changed significantly in the latter round.
Industry, private sector	Very weak—no industrial census or other firm-level data available; trade data sufficient.
Environmental	Very limited data.

ANNEX 7: BIBLIOGRAPHY OF STUDIES AND REPORTS INFORMING THE SCD

World Bank

Report / document (year)
A Safety Net to End Extreme Poverty (2013)
A Technical Note on Lesotho Poverty Measurement (2012)
An Assessment of the Investment Climate in Lesotho (2004)
Basic Education Project (2010)
Country Economic Memorandum (2006)
Country Procurement Assessment Report (2008)
Economic Diversification and the Role of FDI policies (2012)
Education Sector Diagnostic (forthcoming)
Enterprise Survey (2009)
Financial Sector Strategy (2013)
First Growth and Competitiveness DPO (2013)
Health Sector Expenditure Review (2009)
HIV/AIDS Technical Assistance Project (2010)
Integrated Transport Project (2007)
Lesotho Health Sector Status Report (forthcoming)
Lesotho Highlands Water Project (2010)
Lesotho-RSA Customs Collaboration TF (2011)
Investing for Changing Economy: Skill Development with Equity in Lesotho (2013)
Joint IDA IMF Staff Advisory Note on the Second Poverty Reduction Strategy Paper (2012)
Managing Government Finances for Growth and Poverty Reduction (2010)
Maternal and Newborn Health Performance Based Financing Project (2013)
Policy Notes (2010, 2012)
Public Expenditure Review (2007, 2012)
Public Investment Management Review (2012)
SACU regional study on value chains (2014)
SACU Fiscal Rules Paper (2014)
Sharing Growth by Reducing Inequality and Vulnerability: choices for change. A Poverty, Gender and Social Assessment (2010)
Study on Technical Efficiency in HIV programs (forthcoming)
Toward Inclusive Growth (2014)
Various "Doing Business" analytics (2013-14)

Government and development partners

	Organization	Report / document
Government of Lesotho	MDP	Vision 2020
	MDP	National Strategic Development Plan
	MOH	National Health Accounts (2012)
	MSD	Social Protection Strategy (2014)
	MNR	Long-Term Strategy for the Water and Sanitation Sector
	MNR	Lowlands Bulk Water Supply Scheme - guides investments
	BOS	Lesotho Demographic Survey (2011)
	BOS	Lesotho Demographics and Health Survey (2004, 2009)

	BOS	Lesotho Labor Force Survey (2008)
	BOS	Lesotho Manufacturing Reports (2010-2013)
	CBL	Central Bank's Annual Reports (2010-2013)
Development partners / others	Duke	The Apparel Global Value Chain
	EU/MF	Public Expenditure and Financial Accountability Assessment (2013)
	IMF	Policies That Can Raise Potential Growth in Small Middle-Income Countries Of SSA (2014)
	IMF	Inward and Outward Spillovers in the SACU Area (2013)
	IMF	Article IV (2014)
	FAO	Conservation Agriculture
	SACMEQ	Education Quality (2014)
	UNDP	2013 Millennium Development Goals Report (forthcoming)
	UNDP	National Human Development Report on Youth (2014, forthcoming)
	USAID	Diagnostic Trade Integration Study Update (2012)
	USAID	Investor Roadmap Lesotho (2012)
	WHO	National Health Accounts (forthcoming)

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