Economic Review February, 2006

Lesotho's budget speech for the 2006/07 fiscal year: Results Do Matter

The Honourable Minister of Finance and Development Planning presented a budget speech for the 2006/07 fiscal year on the 8 of February 2006. His speech emphasised the need to improve the overall absorptive capacity and delivery on the ground...

Background

The budget speech is the annual government policy document that highlights the objectives that Government commits to achieve. It reviews performance of the preceding budget and provides the outlook for the current year. It is a device for ensuring a continuous monitoring procedure, reviewing and evaluating performance with reference to previously established standards. Through budgets, Governments allocate anticipated revenue collection to various government programmes in line with the agreed priorities and objectives. The funds are allocated to effect delivery of social services and development of infrastructure in an effort to stimulate economic growth and reduce poverty. The budget can be used as a gauge to determine the fiscal incidence (incidence of expenditure and taxation).

The Government of Lesotho (GoL) engaged in a number of reforms in the past recent years. Some of the reforms, though not directly fiscal, have impacted on the fiscal performance. For instance, the privatisation programme has relieved, to some extent, budgetary pressures from some parastatals that were not realising profits. The other reform is the public sector improvement reform programme that is ongoing, which aims at improving efficiency in delivery of public services.

In his presentation on the national budget in Parliament, the Honourable Minister of Finance and Development Planning (MoFDP) reiterated the national objectives for poverty eradication. The objectives synchronised all operational policy documents and linkages to other international treaties that Government has ratified. The Minister emphasised government commitment to the afore mentioned objectives, and hence the Budget could not be divorced from them.

The 2005/06 Budget and its linkage to the current budget

The GoL piloted the Medium Term Expenditure Framework (MTEF) in 2005/06 with three (3) ministries. The current budget proposes inclusion of additional three ministries, which brings the total to six (6). The MTEF is an annual, rolling three year-expenditure plan. It sets out the medium-term expenditure priorities and budget constraints against which sector plans can be developed and refined. MTEF is seen as the cost aspects of the Poverty Reduction Strategy (PRS), which was approved and adopted by Cabinet in 2004/05. The PRS is consistent with the Millennium Development Goals (MDGs), whose achievement will place the country closer to realising the Long Term Vision (Vision 2020).

The following are some of the milestones towards attainment of the MDGs;

- Free Primary Education (FPE) has now entered its final year.
- The fight against HIV and AIDS has been strengthened by provision of anti-retroviral, treatment and support of those infected and affected by the pandemic.
- Local government elections with a balanced gender representation provides for fundamentals of good governance.

The 2005/06 budget stimulated the process to address the investment climate. Specific activities included organisation of the private sector development forum in April 2005, whose aim was to identify the necessary reforms and suggest actions. The implementation of those reforms will continue in the 2006/07 fiscal year, with support of the donor community.

It is with these initiatives that the country scored a BB- rating in Long Term Foreign Currency (LTFC) by Fitch Credit Rating Agency. As in the previous year, Lesotho's ability to pay off its short-term foreign currency loans is rated 'speculative (B)'. The country was rated on a better position to honour long-term local currency commitments than foreign currency obligations at 'BB+' rating.

Focus of the 2006/07 Budget and its Implications

a) Key policy issues

The investment climate and private sector development are the key areas that this year's Budget Speech emphasised. The GoL has undertaken policy reviews to assist the small, medium and micro enterprises (SMMEs), in particular, to take an active role in employment creation. A number of policy reviews and revision of some outdated legislature are either ongoing, or pipelined for the next fiscal year. Producers, whose exports are destined beyond the SACU region, have been accorded a zero per cent company tax on income. The overall company tax has been revised downwards from 35 per cent to 25 per cent. The preferential rate for manufacturing and agriculture has also been revised from 15 per cent to 10 per cent.

These initiatives have some implications on the budgetary operation. Firstly, they aim to protect the existing companies in the economy by foregoing income tax, which forms the significant portion of GoL revenue. Secondly, the budget relies on the customs revenue, which may not be sustainable in the long term, due to the free trade arrangements. This is a challenge to efforts targeted at improving domestic tax revenue. Furthermore, this may result in the fiscal balance being financed through domestic borrowing in the future, and hence crowding out private investment.

The budget also called for the private-public partnership approach to infrastructure provision. The health sector has been earmarked to pilot the initiative, with construction of the ministerial headquarters, as well as, the referral hospital. There are, however, some legislative issues and guidelines that need to be addressed to curb any unforeseen risks.

b) Sectoral allocation

Government is committed to the development of infrastructure, both in the Urban and Rural areas. Focus of the current budget will be on development and construction of roads networks, improvement of domestic and industrial water supply, electricity and communications. Social services will continue to get the largest allocation, with emphasis on improving delivery of health services both at clinics and hospital levels. This is expected to contribute to the reduction in poverty levels in the economy.

c) Budget financing

The proposed budget forecasts an overall surplus equivalent to 2.8 per cent of GDP. This means Government will not crowd out private investment, and hence, enable the private sector to access domestic resources at lower costs.

Challenges

In order to achieve the commitments contained in the Budget Speech, the Honourable Minister acknowledged that there are challenges that remain ahead. For private sector participation in the economy, the following are some of the reforms planned for implementation during 2006/07:

a. Addressing financial sector bottlenecks including improvements in payments and clearing systems, creating an enabling environment for leasing and mortgage regimes, establishing a credit bureau, and improving or enacting related legislation;

b. Strengthening judicial services related to financial intermediation, including strengthening, simplifying, streamlining, and expediting commercial court procedures as well as establishing small claims courts;

c. Streamlining land titling and lease application procedures and computerising lease management and registration processes;

d. Improving and computerising the immigration and passport services;

e. Strengthening capacity building programmes for the private sector, including the establishment of business information centres.

f. Restructuring the government procurement system and expediting payments to suppliers by government.

For the identified development priorities to be realised, Government has to put in place a monitoring and evaluation system. With the local authorities fully functional, physical monitoring of projects is expected to be done by the concerned beneficiaries at the respective community levels. Financial monitoring is expected to be dealt with at the local government structures, and audited by the Central Government.

Prospects

Despite the above mentioned challenges, there is a positive outlook for the future. The Millennium Challenge Account (MCA) and the Japanese Government have pledged to support the review of policies and legislation to improve the investment climate in the country. The grants will be used to improve private sector competitiveness as well as increasing investment, and hence economic growth. These have a potential to eliminate obstacles to investment, focusing on reducing the cost of doing business, improving the legal and regulatory framework and diversifying the economy through skills development and support to Lesotho's SMMEs. MTEF will facilitate alignment of resources with priorities, hence ease implementation of PRS. GoL has established the Cabinet Budget Committee, with the mandate to monitor and ensure adherence to agreed priorities and their relevance to the national goals and objectives.

Even though some factories closed down following the phasing out of the Agreement on Textiles and Clothing (ATC), the operations at the Denim Mill have allayed fears that more of the factories may close. The re-opening of the Masianokeng Cannery, as well as, the sandstones mining also responds well to the need to diversify products. The Postbank has completed the first phase with 11 branches operational throughout the country. This may improve the sluggish financial intermediation in the economy. Its effectiveness will rely on successful implementation of identified pact to improve the investment climate.

The anticipated budget surplus will also provide the private sector an opportunity to access domestic financing for investment.

Conclusion and Recommendations

Government has made commendable strides towards realising a transparent and accountable budget. The Honourable Minister alluded to directing efforts and resources to specific priorities identified during the budget year. This will simplify monitoring, and enhance speedy delivery of tangible results. The establishment of the Cabinet Budget Committee is a positive development to ensuring adherence to budget allocations, while redirecting allocated funds from slow implementing sectors to active projects. However, active participation by parliament in budget monitoring is essential, since the house is responsible to allocate funds to respective sectors of the economy. The public accounts committee (PAC) should be given the necessary support to improve accountability of the ministries, with timely release of audited accounts.

This report has benefited by the Budget Speech for the 2006/2007 fiscal year: Results Do Matter.

Table 1: Monetary and Financial Indicators+

	Nov.	Dec.	Jan.
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	11.50	11.50	11.50
1.2 Prime Lending rate in RSA	10.50	10.50	10.50
1.3 Savings Deposit Rate	1.24	1.24	1.24
1.4 Interest rate Margin(1.1 – 1.3)	10.26	10.26	10.26
1.5 Treasury Bill Yield (91-day)	6.60	6.95	6.84
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2593.5	2565.8	2571.4
2.2 Net Claims on Government by the Banking System	-1103.20	-898.29	-1399.82
2.3 Net Foreign Assets – Banking System	4580.33	4179.63	4631.52
2.4 CBL Net Foreign Assets	3200.22	3076.22	3457.3
2.5 Domestic Credit	-365.57	-71.66	-564.26
2.6 Reserve Money	392.09	545.31	400.80
3. Spot Loti/US$ Exchange Rate (monthly average)	6.6561	6.3691	6.0958
4. Inflation (year-on-year percentage change)	3.4	3.5	
5. External Sector (Million Maloti)	**2005**		

	QII	QIII	QIV
5.1 Current Account Balance (Excl. LHWP)	-122.41	34.71	-51.90
5.2 Capital and Financial Account Balance (Excl. LHWP)	187.88	-102.54	102.73
5.3 Reserves Assets	-94.55	26.53	-86.9

+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