



LESOTHO SIGNS A FIVE YEAR MILLENIUM CHALLENGE ACCOUNT GRANT

The Millennium Challenge Compact between the Kingdom of Lesotho and the Millennium Challenge Corporation aims at reducing poverty through economic growth. It will finance projects in the water sector, health sector and private sector development.....

Background

The Kingdom of Lesotho reached a historic milestone on 26 July 2007, when government signed a grant worth US\$362 million from the United States (US) Government Millennium Challenge Corporation (MCC). MCC administers the Millennium Challenge Account (MCA) which was established by the US Government as a development assistance mechanism to help eligible countries to achieve sustainable economic growth and reduce poverty. The key objectives of MCA are to: (a) encourage and support policy reforms (b) foster sustainable economic growth and (c) promote partnership between MCC and the receiving country, government and Non Governmental Organisations (NGOs) and also private sector and representatives of civil society. About 63 countries were identified as candidates for MCA, and only 16 including Lesotho were selected as eligible in 2004. Eligibility of the MCC funds is based on a number of indicators covering three areas namely; ruling

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justly, investing in people and encouraging economic freedom.

Once a country has been named eligible, in consultation with MCC a country then prepares a compact proposal defining the programmes that can reduce poverty through stimulating economic growth. A Compact is a multi year agreement between MCC and the eligible country to fund specific projects targeted at reducing poverty and stimulating economic growth. To date thirteen compacts have been signed and Lesotho is the seventh from Africa.

Project Areas

As earlier mentioned the aim of Lesotho compact is to reduce poverty through increasing economic growth. The Lesotho compact has three programs namely water sector project, health sector project and private sector development project. These projects would unlock the productive capacity of the economy and provide a sound basis for sustained economic growth.

Water Sector Project

About US\$164 million has been allocated to the water sector. This is about 45.3 per cent of the total grant. The grant will improve water supply for both industrial and domestic needs. The Lesotho industrial sector is dominated by textile and clothing production, which represents about 8.7 per cent of GDP. The textile and garment sector (also known as the wet industry) uses water intensively. Thus the grant would unlock one of the major constraints facing the sector over the medium term. In terms of domestic use, water connections in both urban and rural areas will increase.

Activities to be implemented under the water sector project include the following:

- Construction of Metolong dam-bulk water conveyance system,
- Urban and rural water network activity,
- Rural water supply and sanitation activity and
- Wetlands restoration and conservation activity.

The project is expected to provide a number of benefits. First, it will support the expansion of the industrial sites in Lesotho and enhance employment prospects for a sizable number of Basotho. Second, the number of water

connections to the urban households will increase thereby improving the livelihoods in the urban areas. Third, the rural people access to clean water and sanitation will increase. The wetlands will improve livestock productivity in the identified areas.

Health Sector Project

The health sector project is allocated US\$122.4 million which is 33.8 per cent of the total grant. The objective of this project is to increase access to life extending Anti Retroviral Therapy (ART) and providing a sustainable delivery platform. Lesotho has the third highest HIV/AIDS prevalence rate of about 24 per cent. At that level, Lesotho's long term growth potential is under threat. The project therefore aims to mitigate the negative impact of HIV/AIDS on economic growth.

Activities to be implemented under the health sector project include the following:

- Health centres ,
- ART clinics ,
- Central Laboratory ,
- Blood Transfusion service ,
- National health training college ,
- Health systems strengthening and
- Medical waste management.

The project is expected to address constraints in access to medication and in particular Anti Retro Viral (ARV). There are currently about 17 000 people who cannot access ARVs. It is also estimated that additional 38 000 people will be in need of ARVs in the next ten years. The project aims to improve medical services in Government, CHAL and Red Cross health centres, as well as medical waste management.

Table 1: Multi-Year Financial Plan Summary in Million US\$

	CIF Funding	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Water Sector Project	4.9	21.0	24.2	49.0	47.8	16.8	164.0
Health Sector Project	4.4	17.9	27.9	37.6	24.8	9.6	122.3
Private Sector Development Project	0.7	7.1	10.9	8.5	5.4	3.3	36.1
Monitoring and Evaluation	0.5	2.6	0.6	0.7	0.6	2.6	7.8
Program Management and Oversight	5.1	4.1	5.3	6.1	6.9	4.4	32.2
Total Allocation	15.6	52.9	69.1	102.1	85.7	36.8	362.5

Source: Millennium Challenge Compact between MCC and the Kingdom of Lesotho

Private Sector Development

The last component is private sector development which has been allocated US\$36.1 million, representing 10.0 per cent of the total grant. The project aims to improve access to credit, reduce transaction costs and increase the participation of women in the economy. This contributes to the broader Government of Lesotho reform programme. In addition to the MCC funding, the World Bank is also financing some components of the Private Sector Development Project. The project recognises that access to credit and banking services play an important role in the economic growth process and poverty reduction. A large portion of the population has limited access to banking services.

Activities to be implemented under the private sector development project include the following:

- Credit Bureau and National Identification card.
- Payments and Settlement Systems,

- Land Administration Reform ,
- Civil Legal reform Activity, and
- Training and Public Awareness to support gender equality in economic rights.

The credit bureau, national identification cards and payment and settlement systems are expected to result in significant reduction in transaction costs and enhanced information on clients. This would improve access to credit by the larger population. The project is expected to benefit all economically active citizens including married women. The civil legal reform would make it easier for banks to recover defaults through the courts system, removing structural bottleneck often cited for not extending credit. The land administration reform would improve access to land and security of land rights. Thus land marketability will improve and investment in land pick up thereby resulting in employment generation in sectors such as construction, mortgage lending and real property related services.

Conclusion

The MCC grant implies that the economy of Lesotho will receive an average injection of about US\$72.5 million per year for the next five years. A number of macroeconomic implications may be pointed out. The supply side dynamics of the Lesotho economy may improve significantly. The full participation of women in economic activity, increased capital in the form of roads and improvements on the health status of the society would augment the production capacity of the economy. The demand side of the economy would

be influenced by the significant capital expenditure embodied in construction of Metolong dam and the health facilities. Consumption expenditure is likely to follow as more jobs are created during the implementation of the projects. The removal of structural rigidities in the economy such as legal reform, land administration, credit bureau and payments and settlement systems would enhance the production capacity of the economy and stimulate expenditure by private agents. Last, the improved water system would unlock the industrial sector in Lesotho.

Microfinance Institutions in Lesotho: Prospects and Challenges

Introduction

Lesotho, like other developing countries is characterized by a large population with limited access to financial services. It is estimated that about 70 per cent of the population lives in the rural areas where financial services are limited. As a result, many people do not have access to financial services offered by the banking system. Lack of access to banking services impacts negatively on Government efforts to reduce poverty.

In many developing countries, there has emerged a special type of financial institution known as microfinance institution (MFI). MFIs are defined as those financial institutions that provide banking services to the poor households who do not qualify in the formal banking system.

Experiences from other selected African Countries

Experiences regarding MFIs in a number of African countries have indicated success in mobilizing savings and extending credit to poor people.

In Ghana, MFIs have been very active, covering a number of activities such as individual savings, rotating savings schemes and credit associations, and also savings and credit clubs. Most of microfinance services in Ghana are offered by Rural and Community Banks, Non-bank institutions and Savings and Credit companies. Non Governmental Organisations (NGOs) also contribute to poverty reduction through extending credit to poor people. Since NGOs rely on donor funds, they are not licensed to mobilise savings.

In Benin, MFIs have favoured micro-credit to the poor, through group and individual lending. The borrowers form a group of three to seven members and they become jointly liable for all loans taken out. The payments begin immediately after disbursement and remain constant over the life time of the loan. Individual borrowers may also borrow as long as the loan is approved by group members. The other type of group lending is village banking which brings together 15 to 30 members. They take a single loan, and then disburse to individual members. Same loan repayment terms apply to all members.

In Tanzania, MFIs offer attractive savings services and extend credit to poor people in different forms such as micro loans, individual micro loans, consumer loans and cooperative loans. Non Governmental Organisations (NGOs) in Tanzania also offer microfinance services and rely heavily on foreign donor assistance.

Microfinance Institutions in Lesotho

The Microfinance sector has existed in the country for some time, offering credit to poor people and low-income earners. The sector comprises of; burial societies, rotating savings and credit associations (RSCA), and also money lenders.

Burial societies in Lesotho are very common, Members contribute equal monthly payments to cover families and their relatives against high funeral costs at the time of death. The burial societies cover the principal member and family

and also a certain number of dependents. In order to augment the fund, members are encouraged to borrow from the fund for other purposes at some specified interest rate. The short term loans are covered by the contribution that members have made.

RSCAs are also widespread in the country. Members contribute a specified amount on monthly basis and the collection is allocated to each member on a rotating basis. Allocations are directed towards among others, establishment of business ventures and purchasing of grocery.

Table 2 below indicates that during the last five years, the number of licensed money lenders rose by 88.9 per cent. They are common in the urban areas where they provide short- term loans mostly to the working class. The loans are used to smooth out consumption and finance small businesses. The interest rate charge provided by law is 25 per cent per annum.

Table 2: Number of Licensed Money Lenders

Year	2002	2003	2004	2005	2006
Number of Institutions	27	25	24	43	51

The importance of Microfinance in Lesotho

Microfinance in Lesotho is one of the important activities for poverty reduction. It reduces poverty through offering credit to micro-entrepreneurs and small and medium sized businesses as well as households.

In an effort to enhance performance of the microfinance sector, the Central Bank of Lesotho (CBL) established a Non Banks Division within the Supervision Department, with a

mandate to monitor and supervise the sector in the country.

Furthermore, CBL promotes rural financial intermediation through the rural savings and credit guarantee scheme. The scheme is based on the existing rural savings and credit groups.

Challenges Facing Microfinance

Microfinance institutions in Lesotho can be viewed as highly informal. Thus the major challenge is to transform them into more formal institutions with solid linkages with the mainstream banking

system. Furthermore, for them to have significant impact on poverty reduction MFI should move beyond consumption towards providing start up capital for small businesses. In addition, the appropriate policies and measures for regulation and supervision of MFIs should be enforced and be reviewed in order to maintain sustainability of the sector.

Conclusion

Limited credit extension from the formal banking system hampers success of micro-enterprises, small and medium sized businesses, which are mainly operated by Basotho. In order to address this problem, more effort should be expended towards the development of microfinance institutions. A regulatory framework for MFIs by CBL may also put microfinance institutions into a stable and sustainable financial position.

3. Monetary Policy Operation Report for July 2007

During the review period, monetary policy operations undertaken were successful in attaining their desired objectives. Table 3 below shows amounts auctioned and discount rates that prevailed for the 2007 auctions. In July, two auctions were undertaken, the 91 days treasury bill in which the whole amount of M170 million was issued and the 182 days treasury bill in which only

M32 million was issued. The level of competitiveness in the market, as estimated by the number of participants in an auction, rose during the recent auction. There were 7 bidders who submitted 17 bids for the auction compared to 6 bidders who submitted 14 bids in June. The number of successful bids also rose from 10 bids to 11 bids.

Table 3: Treasury Bill Auctions

Type of Security	Auction Date	Maturity Date	Auction Amount (million)	Amount Issued (million)	Discount Rate
91-day TBs	03 Apr 2007	06 Jul 2007	M160.0	M160.0	7.49%
91-day TBs	02 May 2007	03 Aug 2007	M170.0	M170.0	7.50%
182-day TBs	08 May 2007	09 Nov 2007	M50.0	M30.2	7.45%
91-day TBs	30 May 2007	31 Aug 2007	M170.0	M171.0	7.56%
91-day TBs	04 Jul 2007	05 Oct 2007	M170.0	M170.0	7.62%
182-day TBs	11 Jul 2007	11 Jan 2008	M50.0	M32.0	8.20%

The Lesotho 91-day treasury bill rate continued to increase but remained below its South African counterpart rate. The situation has prevailed since May 2006. The Lesotho 91-day treasury bill increased by 6 basis points to 7.62 per

cent. On the contrary, the counterpart SA rate increased from its previous rate of 8.68 per cent in June to 9.10 per cent in July. Hence, the margin between the two rates widened from 93 basis points to 148 basis points at the beginning of July, as depicted in figure 1 below.

Figure 1: Lesotho and SA 91 day Treasury Bill rate

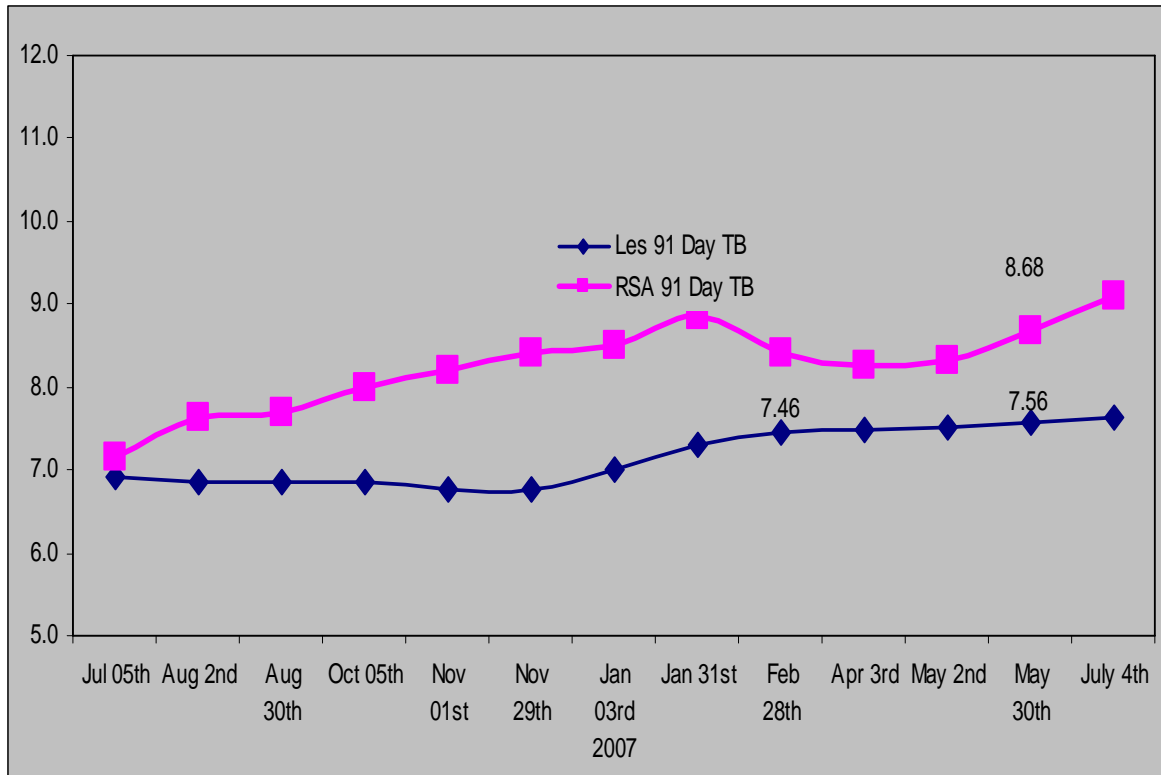


Table 4: Selected Monetary and Financial Indicators+

	2007		
	Apr	May	June
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	13.67	13.67	14.08
1.2 Prime Lending rate in RSA	12.50	12.50	12.50
1.3 Savings Deposit Rate	3.01	3.01	3.21
1.4 Interest rate Margin(1.1 – 1.3)	10.66	10.66	10.87
1.5 Treasury Bill Yield (91-day)	7.49	7.50	7.56
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	3788.3	3621.9	3788.4
2.2 Net Claims on Government by the Banking System	-2977.1	-2710.1	-2420.4
2.3 Net Foreign Assets – Banking System	8014.3	7477.1	6965.2
2.4 CBL Net Foreign Assets	6013.5	5680.8	5233.7
2.5 Domestic Credit	-1956.3	-1673.2	1312.2
2.6 Reserve Money	455.4	470.42	585.6
3. Spot Loti/US\$ Exchange Rate (Monthly Average)	7.1151	7.0142	7.1622
4. Inflation Rate (Annual Percentage Changes)	8.1	7.6	8.0
5. External Sector (Million Maloti)	2006	2007	
	QIV	QI	QII
5.1 Current Account Balance	18.50	697.20	1.68
5.2 Capital and Financial Account Balance	-81.15	190.60	202.63
5.3 Reserves Assets	-32.81	-1023.89	143.38

+ 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 5: Selected Economic Indicators

	2004	2005	2006*	2007+
1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	4.2	2.9	7.2	4.9
1.2 Gross National Product – GNI	7.9	5.5	3.1	3.6
1.3 Per capita –GNI	7.9	5.5	3.1	3.6
2. Sectoral Growth Rates				
2.1 Agriculture	-1.9	-1.7	1.7	-22.5
2.2 Manufacturing	2.1	-8.6	10.5	11.0
2.3 Construction	-4.4	-3.4	0.6	2.5
2.4 Services	2.1	4.1	6.6	6.3
3. External Sector – Percent of GNI				
3.1 Imports of Goods	86.3	83.1	80.1	86.5
3.2 Current Account	-4.7	-5.7	3.5	8.6
3.3 Capital and Financial Account	5.8	3.6	-1.2	5.9
3.4 Official Reserves (Months of Imports)	5.2	5.5	6.7	7.2
4. Government Budget Balance (Percent of GDP)	5.7	4.8	12.6	4.8

* Preliminary estimates

+CBL Projections