Economic Review - February 2004

BUDGET SPEECH FOR 2004/2005 FISCAL YEAR

Free Primary Education enters its fifth year, but there is a looming question over its sustainability beyond class seven due to the high cost. For the first time in seven years, a surplus is forecasted for the year 2004/2005 on expectation of SACU revenue windfall...

Introduction

The budget speech time always transmits an exciting tremor in almost every economy. It is normally centred around the government's self-performance appraisal on execution of the past year's economic policies, outstanding challenges and the way forward. Consistent success in fulfilment of promises made in the budget of previous years could raise confidence in a government's ability to implement its fiscal policies. This feat could serve as an important drawcard of grants and foreign investments as it marks the government's commitment to the country's development. Most importantly, under the way forward, the government presents a package of public expenditure plans and tax legislation for the following fiscal year. This is an important, transparent, enlightening and informative event as the public gets to be acquainted with the government of the day's objectives and aspirations. The public at large, residents and non-residents, are then able to anticipate the likely impact of government behaviour in the short to medium horizon. The information enables them to make necessary adjustments to benefit from the impact of positive policy decisions or cushion the adverse impact.

Budget for 2003/2004 and Outturn

During the fiscal year ending in March 2004, the Government of Lesotho (GOL) projected an overall deficit of 2.9% of Gross Domestic Product (GDP). As can be observed from table 1 below, this projection is a 2.4% reduction from the initial deficit approved by Parliament. The present positive outlook is a far cry from the fiscal year 2002/2003, when the actual overall balance turned out to be sizeably higher than that approved by Parliament. This was mostly due to unforeseen food insecurity in the country. The expected improvement in 2003/2004 stems mostly from a combined effect of additional revenue raising measures and expenditure containment strategies.

From an approved estimate of 40.1% as a share of GDP, the revenue collection for 2003/2004 is expected to improve to 42.6%. The expected improvement emanates mainly from tax revenue in the areas of income tax at 9.9% from initial 8.7%, Value Added Tax (VAT) at 5.9% from 4.5% and Customs at a slightly improved 16.6% from 16.3%. The increase in these areas highlights the commendable contribution that the operationalisation of Lesotho Revenue Authority (LRA) has had as far as revenue collection is concerned.

With regards to expenditure containment strategies employed on the discretionary services, total approved expenditure is expected to fall from 46.1% as a proportion of GDP to 45.5%. Most of the fall in total expenditure is expected to emanate from capital expenditure component. It is expected to decline from 9.9% of GDP to 8.7% while recurrent component is expected to increase marginally to 37.0% from 36.4% of GDP. Since Lesotho is a developing economy, capital expenditure should have been given first priority over some recurrent expenditure in spending decisions as and when funds do allow. However, if the fall in this form of expenditure signals under-spending due to slower than expected implementation of capital projects, then the GOL should improve capacity in this area.

The immense challenges for GOL in 2003/2004 remained mostly in the areas of food security, HIV/AIDS, empowering the private sector to spearhead the much needed economic growth, proper financial management as well as efficient and effective service provision. In order to ensure that economic growth trickles down to the poor, a proper government structure has to be in place. The design of government to achieve efficiency is very important but a complex process of weighing up the costs and benefits of alternative organisational structures. There is an ongoing dialogue on decentralisation, whose main benefits are that smaller local government structures make decision on behalf of consumers.

The Way Forward - Budget Proposal for 2004/2005

For the fiscal year 2004/2005, the Government proposed to register an overall surplus of 2.7% of GDP, the first in seven years. The surplus is expected to emanate mainly from a higher increase in total revenue relative to total expenditure and net lending. The faster increase in total revenue is expected to arise from an increase in Southern African Customs Union (SACU) revenue to 21.3% of GDP from a projected 16.6% in 2003/2004. The windfall in SACU revenue will come as a result of adjustments from previous years. At that level, SACU revenue would make up 47.5% of total revenue. Besides the increase in SACU revenue, the forecast increase in VAT from 5.9% of GDP in 2003/2004 to 7.2% in 2004/2005 is also expected to impact positively on total revenue. On the other hand, Non-tax revenue is expected to fall marginally from a projected 5.8% of GDP in 2003/2004 to 5.7% in 2004/2005.

Table 1. Government Budgetary Operations (Million Maloti; % of GDP)

Budget Item	2002/2003 Budget Outturn		Approved 2003/2004 Budget		Projected Outturn for 2003/2004		Proposed 2004/2005 Budget	
	Amt.	%	Amt.	%	Amt.	%	Amt.	%
Revenue and Grants	3331.0	45.2	3496.1	40.8	3644.9	42.6	4569.6	48.4
Revenue	3034.7	40.1	3203.6	37.4	3368.1	39.4	4232.8	44.9
Grants	296.3	5.1	292.5	3.4	276.8	3.2	336.8	3.6
Expenditure and Net Lending	3532.9	45.8	3946.5	46.1	3892.3	45.5	4318.9	45.8
Recurrent Expenditure	2876.2	35.4	3117.3	35.8	3165.1	37.0	3494.0	37.0
Capital Expenditure	779.9	10.4	846.2	9.9	740.9	8.7	842.7	8.9
Net Lending	0.0	0.0	-17.0	-0.2	-13.7	-0.2	-17.8	-0.2
Surplus/Deficit after Grants	-325.1	-0.6	-450.4	-5.3	-247.4	-2.9	250.7	2.7
Financing	325.1	0.6	450.4	5.3	247.4	2.9	-250.7	-2.7
Foreign Financing	53.4	1.0	-0.2	0.0	-25.9	-0.3	-41.9	-0.4
Domestic Financing	271.7	-0.4	450.6	5.3	273.3	3.2	-208.8	-2.2

Source: 2003/2004 Budget Speech of the Minister of Finance and Development Planning

Total expenditure and net lending are expected to increase slightly to 45.8% of GDP, from 45.5% the previous fiscal year. Of this increase, transfers and subsidies will receive a higher allocation of 9.0% of GDP from 7.4% in 2003/2004 on account of costs associated with introducing M150.00 per person old-age pension for senior citizens aged 70 and beyond. Allocation to other goods and services is expected to fall from 13.9% of GDP in 2003/2004 to 12.8% in 2004/2005 mostly reflecting a substantial reduction in contingencies from 17.1% of the total budget in 2003/2004 to a mere 3.3% in 2004/2005. Interest payments component is forecast to slowdown down marginally to 2.3% of GDP in 2004/2005 from expected outturn of 2.5% in 2003/2004. The decline is expected to be registered in both domestic and foreign debt payments. Capital expenditure is projected to account for 8.9% of GDP in 2004/2005, slightly up from 8.7% in the previous fiscal year. The externally funded portion of the capital expenditure would rise slightly to

5.1% of GDP, from 4.9%, whereby the grant-funded portion comprises the largest portion. The GOL-funded portion would also rise slightly from 3.7% to 3.8%.

The manner in which the Government allocates its finances reflects its priorities. Education and training account for the largest share of expenditure at 22.0% of the total amount to be spent up from 18.8% in 2003/2004. This sector accounts for the largest recurrent budget at 18.2% while it also shares first spot in capital spending of 3.8% with Public Works and Transport. The bulk of this spending is towards Free Primary Education (FPE) which now covers the first five years of primary education (from four in 2003/2004). The second largest share at 12.8% of the total expenditure was allocated to the now merged Ministry of Finance and Development Planning, which has been assigned the task of strengthening the planning and co-ordination functions as well as oversight on the implementation of both the recurrent and capital budgets. Health and social welfare accounts for the third largest expenditure item, the same position held in 2003/2004. In 2004/2005, 7.42% of the total budget has been awarded to cater for HIV/AIDS prevention and control as well as the general functions of the health sector.

In an ongoing effort to address the infrastructural development needs of the economy, public works and transport takes up the fourth largest portion of the budget at 6.7% down from 8.4% in 2003/2004. Among other priority areas of this allocation would be the development of the Tikoe Industrial Estate that was assigned M40 million. Interest charges, Defense and National Security, Home Affairs and Public Safety, Pensions and Gratuities account for fourth, fifth, sixth and seventh largest portions respectively. With regards to Pension and Gratuities, it has already been observed that the proposed old-age pensions account for most of the increase from 2.6% of total budget to 4.3%. With regards to Home Affairs and Public Safety, the increase from 3.2% in 2003/2004 to 4.7% reflects a M20 million amount set aside for the introduction of national Identity Cards (IDs).

In contrast to the previous two fiscal years when expenditure on agriculture and food security was observed to grow, in the coming year it is forecast to fall to 3.3% of total expenditure from 4.6% in 2003/2004. The fall was mostly pronounced in capital expenditure that is supported by grants and loans. To lay the foundation for the government decentralisation, the Independent Electoral Commission (IEC)'s share is forecast to increase to 2.5% of total expenditure from 0.3% in 2003/2004, with the aim to prepare for local elections. In addition, Local Government would be awarded 2.9% of the total budget, up from 2.4% in the previous fiscal year with the same aim of laying the ground for decentralisation.

The proposed budget surplus will be used to repay maturing loans and treasury bills. This implies that the government would not need to issue debt securities to the domestic sector. Furthermore, its deposits holdings with the banking system should be expected to improve. Foreign financing will continue to be negative as repayments of existing foreign debt stay above new loan disbursements.

Implications of the 2004/2005 Budget

On the plus side, the present budget projects real economic growth of 3.6%, which is slightly higher than the growth of 3.4% in 2003. Economic growth is important as it contributes to reduction of income poverty, and could serve as an attraction to foreign capital. Due to its balanced(surplus) nature this fiscal year, it would ensure that the debt burden is reduced as well as future interest payments. In addition, the inflationary pressures associated with high government spending should be expected to subside. With regards to FPE, the strategy will further lessen the burden of poverty by allowing households to spend more on health, nutrition and other necessities of life, while it raises chances for better lives in the future as literacy levels improve. Apart from provision of education, FPE provides nutrition and relevant pastime for poor children and orphans, especially HIV/AIDS orphans. FPE also provides income employment opportunities for more teachers, people building more schools and those cooking for the kids.

The employment creation through public works, would be beneficial, especially for the rural communities who are underemployed in subsistence agriculture, returning migrant miners and former construction workers in LHWP. The improvement of several roads to bitumen standard would continue to open unexplored parts of the country to such opportunities as tourism. The development of Tikoe industrial estate would ensure the industries continue to absorb more workers. The anticipated introduction of IDs in place of passports is a welcome solution of identification for the nation. This would go a long way in inducing some growth in private sector credit extension by financial institutions by providing reliable identification for prospective borrowers. The foundation being laid for decentralisation, would help to improve efficient delivery of services to the people. The increase in civil servants salaries should also incentivise them to further improve services delivery. The sizeable reduction of other goods and services, reflects GOL's intentions to reduce spending and to improve public financial management.

On the shortcomings side, the proposed budget does not target specific quantitative goals such as a certain level of employment or price stability. In addition, the budget recognises the need for Public Private Partnerships and that they would be achieved in the medium to long-term, but there is no clear strategy for the private sector to engineer the much needed economic growth in the interim. This refers in part to the empowerment of the Small and Medium Enterprises (SMEs). Although FPE is beneficial as described above, its long-term sustainability is in question, the fact that the budget speech also admits. From the onset, the financing question has always lingered and the opportunity cost of financing this project is seemingly going to heavily fall on other areas, including other skills development. Economic services, which comprise the ministries of Agriculture and Food Security, Trade, Industry, Co-operatives and Marketing, Tourism, Environment and Culture, Communications, Science and Technology and Public Works and Transport, have been awarded 18% of the budget and seem to be some of those sectors that are beginning to loose out to FPE. These services could contribute a lot in the economy if enough funding is allocated to them. Another grey area of the budget is that it does not specify how the important complementary role of monetary policy would be utilised to arrive at broader economic targets. Lastly, the budget continues to be consumption driven with recurrent expenditure accounting for about 81% (an increase of 2%) of the budget and the remaining 19% (decreased by 2%) only available for capital expenditure. The declining and low levels of capital investment might adversely affect the long-term sustainability of income and employment over the years.

Conclusion and Recommendations

An important principle of budget, whether in public or private sector is to set specific quantitative goals. Having set these targets, then fiscal and monetary policies should be geared towards them. The improvement in revenue collection arising from the inception of LRA should be commended. However, this improvement should be seen to trickle down to the people at the grassroots through appropriate government structures. A budget surplus should also be applauded, thanks to SACU revenue. It should be noted that the long-term sustainability of SACU revenue is in question. Therefore it is important for LRA to be afforded with all necessary resources to improve on its revenue collections in anticipation of the aforementioned. Although it is important to maintain expenditure rationalisation measures in order to accumulate foreign reserves and government savings, non-implementation of the capital projects is not the best of solutions. To address this, capacity has to be built in the project management related areas. On the other hand, government should work hard to contain recurrent budget on a sustainable level.

Table 2. Monetary and Financial Indicators+

	Dec	**Jan**	**Feb**
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	12.50	12.50	12.50
1.2 Prime Lending rate in RSA	12.00	11.5	11.5
1.3 Savings Deposit Rate	2.00	2.41	2.31
1.4 Interest rate Margin(1.1 – 1.3)	2.00	10.09	10.19
1.5 Treasury Bill Yield (91-day)	10.57	9.21	9.21
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2297.9	2217.9	2279.1
2.2 Net Claims on Government by the Banking System	-167.0	-386.4	-371.9
2.3 Net Foreign Assets – Banking System	3460.7	3699.4	3845.7
2.4 CBL Net Foreign Assets	2853.0	3188.1	3055.92
2.5 Domestic Credit	380.6	171.6	30.1
2.6 Reserve Money	364.9	333.6	325.50
3. Spot Loti/US$ Exchange Rate (monthly average)	6.500	6.963	6.6618

4. External Sector (Million Maloti)	2003		
	Q2	Q3	Q4
4.1 Current Account Balance	-304.8	-300.6	-299.8
4.2 Capital and Financial Account Balance	319.3	155.5	320.0
4.3 Reserves Assets	-0.8	391.7	-156.6

+These indicators refer to the end of period. Prime and deposit (savings) rates are averages of all commercial banks' rates operating in Lesotho. The Statutory Liquidity Ratio in Lesotho is 25 percent of commercial banks' short-term liabilities.

Table 3. Selected Economic Indicators

	2000	2001	2002*	2003+
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	1.3	3.2	3.8	3.3
1.2 Gross Domestic Product Excluding LHWP	0.0	3.5	3.3	3.2
1.3 Gross National Product – GNP	-3.2	0.6	2.5	2.7
1.4 Per capita –GNP	-5.0	-1.7	2.1	2.2
2. Sectoral Growth Rates				
2.1 Agriculture	2.9	0.6	-4.0	-0.4
2.2 Manufacturing	4.4	7.9	6.9	5.0
2.3 Construction	9.7	1.3	6.9	4.0
2.4 Services	-0.9	2.2	3.3	3.6
3. External Sector – Percent of GNP Excluding LHWP				
3.1 Imports of Goods	71.9	74.9	87.3	80.6
3.2 Current Account	-8.8	-2.9	-8.6	-7.8
3.3 Official Reserves (Months of Imports)	8.9	11.7	6.4	5.5
4. Government Budget Balance (Percent o GNP)	-4.9	-1.0	-2.7	-2.5

*Preliminary Estimates +Projections