



2021/22 – 2023/24

BUDGET

STRATEGY PAPER

MINISTRY OF FINANCE
AND MINISTRY OF
DEVELOPMENT
PLANNING

AUGUST 2020

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LIST OF ABBREVIATIONS AND ACRONYMS

1. AGOA – African Growth Opportunity Act
2. ART – Antiretroviral Therapy
3. BFR – Big Fast Results
4. BoS – Bureau of Statistics
5. BSP – Budget Strategy Paper
6. CAAMTI – Centre for Aerospace and Advanced Manufacturing, Technology and Innovation
7. CBL – Central Bank of Lesotho
8. CMA – Common Monetary Area
9. COVID-19 – Corona Virus Disease 2019
10. CSOs – Civil Society Organisations
11. DSA – Debt Sustainability Analysis
12. ECF – Extended Credit Facility
13. FY – Financial Year
14. GCI – Global Competitiveness Index
15. GDP – Gross Domestic Product
16. GoL – Government of Lesotho
17. HIV/AIDS – Human Immunodeficiency Virus and Acquired Immune Deficiency Syndrome
18. HDI – Human Development Index
19. IATI – International Aid Transparency Initiative
20. ICT – Information Communications Technology
21. IDA – International Development Association
22. IMF – International Monetary Fund
23. KPAs – Key Performance Areas
24. LHDC – Low Human Development Countries
25. LHWP – Lesotho Highlands Water Project
26. LNDC – Lesotho National Development Corporation
27. LSL – Lesotho Loti
28. MCC – Millennium Challenge Cooperation
29. MDAs – Ministries, Departments and Agencies
30. MDP – Ministry of Development Planning
31. MF – Ministry of Finance
32. MPM – Macroeconomic Policy and Management
33. MSBDCM – Ministry of Small Business Development, Cooperatives and Marketing
34. MSMEs – Micro, Small and Medium Enterprises
35. MTDS – Medium Term Debt Strategy
36. MTEF – Medium-Term Expenditure Framework
37. MTFF – Medium-Term Fiscal Framework
38. NACOSEC – National COVID-19 Secretariat
39. NGOs – Non-Governmental Organisations
40. NSDP II – National Strategic Development Plan II
41. OECD – Organisation for Economic Co-operation and Development

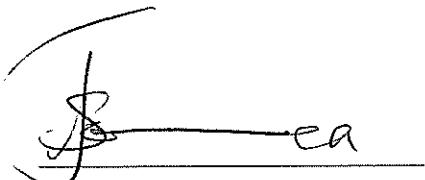
42. PCGS	–Partial Credit Guarantee Scheme
43. PFMAA	– Public Financial Management and Accountability Act
44. PSO	– Public Service Obligations
45. PSID	–Public Sector Investment Database
46. RAS	– Recirculation Aquaculture System
47. SA	– South Africa
48. SACU	– Southern African Customs Union
49. SADC	– South African Development Community
50. SARB	– South African Reserve Bank
51. SDGs	– Sustainable Development Goals
52. SOEs	–State Owned Enterprises
53. TB	–Tuberculosis
54. UN	– United Nations
55. USD	– United States Dollar
56. WB	– World Bank
57. WHO	– World Health Organisation
58. ZAR	– South African Rand

ACKNOWLEDGEMENT

The 2021/22 – 2023/24 Budget Strategy Paper is part of the annual planning process, which facilitates the preparation of the 2021/22 – 2023/24 National Budget. The document forms the basis for discussion of the proposed national policies, strategies and budgetary allocations for the next financial year through the medium-term by various stakeholders at the annual Cabinet Retreat.

The 2021/22 – 2023/24 Budget Strategy Paper follows after the fourth Coalition Government was formed which its main focus is national unity and reconciliation, stability, rule of law, national reforms and stimulation of economic growth.

The current Budget Strategy Paper is prepared during the time when governments are facing social and economic meltdown because of the COVID-19 Pandemic. Therefore, the Government intends to use its spending power during the coming financial year and in the medium-term to intensify efforts towards improving the livelihoods of Basotho.

A handwritten signature in black ink, appearing to read 'TS', followed by a horizontal line and the letters 'ea'.

THABO SOPHONEA (MP)

MINISTER OF FINANCE

1.0 INTRODUCTION

1. Since 2013/14 Fiscal Year, the Ministries of Finance (MF) and of Development Planning (MDP) have produced the Budget Strategy Paper (BSP) that sets a platform for conversing issues and policy interventions for the upcoming budget year, guided by the National Strategic Development Plan (NSDP) II. In preparation for the 2021/22 -2023/24 BSP, the MF has conducted the 2021/22 Pre-Budget Consultations in three administrative districts namely Maseru, Berea and Thaba-Tseka. The plan was to undertake consultations virtually in the remaining seven districts and due to Corona Virus Disease 2019 (COVID-19), the meetings could not be conducted as there were no required technology resources. The aim of the consultations was to make the budget process transparent and inclusive to all stakeholders as well as the general citizens.
2. The objective of the BSP is to facilitate discussions on policy direction that the Government will take in preparing the 2021/22 -2023/24 National Budget. The policy direction is in line with the Vision 2020, NSDP II, the fourth Coalition Agreement and other strategic documents.
3. The 2021/22 -2023/24 BSP is prepared under stringent financial conditions amidst the COVID-19 Pandemic. The pandemic has negatively affected the Government fiscus and as a result, the Government was forced to revise down the 2020/21 – 2022/23 Revenue Estimates while at the same time is in dire need of financial resources to implement the COVID-19 prevention, treatment and mitigation measures; as well as other Government obligations.
4. The strategic thrust for 2021/22-2023/24 National Budget should continue to be the implementation of various reforms, innovative approach to accelerate investment, economic growth and job creation with the aim of enhancing inclusive and sustainable economic growth and private sector-led job creation that contribute towards making all Basotho better off.
5. The Paper consists of eight (8) sections, including this introduction. Section II reviews the development context including the opportunities and challenges facing the economy, Section III analyses both the global and domestic economic performance and outlook. Section IV gives a reflection on Government arrears accumulated during 2008/09 - 2019/20 Fiscal Years. The Economic and Fiscal risks are outlined in Section V, while Section VI discusses the strategies and priorities for the 2021/22 Budget. Section VII reviews the translation of policies into resource allocation, with a conclusion provided in Section VIII.

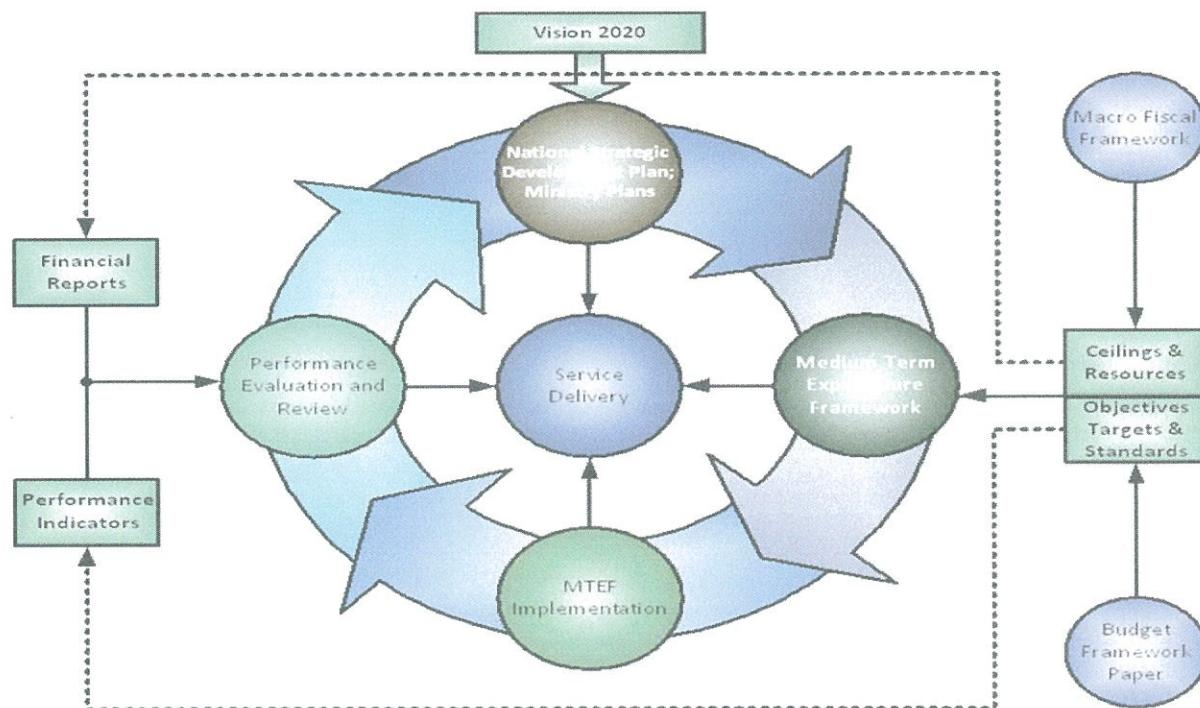
1.1 Working Together for Better Future

6. Over the past years the Government has implemented a ministerial budgeting approach which has resulted in insignificant service delivery due to fragmented activities. In pursuit of substantial service delivery, the government will focus on the implementation of cluster budgeting approach in 2021/22 fiscal year to foster an integrated approach to governance. The objective is to implement Government's integrated planning and budgeting, while improving decision-making and service delivery with the ultimate goal of ensuring proper coordination of all Government programmes both at national and local Government levels.
7. In the current fiscal year, the MF and the MDP will harmonise the clusters used in budget preparation and in the NSDP II to ensure smooth allocation of resources.

1.2 Budget Cycle

8. The Budget Cycle is basically used to describe the processes that the Government undergo in preparing the National Budget. Each process is valuable and requires careful consideration of the Government fiscus relative to expenditure. Adherence to timelines as contained in the Budget Calendar which has been approved by Cabinet is crucial as delay in achievement of one milestone has a significant impact on the proceeding milestone.

Figure 1 Budget Cycle



1.3 Budgetary Principles

9. In response to consistent shortfall in cash and foreign reserves as well as the volatile SACU revenues, the depreciation of South African (SA) Rand against major world currencies and its

negative impact on the external debt stock and strong recurrent expenditure growth which have put pressure on budget deficit, the Government will continue to adopt the following principles which will underpin and guide the 2021/22 – 2023/24 Budget:

- i. Achieve consistency of the Medium-Term Fiscal Framework (MTFF) and Medium-Term Expenditure Framework (MTEF) to the national priorities, and efficiency, effectiveness and value for money in public expenditure.
- ii. Adopt a Budget that is affordable, sustainable, and yet responsive to the needs of the country over the medium-term.
- iii. Achieve sufficiency in domestic revenue mobilisation to finance Government programmes while gradually limiting the dependence on external financing.
- iv. Consistently constraining the Government's recurrent expenditure not to grow more than the development expenditure.
- v. The Government's expenditure on wage bill should not be seen growing as a percentage of Gross Domestic Product (GDP).
- vi. Over the medium-term, the Government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure.
- vii. A realistic degree of predictability with respect to the level of tax rates and tax bases shall be maintained, considering any future tax reforms.
- viii. Improve monitoring, transparency, and accountability mechanisms to ensure expenditure efficiency; and
- ix. Expand the sources of public debt financing to enable the Government to restructure its public debt portfolio and to better facilitate the financing of deficit.
- x. Prioritise the elimination and curtailment of accumulation of arrears.

2.0 DEVELOPMENT CONTEXT

2.1 Background

10. The achievement of Lesotho's development agenda will depend on the extent to which the Government, development partners, Civil Society Organisations (CSOs), the private sector and communities work in partnership to address various challenges that have faced the country for decades. The 2021/22–2023/24 Budget Strategy Paper is developed against the background of a challenging development context which will require strict prioritization of budget allocations and implementation.

2.2 Persistent Poverty and Inequality

11. Lesotho's poverty rate fell from 56.6 percent in 2002 to 49.7 percent in 2017¹ and still exceptionally high, especially in rural areas at 60.7 percent and for female headed households at 55.2 percent. This represents about 7 percentage points decline over a 15-year period. There has been a reduction of about 47,000 in the number of Basotho living with poverty during that period. In 2017, 27.3 percent of Basotho were poor at the international poverty line of US\$1.90/day (in

¹Lesotho's poverty rate is measured at the national poverty line of Lesotho Maloti (LSL) 648.88 (2017 prices) per adult equivalent per month.

2011 PPP terms). Urban areas recorded strong poverty reduction, while rural areas' poverty levels stagnated, adding to an already large urban-rural divide. The urban poverty rate decreased from 41.5 percent to 28.5 percent between 2002 and 2017. In rural areas, muted consumption growth was accompanied by stagnation in poverty rates, which decreased marginally from 61.3 percent to 60.7 percent during the same period.

12. Poverty fell in four out of six regions. The Rural Mountains and Rural Senqu River Valley experienced poverty increase. For instance, 67.8 percent of Basotho living in Rural Mountains were poor in 2017—an increase of 10.9 percentage points from 56.9 percent recorded in 2002. Due to increased urbanisation, the number of rural poor decreased from 864,000 to 801,000, while the number of urban poor increased from 180,000 to 196,000. This is equivalent to the share of urban poor increasing from 17 percent to 20 percent, suggesting that poverty will continue to be a rural phenomenon in the near future if developments are still focused only in urban areas. A profile of Lesotho's poor shows that poverty levels are highest among female-headed households, especially those headed by single women, who are less educated, unemployed and the caretakers of large families and children. This implies acute vulnerability and increased risk of food insecurity in female-headed households.
13. There are high poverty levels despite huge investments in the social sectors that the Government, with the support from its development partners has made and is continuing to make. This points to the need to better target interventions that are sustainable and will make a significant impact on reducing poverty. Food insecurity is also very high, with 179,000 and 720,000 households in urban and rural areas registered food insecure in March 2020 and likely to have increased significantly due to COVID-19.
14. Inequality has declined with Gini coefficient of 44.6 percent in 2017/18 from 51.9 percent in 2002/03. Despite this improvement, Lesotho remains to be one of the 20 percent most unequal countries in the world. The improvement is due to expansion of the social protection programs and an increase in wage incomes among the poor. Lesotho spends 4.5 percent of Gross Domestic Product (GDP) on social protection programs, against the below 2 percent in other African countries or lower middle-income countries.
15. This recent assessment suggests that Lesotho has made a considerable progress towards a more equal society in the past fifteen years. The decline in inequality is more important considering the many factors that were pulling against this decline. In 2015-2016, Lesotho experienced one of the

worst droughts in its history, particularly hurting the rural poor, which had an adverse impact on inequality.

16. Due to a large urban-rural divide, public-private sector wage gaps, and inequalities in educational attainment, a lot more still needs to be done in assuring that all Basotho have the same chances of succeeding in life.

2.3 Rising Unemployment

17. **Unemployment is high at 22.4 percent and even higher among Youth at 29.1 percent.** The labour market performance remains disappointing due to relatively high levels of unemployment estimated at 22.4 percent (males 22.6 and females 22.2)². Unemployment incidence is higher among youth population, estimated at 29.1 percent (males 27.4 and females' 31.1 percent). Employment in the manufacturing sector is likely to be affected as a result of the negative impact posed by the Covid-19 epidemic. The hospitality, food and beverages sectors will suffer from reduced trading hours particularly accommodation, alcohol, and beverages sub-sector.

18. The unemployment challenge is exacerbated by a small private sector. Its competitiveness has been limited by skills mismatches and lack of entrepreneurship programs for growth-oriented businesses. The NSDP II seeks to foster job creation and inclusive growth and further reduce poverty. The plan targets gradual economic growth, from 0.4 percent in 2017/18 to about 5 percent projected in 2022/23 and creation of 49,000 private-sector jobs within the plan period. For this to be realised, the Government must ease regulations governing business and access to finance. However, the anticipated economic growth is likely to be affected by COVID-19, which has negatively impacted the global economy.

2.4 International Competitiveness

19. **Lesotho ranks number 131 out of 141 countries in the Global Competitiveness Index (GCI) and 122 out of 190 countries on the Ease of doing Business in 2019.** As much as the economy is significantly open to global trade especially on textiles production, the COVID-19 pandemic is expected to impact supply chains, hampering trade, as most textiles and apparel firms in Lesotho source raw materials from China. Furthermore, commodity exports to major economies such as Euro Area and the United States are most likely to be negatively affected. The tourism sector is also expected to be negatively affected by the advent of COVID-19, due to travel restriction between countries and people becoming more cautious about travelling. The country is currently not in a position to export goods or services.

²BOS Labour Force Survey 2019

Table 1: International Competitiveness of SACU Countries, 2019

Country	Global Competitiveness Ranking	Ease of Doing Business
South Africa	60	84
Botswana	91	87
Namibia	94	104
Eswatini	121	121
Lesotho	131	122

Source: 2020 Global Competitiveness Report and World Bank Ease of Doing Business Report

20. Lesotho's international competitiveness ranking is low in comparison to other SACU countries in both Global Competitiveness and Ease of Doing Business Ranking. Lesotho's economy is highly dependent on trade, making it particularly vulnerable to international and regional shocks. To reduce this vulnerability, Lesotho must diversify into new economic activities and remain competitive in the region and beyond.

2.6 Human Development

21. Lesotho continues to experience low levels of human development as compared to other developing countries in the region. The country ranks 164 out of 189 countries on the 2019 UN Human Development Index (HDI), falling into the category of low human development with a score of 0.518. Lesotho is ranked the lowest among all SACU countries. There are high levels of communicable and non-communicable diseases and the HIV/AIDS epidemic has had a devastating impact on the country, its economy, social structure and capacity of families to care for themselves and the situation will be worsened by the COVID 19 pandemic.

Table 2: Human Development Index of SACU Countries, 2019

Country	HDI Rank	HDI Value	Life expectancy	GNI Per Capita
Botswana	94	0.728	69.3	15,951
South Africa	113	0.705	63.9	11,756
Namibia	130	0.645	63.4	9,683
Eswatini	138	0.608	59.4	9,359
Lesotho	164	0.518	53.7	3,244

Source: 2020 UN Human Development Report

22. The prevalence of HIV/AIDS is estimated at 25.6 percent of the sexually active population. Lesotho remains on the WHO list of the 30 high TB burden countries in the world with an estimated annual incidence of 611 TB cases per 100,000 population which is a reduction from 665 TB cases reported in the WHO Global TB report of 2018. The TB/HIV incidence rate is at 398/100,000 and has declined from the 2018 incidence which was at 470/100,000. The mortality rate in TB/HIV co-infected patients is 155 per 100,000 populations (Global TB Report, 2019). The

Sustainable Development Goal (SDG) 3 target to end both TB and HIV with ambitious targets of 90/90/90 which were set to necessitate a strengthened and resilient health system.

2.6 Corona Virus Pandemic

23. The Coronavirus (COVID-19) pandemic is the defining global health crisis of our time and the greatest challenge we have faced since World War II. Since its emergence in Asia in late 2019 the virus has spread to every continent except Antarctica. Cases are rising daily in Africa, Asia, the Americas, and Europe. Countries are racing to slow the spread of the disease by testing and treating patients, carrying out contact tracing, limiting travel, quarantining citizens, and cancelling large gatherings such as sporting events, concerts, and school attendance. As the impact of COVID-19 is already being felt, the Government has taken steps to prepare and mitigate the potential impact on the health, social and economic wellbeing of Basotho. The Government has established the National COVID-19 Secretariat (NACOSEC), led by the Prime Minister and the Ministry of Health for national response planning and preparedness and has developed a Contingency Plan which outlines the key investments and interventions necessary to help the country to manage the possible outbreak.
24. The COVID-19 poses challenges to Lesotho's health system and the effects are not only felt in responding to the epidemic, but also in domestic and international trade, the pandemic affects supply chains and thus hamper economic and social sectors.

2.7 Climate Change

25. **Harsh climatic conditions and increasing environmental degradation as a result of climate change have long had a negative impact in the country's development.** Lesotho has extreme climatic conditions characterised by droughts, floods, strong winds, early/late frosts, hail and snow. Increasingly warmer temperatures and lower levels of rainfall have significant implications for agriculture, food security, poverty and vulnerability, as the agriculture accounts for livelihoods of 70 percent of the population, and most of the population live in rural areas. This exacerbates vulnerability among the poor and rural communities who tend to have lower coping capacities.
26. Increased use of natural resources for farming, grazing, and fuel has resulted in high environmental degradation, presenting both economic and governance challenges. Access to grazing land fuels communal conflicts, particularly during periods of drought. Arable land suitable for agriculture is below 9 percent (279,773 hectares) of total land area (3 million hectares). Annual depletion of natural resources is estimated at 4.6 percent of gross national income and the country loses at least 2 percent of its topsoil annually due to erosion. About 66 percent of households live on degraded land which represents a direct challenge to agricultural production and food security.

2.8 Persistent Political Challenges

27. Political developments in Lesotho have been marked by cyclic instability and insecurity. The Ibrahim Index of African Governance (2019) ranks the country 16 out of 54 countries with a score of 57.1, the collapse of three successive coalition governments and three national elections between 2012 and 2017, demonstrate the extent of Lesotho's political volatility.
28. Lesotho slipped in the ranking on the Corruption Perceptions Index from 78 (2018) to 85 out of 180 countries (2019). This political climate has created a politicised public service with low public service delivery, poor accountability and transparency. The efforts for economic growth, employment creation and poverty reduction have been undermined by increased political instability in the country.

2.9 Human Trafficking

29. The U.S. State Department's Office for Monitoring and Combating Trafficking in Persons has ranked Lesotho in "Tier 3" in the 2020 Trafficking in Persons Report. Lesotho has been classified as a source, transit, and destination country for women and children subjected to forced labor and sex trafficking and for men subjected to forced labor, in Lesotho and South Africa. The country has declined from the highest TIP ranking of Tier 2 in 2016 – 2018. In 2019, Lesotho declined to Tier 2 watch list and in 2020 declined to the lowest Tier 3. The Tier 3 countries will face Aid, Trade and Security Assistance restrictions from the United States Government.
30. All assistance to the Tier 3 countries is scoped to ensure that there is no benefit to the Government and support is only for the Non-Governmental Organisations (NGOs) or other implementation partner programmers. This category means that the Government of Lesotho will not benefit from much of the US government grants and initiatives. This could affect Lesotho's eligibility on Millennium Challenge Cooperation (MCC). Due to the Tier 3 status, Lesotho now becomes ineligible for trade related programs such as African Growth Opportunity Act (AGOA) and the renegotiation for extension of the programs will become difficult.

2.10 Increasing Demand for Social Protection

31. Lesotho is experiencing increasing demand for social safety nets from the poor and vulnerable groups such as orphans and people with disabilities, particularly for those leaving in rural districts. With increased poverty, food insecurity, negative effect of climate change and COVID-19, many people will continue to need and demand social protection services and empowerment. The World Bank (WB) analysis shows that poverty has decreased in the country and one of the contributing factors is the availability of the social safety nets. It is therefore important to have a sustainable financing of this income for the poor and vulnerable groups.

32. There is increasing evidence that social protection not only reduces poverty among direct beneficiaries and their households, but it also improves wealth distribution and economic growth within local communities. This makes comprehensive social protection an attractive policy instrument for both social protection and economic point of view. It also enhances human dignity, social cohesion, and political stability.
33. Lesotho has established several social protection programmes that provide grants to various vulnerable groups. These include the Nutrition Support Programme, Child Grant Programme, School Feeding Programme, Orphaned and Vulnerable Children Bursary Programme, Tertiary Bursary Programme, Public Assistance Programme and Old Age Pensions. There is increasing demand for support of the vulnerable groups as a result of COVID 19.

2.11 Declining Donor Support

34. **There is a decline in support from development partners which hampers support for development and social programs.** Following the global financial crisis of 2007-2008, there have been changes and shifts in the development finance landscape for most developing countries. This is due to changing international priorities such as climate change, increasing incidences of natural disasters and conflicts, which means that traditional sources of aid may well become scarcer. These changes and shifts meant that developing countries have been obliged to seek alternative opportunities and options to access finance for their investment priorities. This implies that it may no longer be possible to depend largely on traditional sources of finance. Lesotho is no exception, particularly as it is widely acknowledged that traditional sources will not be enough to meet the financial needs of development agenda, which may require huge amount of funds.
35. The decrease of external assistance inflows observed in 2015 represented a 10-year low of US\$120 million compared to 2014 inflows. Given that external development assistance continues to play an important role in the development, such reduction of aid had an impact on development in Lesotho. For instance, the fall of donor support impeded the realisation of some NSDP I strategies and goals. In 2017 the external assistance inflows increased more than two-fold as compared to 2016. This apparent increase may be due to using data from International Aid Transparency Initiative (IATI) as opposed to the Public Sector Investment Database (PSID).

2.12 Financial Sector Development and Financial Inclusion

36. Financial sector development and access to a broad range of quality financial services is an important policy intervention for employment creation and promotion of inclusive economic growth through financing the private sector particularly the Micro, Small and Medium Enterprises

(MSMEs) and reducing vulnerability by providing secure means of saving for investment. Specifically, NSDP II identified increasing financial inclusion and access to credit as priorities meant to kick start the productive sectors in the economy.

37. A liquid, stable, competitive, and efficient inclusive finance sector is a necessary precondition for expanding agricultural production, eliminating financial constraints faced by several micro and small enterprise operators in manufacturing, tourism and other growth sectors. Such finance would enhance their expansion thereby creating employment and increasing household income in a sustainable manner. Further, the provision of financial services, particularly to the excluded, would increase income in the wider economy by mobilising savings and providing loans, which can be used to support the creation and expansion of small business in urban and rural areas.
38. The MF has been playing a catalytic role for the development, adoption and usage of mobile money and other digital financial services for payment of goods and services, in particular by the MSME sector coupled with related financial education. In an effort to cut cumbersome processes in accessing financial services, implementation of digital financial identity (electronic Know Your Customer) linked to the national identity and registry system is underway.
39. The MF will develop an overarching financial inclusion policy, which will provide the direction for the development of the national financial sector and financial inclusion in general. The policy will take into consideration trends and development with international agendas, technological advancement and digitization and financial consumer protection thus ensuring that access to finance has a measurable impact on the real economy.
40. The MF thus intend to conduct a nation-wide FinScope Consumer Survey, which provides insights into the financial needs, preferences, and behaviours of people. The study is tailored to be optimally useful for those who want to enter new markets, regulate the market, change the market conduct and roll out new products in retail financial services. FinScope consumer survey takes financial markets, and the individual's interaction with the financial system, as its departure point. The survey deals with financial behaviour, needs, household structure, household livelihoods, wallet size and financial products.
41. FinScope covers general money matters (both formal and informal financial service products and providers), digitalisation (e-payments), savings and investments, credit and loans, long-term and short-term insurance, legal and housing questions, and other categories of interest in the financial arena. Importantly, in FinScope surveys, the focus on finance goes beyond formal sector provision

to include, and cover in detail, participation in informal financial activities and bodies. The result is a rich understanding of financial markets through the lens of the behaviour and needs of consumers.

42. While the country has over 76,000 MSMEs employing approximately 120,000 individuals, access to finance is still a challenge. Only 2 percent of MSMEs borrow from banks, 7 percent use informal financial services and 91 percent refrain from borrowing due to their apprehension that they will not be able to service the loans. Most MSMEs do not have credit history because owners use their personal bank accounts for banking. Finally, over-reliance of rural and MSMES on informal mechanisms to access financial services further pushing them out of the financial inclusion boundaries. As such the MF intends to develop and implement a microfinance policy and program, which aims to increase financial access to excluded and underserved MSMEs through formal microfinance products and services. The program further intends to build the capacity of stakeholders in the financial sector in microfinance and microfinance operations to create a conducive environment for the growth and development of microfinance in Lesotho.

3.0 MACROECONOMIC TRENDS AND OUTLOOK

3.1 Introduction

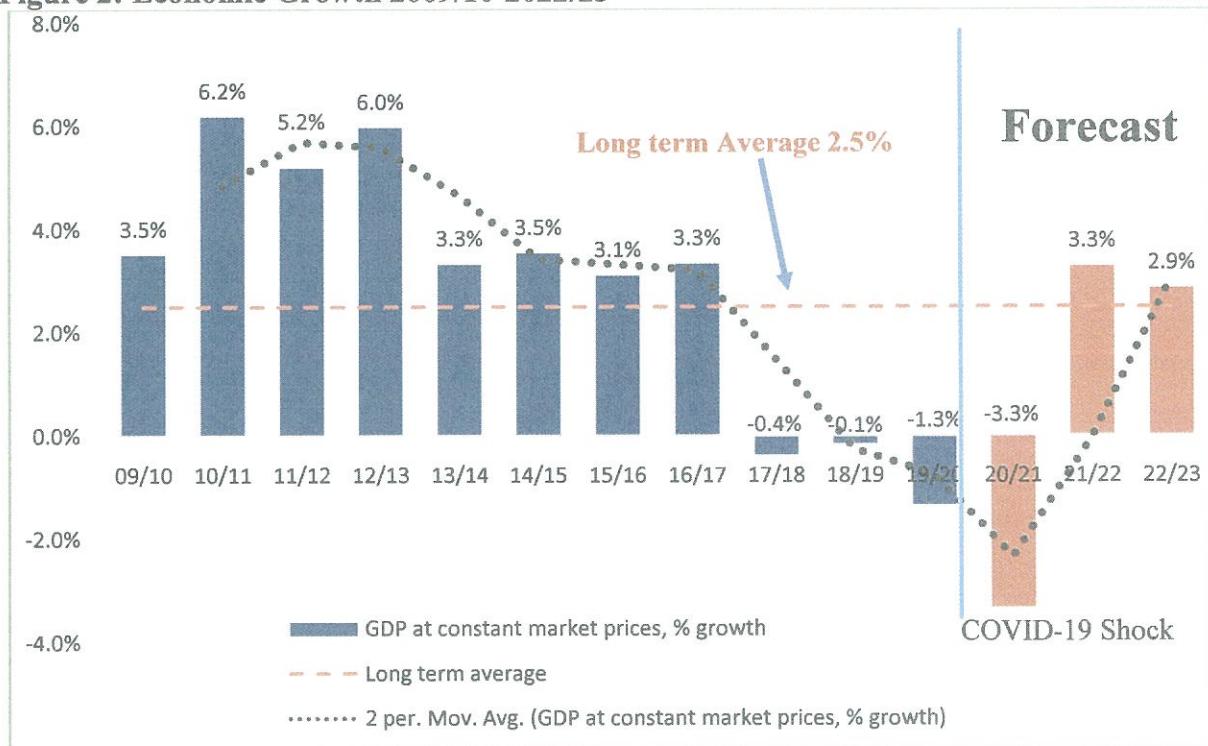
43. Following economic contractions over the past two years (2017/18 and 2018/19), Lesotho's economy is expected to continue to worsen further in 2019/20 and 2020/21, as it moves slowly away from investment spending to consumption-oriented spending. This transition is expected to extend throughout the medium term.

44. Investment in agricultural production remains very poor with no sign of migration from the current rain-fed subsistence farming to a more commercial oriented farming. Agriculture suitable land continues to dwindle as urbanisation sprout on agriculture rich soil and only available arable land.

45. Unemployment remains high joined with high inequality and poverty especially in the rural areas, leading to wider urban-rural inequality.

46. Furthermore, sustained political volatility in the country, combined with slow economic growth in the South African, contribute to poor economic performance. Real GDP growth contracted by 0.4 percent and 0.1 percent in 2017/18 and 2018/19 respectively and is estimated to plunge further to -1.3 percent in 2019/20, before worsening to -3.3 percent in 2020/21, largely attributed to the expected negative impact of COVID-19.

Figure 2: Economic Growth 2009/10-2022/23



Source: Ministry of Finance – MPM Estimates

3.2 Recent Economic Development

47. In 2019/20, economic activity is projected to have plummeted by 1.3 percent, primarily due to expected poor crop production following below-average rain falls received during the year. This follows a poor 2018/19 season, leaving families across the country suffering from consecutive shocks. Mining sector on the other hand drowns to 7.4 percent taking strain from low diamond price resulting from extended trade war between US and China, and the emergence of synthetic diamonds. Low investment spending during the past 2 years and in 2019/20 have resulted in the construction sub-sector shrivelling by 6.5 percent while manufacturing sub-sector is expected also to contract by 8.2 percent.
48. In 2020/21, the crisis triggered by the coronavirus pandemic has plunged Lesotho's economy adding to the woes of the economy that was already struggling to recover since 2017. Beyond its impact on human health, COVID-19 has disrupted a connected world economy through broken global value chains, sudden falls in commodity prices, fiscal revenues, foreign exchange receipts,

foreign financial flows, travel restrictions, declining of tourism and hotels, frozen labour market, etc.

49. Growth in 2020/21 is therefore, projected to plummet by 3.3 percent. The decision to lockdown South Africa on March 26, 2020 followed by similar lockdown at homecoupled with reduced global demand have taken a severe toll on an already ailing economy. Border closures between Lesotho and South Africa has had negative penalties for not only tourism sector and cargo flows but also for traders especially informal traders throughout the country, with South Africa being the major source of both consumer and intermediate goods. Besides border closure, lockdown resulted in significant loss of revenue particularly in both retail and food services, and transport sectors.

3.3 Beyond 2020/21

50. A 3.3 percent recovery is projected in 2021/22 following expected strong global recovery of 5.4 percent (IMF's World Economic Outlook Update, June 2020), at the same time South Africa will expand by 2.6 percent (RSA Treasury Supplementary Budget Review2020). However, the global economy is at risk of stagnation. Lower investment and increasing indebtedness together with trade barriers, are expected to strain economies around the world going forward.

3.4 External Sector

51. The balance of payments is susceptible to external shocks through both the demand and supply sides. The current year is more peculiar due to the COVID-19 crisis that occurred when the economy was already undergoing both fiscal and external imbalances. In the past the country entered into the Extended Credit Facility (ECF) Programme with International Monetary Fund (IMF) to buttress the external sector crises which seem to be imminent because of the pandemic and other domestic challenges.

52. In 2019/20, the external position continued to deteriorate as current account registered a deficit of 5.6 percent of GDP relative to the deficit of 3.7 percent observed in the preceding year. Underpinning the widened trade account deficit was primarily a decline in diamond exports as the sector was faced with both demand and supply shocks. The marginal improvement in compensation of miners in South Africa boosted the primary income surplus while the secondary income surplus was supported mainly by higher SACU receipts. A massive capital account increase of 158 percent related to preparatory infrastructure development of Lesotho Highland Water Project(LHWP)Phase II was recorded in 2019/20. The project will continue to boost the capital account through the medium term as the excavation for two diversion tunnels has commenced.

53. A precipitate decline of the external position is expected in the current fiscal year emerging from a combination of factors. The diamond and textiles sectors were already under distress prior the pandemic and it's inevitable that the decline will be steeper. Furthermore, the construction activities related to LHWP will result in thriving imports which will in turn worsen the trade account deficit. In addition, the mining activity in SA is expected to slow down due the pandemic effects which will directly distress compensation of miners in South Africa. On the contrary, the secondary income will remain resilient due to higher SACU receipts. Notwithstanding this positive prospect, the deficit will persist into the medium term howbeit at a lower magnitude as the global economy is projected to recover in the medium term.

3.5 Prices and Monetary Developments

54. Lesotho is the member of the Common Monetary Area (CMA) and as such Central Bank of Lesotho (CBL) is required to maintain adequate reserves equivalent to 120 percent of narrow money (M1) in order to keep the parity between Loti and South African Rand. In months of import coverage, the country targets reserves equivalent to 5 months which is in excess of the international benchmark of 3 months. The buffer is to cushion the economy against external and domestic shocks given its susceptibility. In the past, the reserve buffers have been used to anchor the economy during periods of economic depresses. The prevalent fiscal imbalances which will escalate in the current fiscal year due to Government mitigating measures pose a threat to the reserve adequacy as the budgetary operations are expected to remain in deficit over the medium term at the back of slow revenue performance against plummeting expenses.

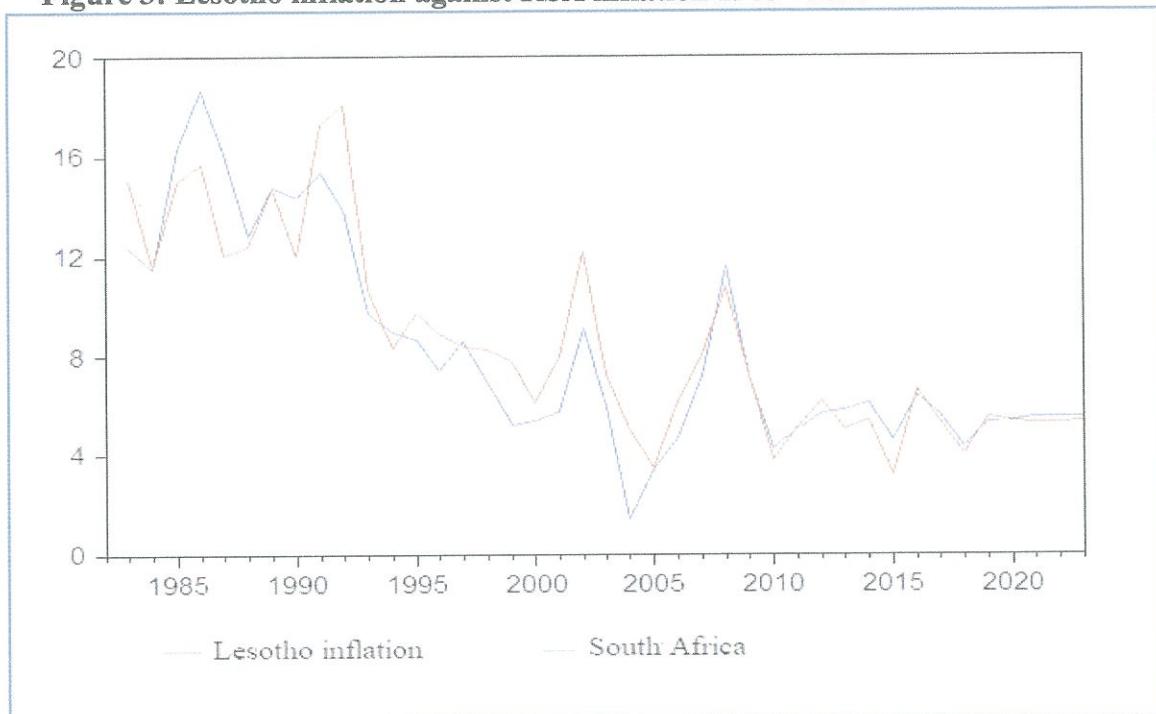
55. The Official International Reserves recorded a moderate improvement of 11 percent in 2019/20 mainly due to valuation gains and are at 4.6 months of import cover. This suggests that at present, there is no external crises but the uncertainty facing the economy dictate that it may be at hand. Although there is an injection from SACU receipts in 2020/21 the current mitigating measures against COVID-19 pandemic will supersede the rebound and as such, reserves are expected to decline to 4.2 months of import cover which is below the 5months' policy target. This restrains the required funding for the country's development goals.

56. Credit to private sector which is one of the engines of economic growth registered an increase of 8 percent in 2019/20. Although CBL has lowered its policy rate by 250 bp from 6.25 to 3.75 percent, credit to private sector is expected to decline in 2020/21 due to lower economic activity in most sectors of the economy. The expected rebound in economic activity in the medium term will positively contribute to improvement in credit extended to private sector.

3.6 Inflation

57. Inflation in Lesotho continues to be driven by price developments in South Africa, which remains the primary source of the country's imports. Imported inflation is estimated at between 60 and 70 percent of Lesotho inflation while the residual is domestically generated.

Figure 3: Lesotho inflation against RSA inflation 1985 - 2020



Source: Ministry of Finance – MPM Estimates and SARB Estimates

58. Inflation as reported by the Bureau of Statistics as at April 2020 was estimated at 4.2 percent, reflecting 0.2 percentage points increase from inflation reported for March 2020. This increase in overall prices was observed in the categories of Food and Non-Alcoholic Beverages (8.7%), Clothing and footwear (3.9%), Furnishings, Household Equipment and Routine Maintenance of the House (1.9%). In 2021/22 through the medium-term inflation is expected to move in line with price developments in South Africa. On average, inflation is expected to remain at 5.1 percent.

3.7 Financing and Debt Management

59. Total debt stock as at July 2020 has increased by 13 percent from August 2019 mostly influenced by movements in external debt. Disbursements accounted for only 1.2 percent of the increase while the bulk of the upsurge is attributed to exchange rate losses suffered to the portfolio which were worsened by the COVID-19 pandemic. This further highlights the importance of developing domestic market and hedging against unfavourable exchange rate movements or swapping foreign

currency denominated debt with South African Rands (ZAR). On the domestic front, the Government is expected to issue LSL500 million to finance the fiscal deficit. The most recent Debt Sustainability Analysis (DSA) assesses Lesotho's risk of external and overall debt distress at moderate despite the impact of the COVID-19 shock, but risks to debt sustainability have risen since the last DSA. The overall risk of debt distress is also assessed to be moderate. The moderate risk tool suggests limited space to absorb shocks.

Table 3: Debt Indicators

	2018/19	August 2019	July 2020/21
Total Public Debt	16 112,8	16 913,6	19 120,5
External Debt	12 904,4	13 225,3	15 432,2
Bilateral	1 008,3	1 082,7	1 173,7
Export Credit	987,7	942,2	1 168,3
Multilateral	10 907,9	11 200,3	13 090,2
Domestic Debt	3 208,4	3 688,3	3 688,3
Long term	2 331,6	2 382,6	2 812,6
Short term	876,8	1 305,7	875,7
<i>In Percentage of GDP</i>			
Total Debt	49,4%	48,8%	53,2%
External Debt	39,5%	38,2%	42,9%
Domestic Debt	9,8%	10,6%	10,3%
<i>In Percentage of Total Debt</i>			
External Debt	80,1%	78,2%	80,7%
Domestic Debt	19,9%	21,8%	19,3%
GDP	32 649,6	34 648,0	35 971,3

60. Debt carrying capacity of the Government has been massively eroded which in turn might hinder its ability to extend stimulus packages and/or guarantees to most businesses affected by COVID-19. The Government had pledged M500 Million towards Partial Credit Guarantee (PCGS) facility for the private sector stimulus package through Lesotho National Development Corporation (LNDC) (M350 Million) and the Ministry of Small Business Development, Cooperatives and Marketing (MSBDCM) (M100 Million). This PCGS was to be implemented through the LNDC at M350 million and the MSBDCM at M150 million.
61. The Medium-Term Debt Strategy remains to develop the domestic market and attain a share of 70 percent external debt to 30 percent domestic debt in the long-term. To fast-track the growth of domestic market the Government has begun financing capital projects such as construction of factory shells in Belo, Butha-Buthe and Tikoe, Maseru with locally issued bonds. However, the

shallowness of the domestic market means the bulk of projects will continue getting foreign financing, which will further prolong the process of shifting towards domestic biased financing.

62. The bulk of external debt stock is concessional but the level of concessionality is expected to decline moderately, while remaining significant as Lesotho grows and graduates from some concessional borrowing sources. The interest rates on most multilateral debt range from 0.75 to 2 percent while recently, the IDA window has established scaled up facility to support transformational initiatives when IDA18 is insufficient. The interest rates on the scaled-up facility consist of a market-based floating reference rate and a spread. The reference rate varies by currency (6-Month LIBOR for USD, JPY and GBP and EURIBOR for EUR). On the bilateral front, the main creditors are China and Kuwait with interest rates ranging around 2 percent and generally their loans are concessional. The export credits, while constituting just below 8 percent of the external debt stock, are mostly non-concessional in nature.

4.0 DOMESTIC ARREAS

63. The Government is undertaking the clearance of arrears accumulated from the fiscal year 2017/18 through 2019/20. For this endeavour, M550 million has been raised from the domestic bond auctions, of which M400 million has been warranted in the current fiscal year. M362million has already been spent on settlement of arrears while M150 million is in the process of being availed before the end of the current fiscal year.

64. To curb the resurgence of domestic arrears, delayed payments will be monitored on a monthly basis and reported quarterly. MDAs are expected to pay the arrears within the relevant financial year. Strict controls of monitoring should ensure critical analysis and justification of those that fall beyond the financial year. The said justification should be the basis for granting authority to pay with the following year budget. The arrears budget as prepared annually will be informed by the quarterly monitoring of the domestic arrears. MDAs will be expected to pay the arrears within the first quarter of the financial year.

5.0 RISKS TO THE ECONOMIC AND FISCAL OUTLOOK

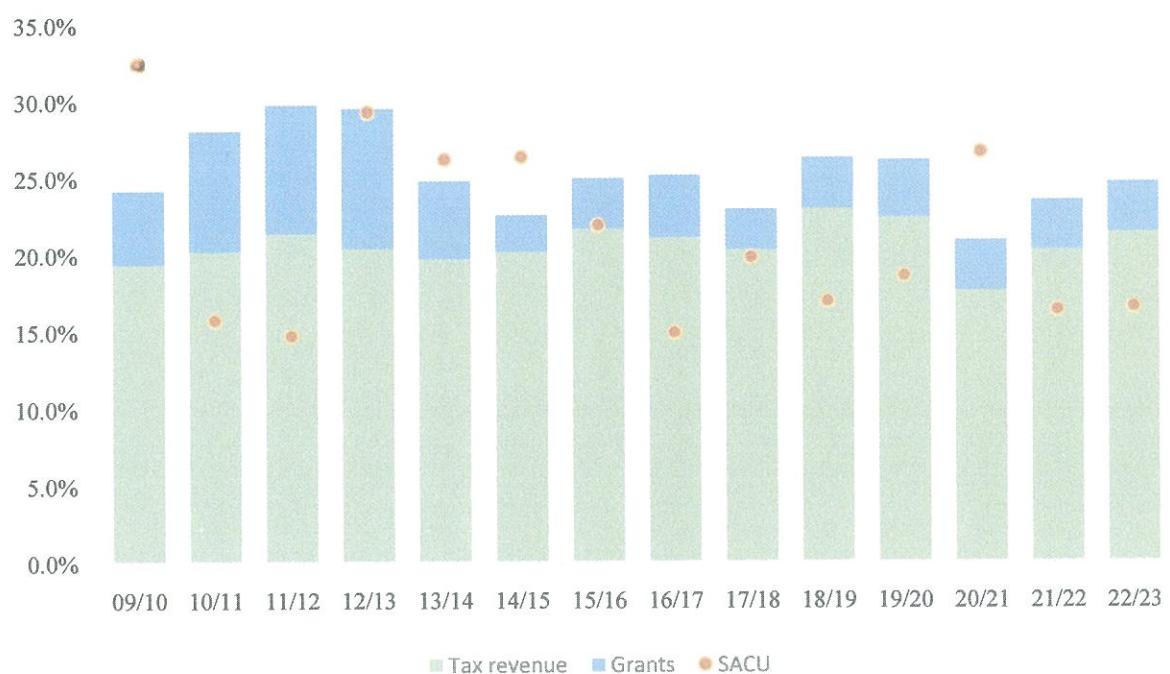
5.1 Fiscal Outlook

5.1.1 Division of Revenue

65. As outlined in earlier in the chapter, economic growth in Lesotho is fading, resulting in subdued growth in revenue collections, which coincides with the Lesotho's share of SACU revenue declining sharply due to poor performance of South African economy and lack of export diversification in Lesotho.

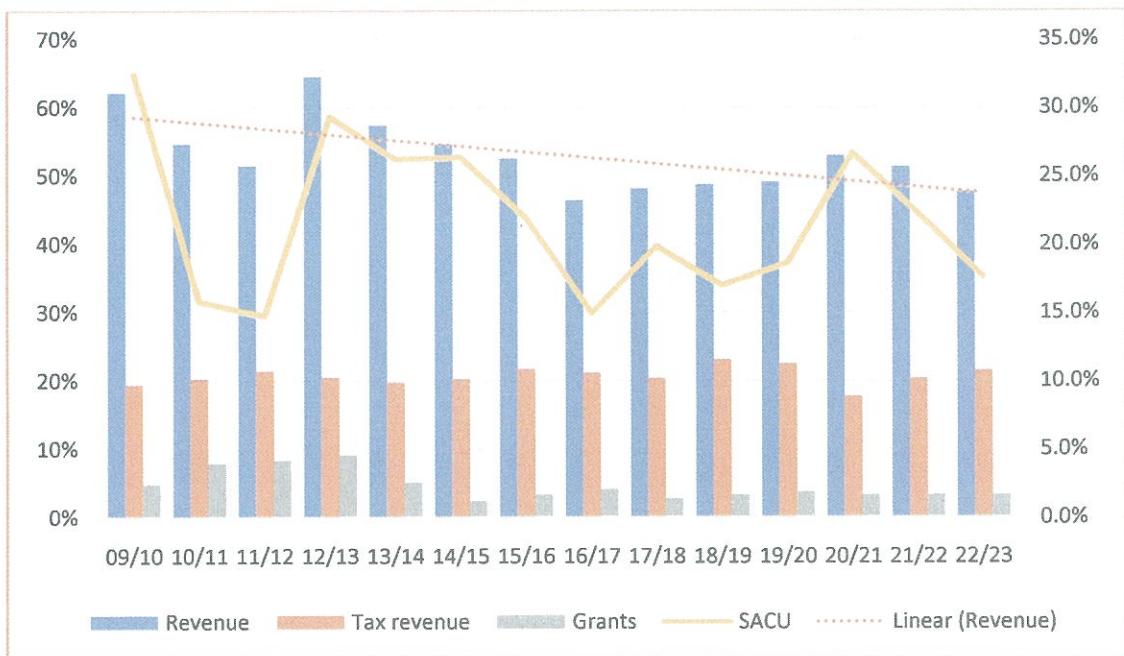
66. General government sector revenue growth including SACU is expected to average 49.1 percent of GDP in 2019/20 before climbing to 52.9 percent of GDP in 2020/21, largely owing to higher than expected SACU which was 11.6 percentage points (M2.9 billion) higher than initial forecast. On the flip side, domestic revenue is expected to slow to 22.4 percent of GDP in 2019/20 before deteriorating further to 17.5 percent of GDP in 2020/21, reflecting adverse COVID-19 economic shock, the downside risk to SACU revenue in 2021/22 forecast point to a possible huge negative adjustment which SACU Member States will have to pay following South Africa's credit rating downgrade to junk status by Moody and Fitch rating agencies. Therefore, SACU revenue in 2021/22 is projected to dwindle to M6.02 billion representing 16.4 percent of GDP. This poor SACU revenue forecast is expected to drive general government revenue a record low of 45.4 percent of GDP which is equivalent to M16.72 billion.

Figure 4: Revenue performance and outlook (% of GDP)



Source: Ministry of Finance – MPM Estimates

Figure 5: Division of Revenue and outlook

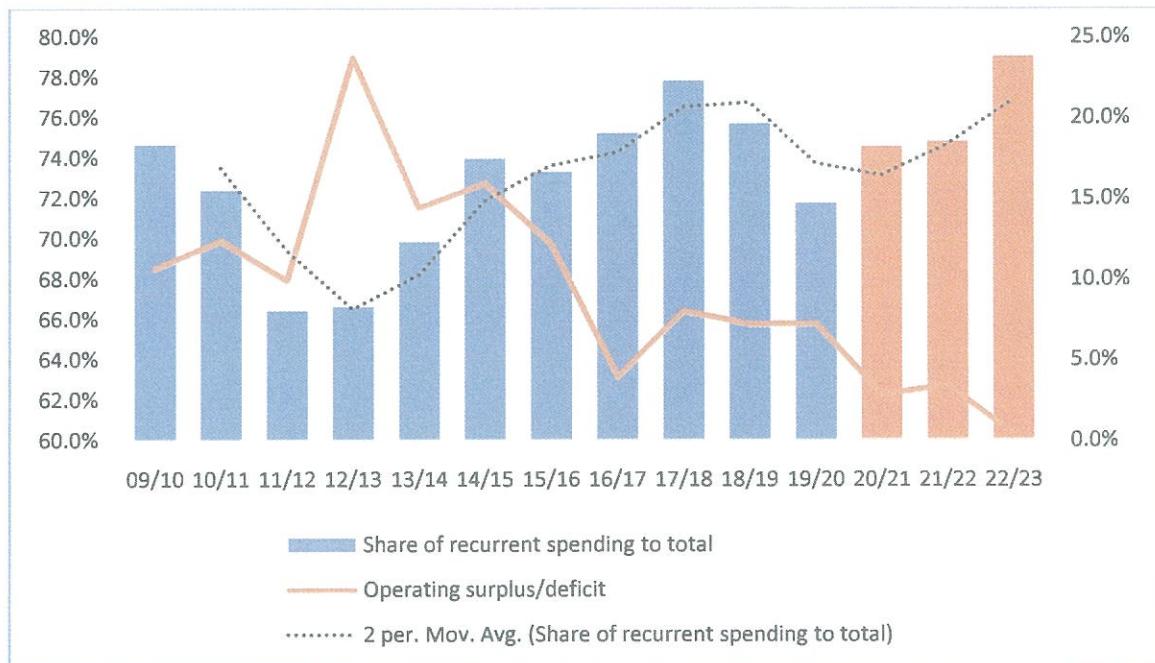


Source: Ministry of Finance – MPM Estimates

5.1.2 Recurrent Spending

67. Recurrent spending as share of total expenditure is expected to average 74.5 percent in 2020/21, up from 71.8 percent observed in 2019/20. These projections are leading to very small general government sector operating surplus that is insufficient to fund the Government's infrastructure investment. This is driving further increases in net debt and gross borrowing levels. Wage bill is expected to continue to drive recurrent spending at 21.3 percent of GDP in 2020/21, up from 17.6 percent of GDP observed in 2019/20. On the flip side, fiscal consolidation had reduced spending on use of goods and service in 2019/20. However, in 2020/21 it is projected that use of goods and services will expand to 10.0 percent of GDP from 9.4 percent of GDP observed in 2019/20.

Figure 6: Recurrent spending against total expenditure (FY09/10-FY22/23)

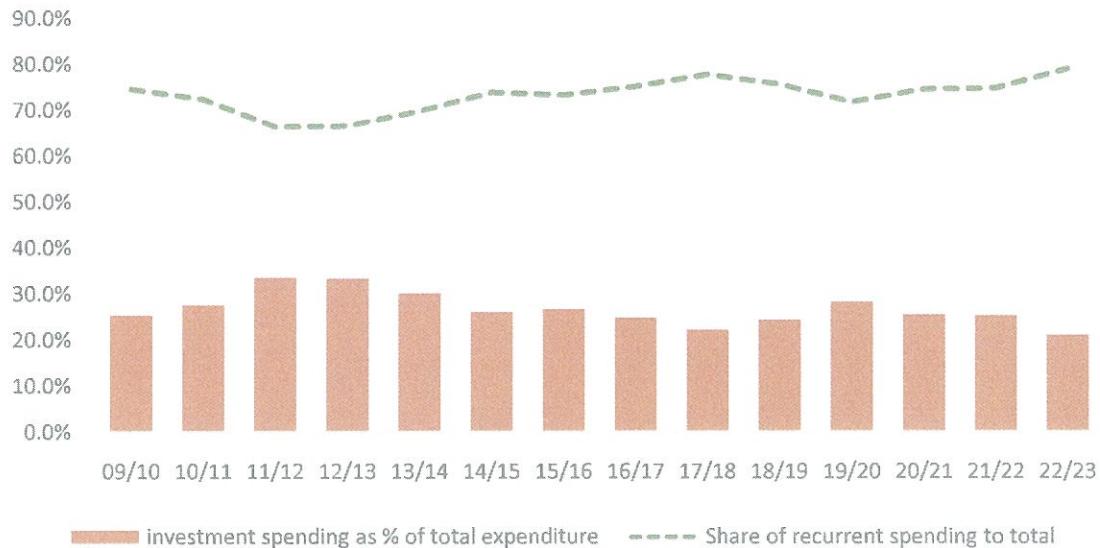


Source: Ministry of Finance – MPM Estimates

5.1.3 Investment spending

68. For the past years, capital budget has been marked by slow implementation of capital projects by the Government and this has resulted into sporadic economic contraction between 2017/18 and 2019/20 and through the medium-term. Investment spending as a share of total expenditure for 2020/21 is expected to average 25.5 percent and remain the same for 2021/22 before slowing to 21.0 percent in 2022/23. However, out of the projected M5.6 billion in investment spending, M1.5 billion will be diverted to COVID-19 pandemic response through large scale economic and social relief measures. This measure will result in capital spending as a share of total expenditure slowing to 17.7 percent, putting more strain on growth in 2020/21.

Figure 7: Investment spending as % of Total Expenditure



Source: Ministry of Finance – MPM Estimates

69. Generally, these developments are expected to increase the overall fiscal deficit to 12.3 percent of GDP in 2020/21 from budgeted 4.7 percent of GDP (2020/21 Budget speech).

Figure 8: Overall fiscal position (2009/10 – 2022/23)



Source: Ministry of Finance – MPM Estimates

Table 4A: Medium-Term Fiscal Framework - Division of Expenditure

	18/19	19/20	20/21	21/22	22/23
	Act.	Act.	Est.	Proj.	Proj.
Revenue					
Revenue without SACU	15,925.7	16,412.5	17,863.0	16,720.8	18,654.3
Taxes					
Taxes on income, profits and capital gains	10,383.5	10,186.3	8,882.5	10,698.7	12,024.8
Payable by individuals	7,528.9	7,501.4	5,958.9	7,472.8	8,594.5
Payable by corporations and other enterprises	4,313.1	4,052.1	3,274.6	3,990.2	4,408.3
Other taxes on income, profits and capital gains	938.9	851.9	475.8	944.0	1,042.9
Taxes on goods and services	3,211.7	3,449.2	2,683.5	3,481.7	4,185.3
Value added taxes	2,899.8	2,906.6	2,330.8	2,980.7	3,658.9
Excise taxes	305.2	527.5	332.1	479.4	503.7
Grants	1,076.8	1,255.9	1,108.4	1,193.7	1,296.8
Recurrent	232.2	240.8	250.2	262.7	275.8
Capital	844.6	1,015.1	858.2	931.0	1,021.0
Other revenue	1,777.8	1,429.0	1,815.1	2,032.2	2,133.4
Property income (primary income)	689.8	531.6	477.1	648.8	680.8
Interest	11.6	7.5	78.4	7.5	7.5
Dividends	318.5	175.8	144.8	164.6	172.9
From FPCs	0.0	155.1	144.8	152.0	159.6
From NFPCs	0.0	4.9	0.0	12.6	13.2
Other dividends	318.5	15.9	0.0	0.0	0.0
Rent	359.7	348.3	263.9	476.7	500.5
Rent on land	3.2	3.1	6.7	7.1	7.4
Rent from royalties	356.6	345.2	247.2	469.6	493.1
Sales of current goods and services (incl Telecom lic.)	1,087.5	896.1	1,333.6	1,378.7	1,447.7
Sales by market establishments	999.9	825.1	1,121.2	1,177.2	1,236.1
Electricity Muela	67.6	31.9	61.2	64.3	67.5
Water LHDA	932.3	793.2	1,060.0	1,113.0	1,168.6
Administrative fees	22.3	12.5	72.1	54.7	57.4
SACU	5,542.2	6,226.2	8,980.5	6,022.1	6,629.5

Table 4B - Medium-Term Fiscal Framework – Division of Revenue

	18/19	19/20	20/21	21/22	22/23
	Act	Act.	Est	Proj.	Proj.
Expenditure					
Expense					
Compensation of employees	17,310.5	18,841.6	22,021.2	22,870.5	23,236.1
Wages and salaries	13,102.7	13,521.0	16,416.5	17,105.6	18,363.3
Social contributions	5,994.7	5,890.6	7,180.3	7,850.4	8,528.4
Funded	5,469.0	5,425.2	6,595.2	7,236.1	7,883.3
Unfunded	525.6	465.4	585.1	614.4	645.1
Use of goods and services	525.6	465.4	585.1	614.4	645.1
Travel and transport, domestic	3,112.5	3,161.1	3,391.1	3,117.9	3,390.8
Travel and transport, international	361.5	310.6	424.7	334.5	468.3
Operating costs (incl. special in 2008/09)	164.5	176.1	120.6	95.0	99.7
Interest	2,586.5	2,674.3	2,845.8	2,688.4	2,822.9
To non-residents	482.6	479.5	504.8	530.0	556.5
To residents	228.9	227.2	282.8	296.9	311.8
Subsidies (almost all to public NFC)	253.7	252.3	222.0	233.1	244.8
Grants to international organisations	279.2	338.0	1,068.5	1,121.9	1,178.0
Grants to other general government units	34.4	34.4	36.9	38.7	40.6
Social benefits	839.5	1,098.4	1,082.1	1,136.2	1,193.0
Other expense	1,734.3	1,687.4	2,200.5	2,310.6	2,426.1
Students	625.6	831.5	952.3	999.9	1,049.9
Other	577.0	761.5	904.4	949.6	997.1
	48.6	69.9	47.9	50.3	52.8
TRANSACTIONS IN NONFINANCIAL ASSETS	4,207.7	5,320.6	5,604.8	5,765.0	4,872.8
 Fixed Assets	4,207.7	5,320.6	5,604.8	5,765.0	4,872.8
Buildings and structures	4,036.4	5,221.5	5,429.4	5,580.8	4,679.4
Machinery and equipment	166.6	94.2	175.4	184.2	193.4
Unidentified	4.8	5.0			
OVERALL BALANCE	-1,384.8	-2,429.1	-4,158.2	-6,149.7	-4,581.8

5.2 Fiscal Policy

70. The fiscal policy over the next three years aims at reinforcing long-term fiscal sustainability and providing a sufficient fiscal and/or foreign reserve buffer against domestic and external shocks and imbalances. Prudent fiscal management will also help to sustain confidence of investors and development cooperating partners and help to secure financing for investment by the private sector and for infrastructure projects.
71. This objective will be achieved through a reduced dependence on volatile and pro-cyclical SACU receipts by moving to a situation where current expenditures can be covered by tax and non-tax revenues, with SACU revenues and donor funding being used to finance infrastructure and other capital expenditures and maintain sufficient reserves for financing forward capital spending commitments. Key measures to achieve this outcome include:
- Maintaining adequate reserves to provide 5 months of import cover as a buffer against both external and fiscal shocks.
 - Reducing high and unsustainable level of recurrent spending. This will require tighter control over recurrent expenditure budgets to ensure that existing resources are utilised more effectively and efficiently as well as targeting no real increases in recurrent spending over the next three years (excluding maintenance of assets).

- **Improving mobilization of domestic non-tax revenues.** This will require identification and assessment of new revenue sources and adjustment of selected fees, penalties and charges that have not been increased for several years. In addition, we would consider measures including exploring a new mining taxation regime and improving revenue administration.
- **Mobilising additional resources,** especially grants to finance public investments and crowding- in private investment.

72. The Government will further implement the following additional measures in the medium-term:

- Institute COVID-related mitigation measures to protect the poor, vulnerable and affected sections of society while allow economic activity to continue with caution and within safe margins with clear protocols and guidelines for safety.
- Review and adopt a new Public Service Employment Policy that aims to maintain a sufficiently lean, largely professional, and highly efficient civil service while addressing the high wage-to-GDP ratio.
- The maintenance of a sufficiently lean and efficient administration by way of reduction and emergence of some portfolio ministries, a process that has commenced, while improving governance of the public service.
- Review and rationalize the Foreign Mission Policy with the intention to reduce foreign representation costs.
- Enhance collection of student loans and review the model for granting educational loans to ensure efficiency and sustainability.
- Enactment of fiscal rules which will ensure fiscal sustainability and accountability as outlined in paragraphs 67 and 68 above.
- Accelerate the implementation of Fiscal Decentralisation Policy.

6.0 STRATEGIC PRIORITIES FOR 2021/22 – 2023/24 BUDGET

6.1 Key Policy Targets

73. The medium-term national priorities were established as part of the NSDP II with consultations with MDAs on their annual implementation of the national plans. The priorities are also drawn from the Government's two-year policy program implementing the 4th Coalition Government Agreement. The priorities are articulated to accelerate implementation of the National Reform, halt social and economic effects of COVID-19 and foster inclusive growth. It is therefore proposed that in developing the Government budgetary plans for 2021/22 to 2023/24, the focus should remain on the Government priorities. The key policy targets are:

- Creation of an estimate of 49, 319 private sector jobs (23, 096 from the 4 productive sectors and 26, 223 from rest of the economy) over the plan period or 9,863 jobs created each year.
- Increasing economic growth to at least 5 percent growth per annum over the plan period with gradual increase in average propensity to invest in capital formation from the current 28.2 percent to 50.3 percent over the plan period.

- Restoring macroeconomic stability to sustainable levels by reducing fiscal deficit to less than 5 percent of GDP.
- Accelerate implementation of National reforms.
- Reducing the country's ranking on the ease of doing business from position 122 (in 2019) to at least position 80 in the medium-term through implementation of Investment Climate Reforms
- Enhance capacity to respond to COVID-19 and other similar epidemics/pandemics and Disaster Risk Management
- Develop post COVID-19 economic recovery action plan
- Reduce TB incidence from 611 to 475 per 100, 000 population.
- Reduce Mortality rate in TB/HIV from 206 to 140 per 100,000 populations
- Reduce incidences of HIV/AIDS and increase coverage of Anti-Retroviral Treatment (ART) to 100 percent.
- Provide adequate infrastructure to support private sector projects.
- Increase electricity generation capacity from 72MW to 178 MW
- Increase energy access from 45 percent to 100 percent by 2038
- Improve the status of Lesotho in Trafficking in Persons from Tier 3 to Tier 2

74. The NSDP II emphasises private sector development and gives priority to pursuing people-centered development. Annual national budgets provide an opportunity for Government to implement specific strategies and allocate appropriate resources to the relevant sectors of the economy to realise these national priorities. The 2021/2022 financial year is the fourth in the implementation of NSDP II, and therefore, the proposed policies and strategies for implementation during the year, as well as the resource allocations, should be aligned to the national priorities.

6.2 Expenditure Priorities

75. The key expenditure policy priorities for the medium-term budget of 2021/22-2023/24 will focus on enhancing inclusive and sustainable economic growth and private sector-led job creation. The budget will address the economic and social challenges brought by COVID-19 and the expenditure priorities will include the following:

- Increase cereal crop production and enhance food and nutrition security.
- Promote climate smart agriculture and food security system
- Increase production of high value crops, livestock, and cottage industry.
- Increase irrigated crop production.
- Enhance e-Governance solutions.
- Diversify products and market access for Lesotho's products and services.
- Strengthen investment and trade promotion.
- Build efficient special economic zones, industrial clusters for integrated supply chain.
- Accelerate establishment of the delivery unit.
- Improve Roads construction and maintenance
- Improve access to clean water for households and industries

- Improve access to electricity for households and industries

7.0 TRANSLATING POLICIES INTO RESOURCE ALLOCATION

7.1 2021 – 22 Development Budget Initiatives

7.1.1 Introduction

76. The present Budget Strategy Paper for 2021/22 fiscal year will be realised by introducing the following initiatives: Encourage the establishment and implementation of priority projects that would stimulate the economy. There is an ongoing initiative on the enhancement of capacity of Ministries, Departments and Agencies (MDAs) on appraisal tools and techniques among others for better appraisal of development projects to ensure that the Public Sector Investment Programme (PSIP) contains bankable projects. There is also a concerted effort to improve the absorptive capacity of capital projects whereby the frequency of site visits coupled with progress reporting will be increased to enable taking corrective measures on time. The Government has introduced a project “Advanced Infrastructure Development for Economic Growth and Job Creation” which is meant to provide the necessary impetus for private sector-led economic growth. In addition, institutional capacity will be improved through resuscitation of sector working groups. The prerequisite studies will be done prior to implementation of development projects.

77. For the Government to realise the NSDP II, priority projects that best address issues contained in the plan and that promise to deliver aspirations of the plan were identified and have to be implemented. For the effective implementation of the identified 77 (i.e. Agriculture 25, manufacturing 22, Tourism and Creative industries 13 and Technology and Innovation 17) projects under the Big Fast Results (BFR) Methodology which are set to reduce unemployment and enhance economic growth, these projects have potential to create 30,021 new direct jobs in the private sector. There is a need for government to establish the central delivery unit that will effectively drive the implementation of the identified projects. The Government should also ensure that it creates a conducive environment for projects to be successfully implemented.

78. NSDP II stipulates that the country should transform from consumer-based to producer-based economy. Even though NSDP II has identified the four productive sectors that fall under Key Priority Area (KPA 1), the presence of COVID-19 pandemic signals the need to review our priorities and focus more on sectors which will indeed bring real transformation in the economy. For example, investing in the tourism sector is risky as one of the identified sectors has already been heavily affected by the COVID-19 breakout as a result of mobility restrictions and social distancing measures imposed for health reasons. The General Agreement on Trade in Services mode 4 (i.e. involving the temporary movement of natural persons) has been largely paralysed. Therefore, there is a need to put focus on other sectors other than the tourism sector.

7.2 Initiatives under Big Fast Results

79. In the agriculture sector, the main projects of the identified 25 include i) increasing commercial production of grains such as maize, sunflower, sorghum, wheat, beans and peas, and ii) Industrial Aquaculture Project whose aim is to develop a large-scale indoor production of Atlantic salmon based on an advanced Indoor Recirculation Aquaculture System (RAS) technology. The two projects have the potential to create an impressive 759 jobs with an investment of M1,260 million.
80. In the manufacturing sector, the most impactful project of the 22 identified is establishment of a Centre for Aerospace and Advanced Manufacturing, Technology, and Innovation, producing both manned and unmanned avionics system. The target market is for export within Africa Continent for the purpose of surveillance and security. The project has the potential to create 1, 048 new direct jobs with an investment of M717 million.
81. In the tourism and creative arts sector, the main projects of the identified 13 include i) ***Morija-Matsieng Heritage Tourism Project***, which involves up-scaling of the Morija Arts Centre to become a vibrant hub for skills training in art/craft as well as incubation for small creative business ventures; and ii) ***Sehlabathebe Luxury Adventure Resort and Spa Project*** where the plan is to build a luxury adventure golf and spa estate at the Sehlabathebe National Park as well as to include academic activities such as geology, botany and zoology; that would attract local and international scholars for research. These projects have the potential to create 560 jobs with an investment of M478 million.
82. In the technology and innovation sector, the main projects of the identified 17 include i) development of a Smart City Solution for the Government. The first phase of this solution will cover a Safe City solution consisting of: a Unified Command Centre, an Intelligence Video Surveillance, an Intelligence Traffic System and Data Centre; and ii) pre-feasibility study to develop a manufacturing facility in Maseru to produce Cell phones, Tablets, Laptops and PC boards. Together these initiatives have the potential to create 585 jobs with an investment of M288 million.
83. In addition to identified projects under BFR Methodology, the Government is already undertaking projects that are geared towards the NSDP II goals.

7.3 Government Initiatives

7.3.1 Agriculture

84. The NSDPII has identified 7 investment areas to boost the sector; these are Bio-trade, Poultry production, Horticulture, Aquaculture, Red meat production, Medicinal plants and Wool and mohair production.

85. There are 3 on-going projects that are geared towards the increased production of crop and fruit. These include *i) High Value Irrigated Crop Project (M33million), ii) Mushroom Production Project (M54million) and iii) Smallholder Agriculture Development Project (additional finance (M818million))*. Furthermore, there is a project that addresses increased production and improved value chain of wool and mohair, i.e. *Wool and Mohair Production Project (M466.8million)*. All these projects will be completed during the plan period except for *Smallholder Agriculture Development Project (additional finance)* that would go beyond the plan period.
86. Beef Production Project and Agriculture Productivity Program for Southern Africa Project proposals' have been approved. The two projects will address beef production and machinery associated agriculture products respectively.

7.3.2 Manufacturing

87. The NSDPII has identified 10 potential investment areas to enhance the sector; these are organic and fortified foods, grain production; water bottling; processing sandstone for building; brick making; packaging materials; leather products; waste management and recycling; electronics and car parts; medicaments; and food processing.
88. The Government has invested in the project (*Economic Diversification Support Project, M151 million*) that supports private sector development through improving partnership, entrepreneurship and skills development, access to finance and market, and investment promotion in the selected sectors critical for economic diversification. In addition, and most importantly, the Government is already undertaking a project that will improve the '*Ease of Doing Business Ranking*' of the country through the improvement of access to finance, support investment promotion activities in new sectors. The project will also enhance linkages to domestic MSMEs and improve economic diversification through targeted support to new growth sectors such as horticulture and tourism (*Private Sector Competitiveness and Economic Diversification Project – Phase II, M188 million*).
89. In order to facilitate diversified private investment, the Government has embarked on building industrial infrastructure and factory shells (*Tikoe Industrial Infrastructure Phase 3 (M323 million)* and *Belo Industrial Infrastructure Phase 1 (M800 million)*). There is also *Construction of Slaughterhouses and Fresh Produce Market Centres* to improve competitiveness and access to markets respectively; *i) Poultry and Piggery Slaughter Plants (M100 million)* and *ii) Regional Fresh Produce Market Centre (M52 million)*. In addition, the Government is undertaking projects on the establishment of standards and accreditation (*Standards and Quality Infrastructure, (M50 million)*).

7.3.3 Technology and Innovation

90. The NSDPII has identified 3 priority areas that would improve the sector; these are strengthening research for policy making and product development; functioning incubation centres and industrial parks; and improving use of Information Communication Technology (ICT).
91. The Government has invested in an e-Government Infrastructure Project which is being undertaken in two phases. The objective of the project is to drive digital finance and financial inclusion by improving access to reliable digital services, particularly among citizens living in rural and unserved areas. The aim is to provide access to diverse range of financial products and services for individuals as well as small, medium, and large businesses through the expansion of digital infrastructure and services, which will lead to creating jobs, and contributing to Lesotho's economic growth.
92. Specifically, the project shall: increase data enabled coverage in rural and unserved areas; improve financial inclusion among unbanked citizens in Lesotho by developing digital payment infrastructure and strengthening digital services ecosystem and improve government skills to oversee and implement ICT initiatives. This requires optimising an existing metropolitan fibre network linking ministries and the data centres, improving bandwidth access to submarine cable systems for e-Government services. The first phase of the project has been completed and has since moved to the second phase which will be completed in 2024.
93. With regard to research for product development, there is already an approved concept on the establishment of a well tissue culture and storage facilities for seed potato so as to have a sustainable potato production for local and international markets (Potato Value Chain).

7.3.4 Tourism

94. NSDP II has identified 5 priority areas that would enhance the sector and these include increasing tourism investment, improving visibility of Lesotho as a destination of choice, improve protection and management of heritage resources, improve institutional frameworks for tourism and building sustainable infrastructure for tourism. The sector has been heavily hamstrung by the prevalence of COVID-19. Although international tourism has been paralysed, there has been an improvement in the performance of domestic tourism in the advent of COVID-19 pandemic. Therefore, institutional reforms with regard to the sector need to be enhanced.

7.4 Initiatives that enhances the Enabling Environment

95. In order to achieve the above initiatives, the Government would need to pave way through the enhancement of enabling environment. This would be done through implementation of the following development initiatives: *i) Lesotho Lowlands Water Supply Scheme* which include

construction of *a) Hololo Multi-Purpose Dam, b) Hlotse Multi-Purpose Dam, c) Makhaleng Multi-Purpose Dam and d) Senqu Multi-Purpose Dam to the tune of M8,143.9million and ii) The Construction of Maseru District Hospital to the tune of M1,191.5 million* and the prevailing situation has shown how important health infrastructure is. Therefore, the Construction of Maseru District Hospital will close the gap between the Clinics and the Referral Hospital to serve the intended plan.

7.5 SOEs Reform

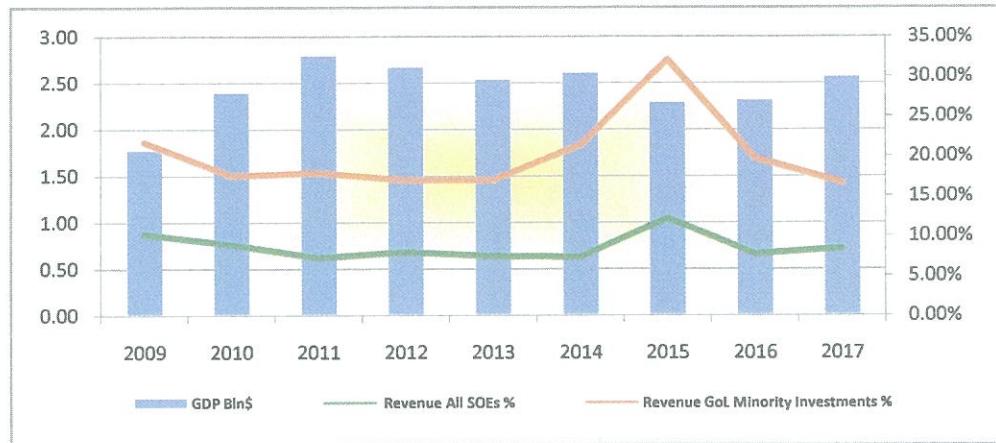
96. The State-Owned Enterprise (SOE) reform programme seeks to develop and implement regulatory framework and Programmes to support the Government in developing enhanced policy oversight, management, and control of Lesotho's public enterprises.
97. The government has a mandate to actively manage the SOEs as valued assets of the Basotho people to ensure that the enterprises operate at optimal performance and that they provide value to government and the people; not only in financial terms but also through Public Service Obligations (PSOs) that may be imposed upon them.
98. The Public Financial Management Accountability Act defines a public enterprise as an entity which is (a) established by law to carry out specific commercial activities, (b) is owned and controlled by Government or its agencies; and (c) is a distinct accounting entity producing its own financial statements. A statutory body is similar but is defined as an entity established to carry out specific Government functions.
99. The fragmented and incomplete understanding of the SOE sector; its value to the economy and the country; poor reporting performance; and current weak oversight and management is exacerbated by the lack of a clear SOE policy. It is now an ideal opportunity to take stock and introduce an SOE policy that reflects Governments' needs. Managing, controlling, and reporting on SOEs is a crucial task for the Governments and sustainable public management practices in a globalised world.
100. In line with New Public Financial Management reforms, will emphasise the relevance of accountability and transparency of SOEs, especially regarding the increasing debates on government debt, corruption, shadow economy, and tax burden.

7.5.4 Total Government Portfolio

101. Figure 6 and Figure 7 shows the total revenues of the two SOE categories combined, and the Government minority interests, as a percentage of GDP. The companies in which the Government maintains a minority interest are (as a group) significantly larger than the SOEs. The peak year of

2015 at 44% (minorities 32.10% and SOEs 12.18%) is more a function of GDP decline rather than significant increases in company revenues.

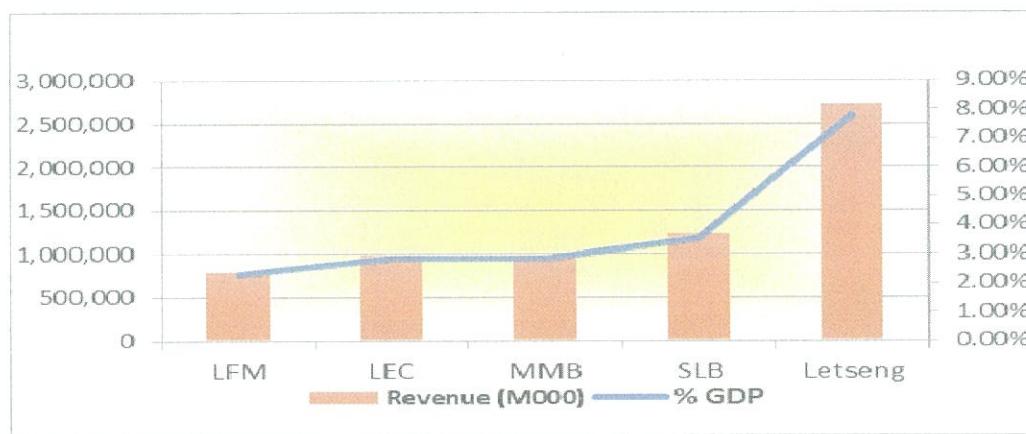
Figure 9: SOE and Minority Invested Company Revenue as Percentage of GDP



Source: Ministry of Finance – SOE Annual Report

102. These five companies are significant to the country's economy, yet only 2 SOEs are included in the top 5 companies by revenue. The other three are companies in which the Government has minority interests. Letšeng Diamond Mine dominates but is important to note that Letšeng Diamond Mine's 2017/18 revenues have declined by 13.9% in the past two years. More significantly this translates into a 51.6% reduction in tax payments from Letšeng Diamond Mine.

Figure 10: Largest Companies 2017/18 Revenue as equivalent of percentage of 2017 GDP



Source: Ministry of Finance – SOE Annual Report

103. Limited state oversight of the SOEs limits the ability of the 'SOE oversight by the MF to estimate the overall fiscal implications of the SOE sector. Need to strengthen oversight to effectively monitor and analyse SOE sector performance, its impact on public finances, including,

the net budgetary burden of the sector. That would put the Government in a stronger position to manage its relationship with SOEs.

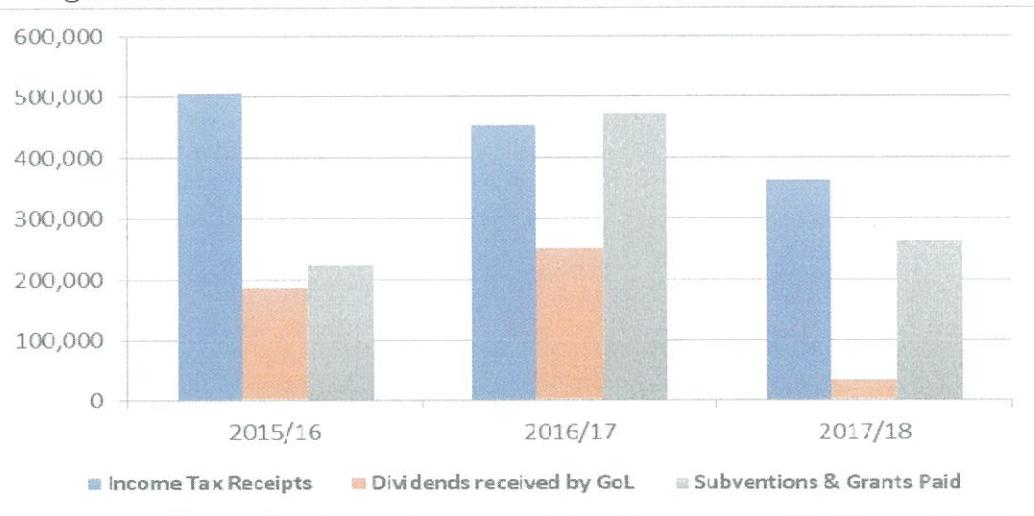
104. **The Public Finance Management and Accountability Act of 2011 (PFMAA) empowers the MF to receive audited financial statements from the SOEs on a timely basis.** However, ownership of the SOE sector in Lesotho is fully decentralised with line ministries exercising the ownership and oversight role and the Ministry is not receiving the financial statements regularly; from either the SOEs or the line Ministries.

105. **State oversight could be strengthened by the way Government exercises its ownership function on SOE boards.** There are weaknesses in the nominating processes and compositions of SOE boards of directors, particularly with respect to government representation on the boards. The Founding Acts and Articles of Association of the wholly owned SOEs in general do not spell out the expertise needed on the boards.

7.5.5 Oversight Monitoring by the Ministry of Finance

106. There are significant financial flows between the State and some SOEs and invested enterprises. Such flows may be inbound, to treasury through taxes, royalties, dividends and import duties and may be outbound through direct transfers, subsidies, or debt concessions. The MF has had difficulty coordinating the collection of relevant data and does not have access to a full history of fiscal relations with SOEs. It is an on-going but critical challenge to improve such data collection. In the long run, the MF aims to improve on fiscal transactions with SOEs, including government guarantees on SOE borrowing, all duties and tax exemptions, and any other concessions and be able to comment appropriately in the SOE annual report.

Figure 11: Direct Inflows and Outflows between GOL and SOEs



Source: Ministry of Finance – SOE Annual Report

107. Whilst the balance of inflow is greater than that of outflow, the chart clearly highlights the vulnerability of inflows as they have been greatly dependent upon Letšeng Diamonds Mine which has not declared dividends in 2017/18, and its tax payments have reduced by 51% in the past 2 years.

8.0 SUMMARY CONCLUSION

108. Fiscal sustainability remains a real challenge in the short to medium-term and even beyond which calls for government's deliberate effort towards fiscal adjustment and concessional resource mobilization. In the event of a deterioration in the South African growth environment coupled with a decline in SACU revenue and donor support, expenditure will have to be brought inline with the available resources.

109. The government is committed to strengthen macroeconomic stability and lay the ground for sustainable and inclusive growth. Such a delicate situation is likely to coincide with slow domestic growth and call for severe fiscal adjustment with significant political consequences given the state of unemployment and poverty in the country. Reforms tailored towards creating a more favourable investment environment become more critical than ever before.