THE UPWARD REVISION OF ROAD MAINTENANCE LEVY: IMPLICATIONS FOR LESOTHO ECONOMY

The adjustment of the road maintenance levy during the month of June 2006 will augment funds available for road infrastructure development. However, there are concerns on the possible implications, particularly, given the developments in international oil prices……..

Background

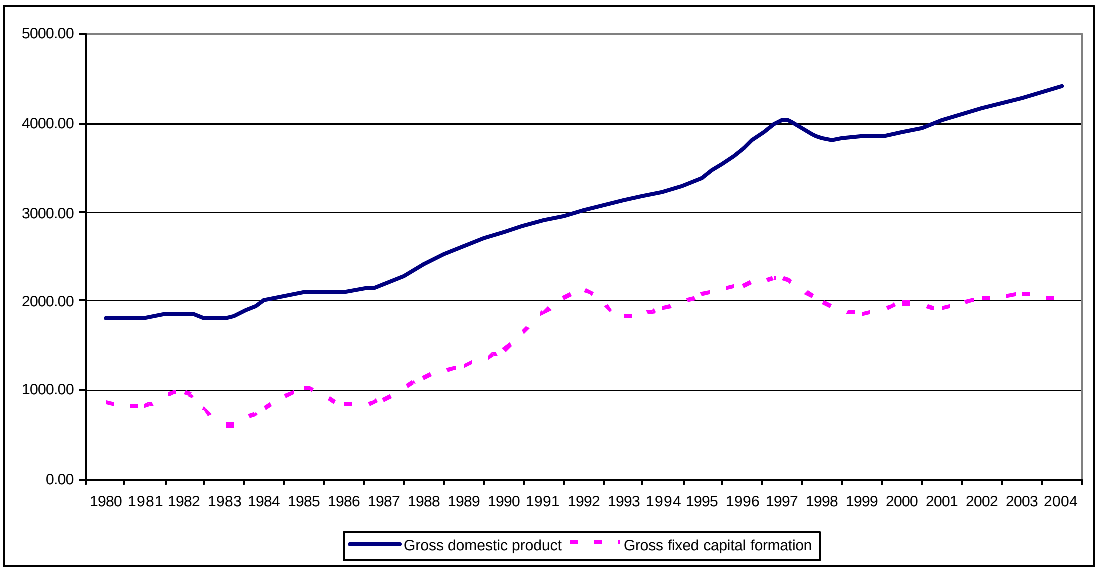
The development of road infrastructure is one of the main challenges facing developing countries including Lesotho. The challenge is even more acute in Lesotho given the topography of the country, whereby a large portion of the surface area is mountainous. This has led the Government of Lesotho (GOL) through the Poverty Reduction Strategy (PRS), to regard construction of rural and urban roads as one of the priority areas. The management of road infrastructure in Lesotho is delegated to the Lesotho Road Fund. The Fund is intended to ensure that road users bear the burden of maintenance and rehabilitation of roads in the country. The largest source of revenue for the Lesotho Road Fund is the road maintenance levy. This levy is included in the price of fuel, in particular petrol and diesel. During the month of June 2006, the Lesotho Petroleum Fund Board announced 3.50 per cent and 5.02 per cent increases in the prices of petrol and diesel, respectively. The main reason for the increases was the review of the road maintenance levy, which was doubled from 15 lisente per litre to 30 lisente per litre for petrol, and from 20 lisente per litre to 40 lisente per litre for diesel. This is the first adjustment since 1998, when the levy was introduced in Lesotho.

This article intends to highlight the benefits of augmenting resources available for road infrastructure and the potential negative impact of the upward adjustment of the road maintenance levy particularly at the time when international prices of petroleum products are high and expected to remain under pressure.

The role of infrastructure development in output growth

The relationship between infrastructure development and output is well articulated in economic theory. Infrastructure development, amongst others, includes road networks, footbridges and information technology infrastructure. Economic theory posits a strong long run relationship between the two variables. It argues that capital investment increases the marginal product of capital and hence impacts positively on growth of output. Capital accumulation provides workers with better equipment and increases productivity of labour. Thus both output per worker and total output increase. It should be noted that the relationship is not automatic hence caution is drawn to idle investment which is not productive. Furthermore, the rate at which Government implements capital projects is very crucial. Lesotho's historical data shows a clear relationship between infrastructure investment and growth, particularly during the implementation of LHWP. The project involved huge investment in the construction of roads and dams infrastructure. Figure 1 below shows the evolution of gross domestic product (GDP) and gross fixed capital formation (capital investment) in Lesotho for the period 1980-2004. Road infrastructure is a component of capital investment. It can be seen that the two variables are positively correlated. During the period, real GDP growth averaged 3.86 per cent and total capital investment averaged 5.00 per cent.

Figure 1: Gross Domestic Product and Gross Fixed Capital Formation (Million Maloti in Constant 1995 Prices)



Furthermore, some theories argue that there is complementarity between government investment and private investment. It is argued that government capital investment leads to private investment. Government roads construction can trigger private investment and employment creation in sectors such as tourism, retail, wholesale and repairs and agriculture. In the case of Lesotho, road infrastructure would certainly unlock economic growth as the majority of the country is still inaccessible. The retail services are concentrated in the urban centres. Tourism is also in its embryonic stage and access to the countryside would greatly enhance the sector. It is worth noting that domestic tourism can also play an important role in the economic growth process. In addition, the agricultural sector would also benefit as products would be able to reach the preferred market in time.

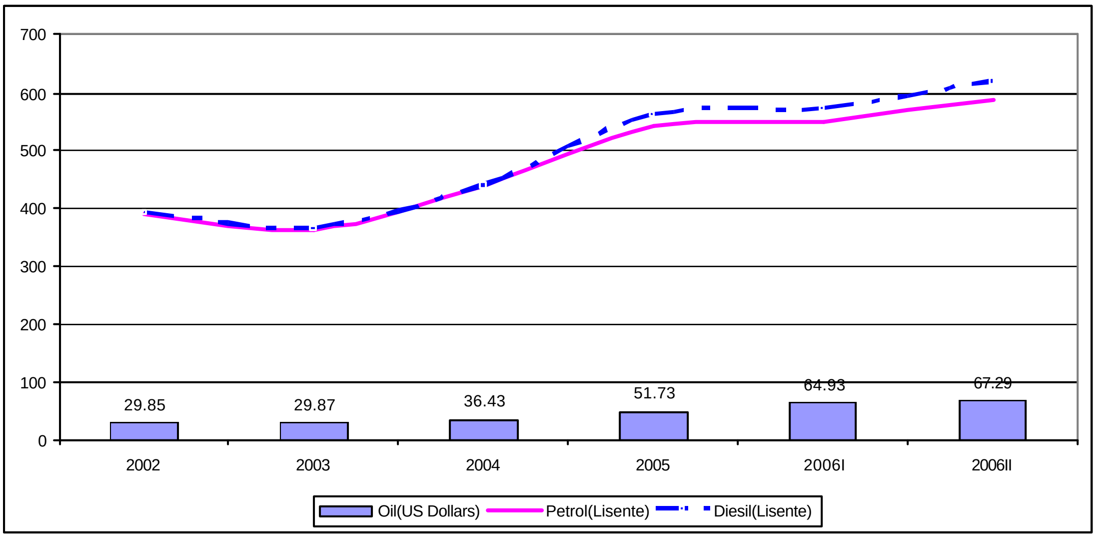
Road infrastructure in Lesotho

The road network in Lesotho is estimated at 7438 kilometres of which paved is 1217 kilometres while gravel is 3758 kilometres. Other types include earth which is 1885 kilometres and other which is 578 kilometres. The road network is managed by four institutions; Roads Branch, Department of Rural Roads, Maseru City Council (MCC) and the Ministry of Local Governments.

Recent performance in the oil market and domestic petroleum products prices

The international price of oil has increased significantly during the last four years. As shown in figure 2, the price of oil rose from $29.85 per barrel at the end of 2002 to $67.29 per barrel at end of the second quarter of 2006. The continued increase in the price of oil has been driven mainly by the strong demand in the US and Peoples Republic of China and the uncertainties in the Middle East. The Middle East accounts for the bulk of global world oil supply. Domestic prices of petroleum products although controlled, followed the trend in the international price of oil. The price of petrol rose from 390 lisente per litre to 590 lisente per litre while that of diesel rose from 392 lisente per litre to 620 lisente per litre during the same period. However, the economy has not felt the full impact of the price increase because the loti appreciated significantly during the period. Thus mitigating the negative impact of the increase.

Figure 2: Prices of International oil per barrel (US dollar), Petrol per litre (Lisente) and Diesel per litre (Lisente):2002-2006II (End of Period)



Implications for the Lesotho economy

A number of both positive and negative implications of the recent adjustment of the road maintenance levy can be traced. Looking at the positive ones; first, the funds available for road maintenance and construction in the country would be augmented significantly. This follows from the fact that road maintenance levy contributes about 80 per cent of the total revenue of the Lesotho Road Fund. The funds are utilised by MCC, Department of Rural Roads and Ministry of Public Works. Second, the resultant construction is likely to generate employment for Basotho. Third, the improvement of the road infrastructure augurs well for the PRS and the current budget priorities. This is likely to trigger domestic and foreign investment in some sectors of the economy. The tourism industry is likely to reap benefits from improved road networks. Fourth, quality of the road network in Lesotho would be maintained in the face of visibly increasing number of vehicles in the country. In addition, a number of roads, which were destroyed by heavy rainfalls experienced late in 2005 and the first quarter of 2006, may benefit in the form of rehabilitation.

The magnitude of the adjustment is indicative of the correction for the period since 1998 during which road usage fees were not adjusted in line with developments in the transport sector. The negative implications arise because of the ongoing uncertainties in the international price of oil that has increased transportation costs in the country. Thus the adjustment has exacerbated the already vulnerable situation as depicted above. However, no immediate inflationary implications are expected. But since the majority of the Lesotho workforce rely on public transport, there is a high probability that in the next wage negotiations there would be higher wage demands. Furthermore, the taxi operators may push for upward revision of fares to avoid lower profit margins.

Conclusions and recommendations

Although the recent adjustment coincided with the high international price of oil, it is important that road users incur the cost of road maintenance and rehabilitation in the country. This will allow Government to reallocate resources to other and more pressing areas such as education and health. This is crucial especially because road construction in Lesotho is costly as a result of the country's topography. The increased collections would further ensure that GOL continues investing in road infrastructure, which, as already discussed is very important for economic growth. The improved infrastructure would attract the much needed private investment in numerous sectors like tourism, agriculture, retail and wholesale and repairs. Therefore, the challenge is for the implementing agencies to ensure that the available resources are utilised properly to ensure that the country reaps the expected benefits.

Table 1. Monetary and Financial Indicators+

	Mar.	Apr	May
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	11.50	10.50	11.63
1.2 Prime Lending rate in RSA	10.50	10.50	10.50
1.3 Savings Deposit Rate	1.24	1.24	1.40
1.4 Interest rate Margin(1.1 – 1.3)	10.39	10.39	10.23
1.5 Treasury Bill Yield (91-day)	6.90	6.80	7.10
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2566.93	2610.78	2613.74
2.2 Net Claims on Government by the Banking System	-1027.20	-1694.13	-1471.58
2.3 Net Foreign Assets – Banking System	4377.47	5035.30	5129.82
2.4 CBL Net Foreign Assets	3803.31	4364.59	4353.91
2.5 Domestic Credit	-191.48	-882.79	-651.42
2.6 Reserve Money	461.05	429.78	379.52
3. Spot Loti/US$ Exchange Rate (monthly average)	6.2537	6.1064	6.3178
4. External Sector (Million Maloti)	**2005**		**2006**
	QIII	**QIV**	**QI**
4.1 Current Account Balance (Excl. LHWP)	34.71	-51.90	60.52
4.2 Capital and Financial Account Balance (Excl. LHWP)	-102.54	102.73	48.87
4.3 Reserves Assets	26.53	-86.9	-177.17

+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 2. Selected Economic Indicators

	2002	2003	2004	2005*
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	3.5	3.1	3.1	1.2
1.2 Gross Domestic Product Excluding LHWP	2.9	2.9	3.7	1.1
1.3 Gross National Product – GNI	1.6	6.0	6.1	0.3
1.4 Per capita –GNI	-0.2	3.7	3.9	-0.9
2. Sectoral Growth Rates				
2.1 Agriculture	-4.2	-1.8	1.2	1.8
2.2 Manufacturing	6.9	5.2	5.9	-8.3
2.3 Construction	6.9	4.3	0.4	2.0
2.4 Services	2.2	3.9	4.4	4.2
3. External Sector – Percent of GNI Excluding LHWP				
3.1 Imports of Goods	93.9	80.1	81.3	76.0
3.2 Current Account	-11.6	-5.8	1.0	0.5
3.3 Capital and Financial Account	6.4	3.8	1.4	0.4
3.4 Official Reserves (Months of Imports)	6.2	5.8	5.2	5.8
4. Government Budget Balance (Percent of GDP)	-2.8	-0.3	8.4	1.5

* Preliminary estimates