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LESOTHO NATIONAL BUDGET BRIEF

1 NOVEMBER 2017

This budget brief is one of four that explores the extent to which the national budget addresses the needs of children under 18 years in the Kingdom of Lesotho. This brief analyses the size and composition of budget allocations for the fiscal year 2017/18, and offers insights into the efficiency, equity and adequacy of past spending. The main objectives of the brief are firstly, to synthesise complex budget information so that it can be easily understood by all stakeholders, and secondly, to put forth key messages which can inform policy and budgeting decision-making processes.



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KEY MESSAGES

- **Despite having one of the largest budgets in the world as a percentage of gross domestic product (GDP), social sector spending remains below international targets as well as neighbouring countries.** Given that Lesotho will be one of the first countries in Africa to close its demographic dividend window, there is tremendous urgency to better prioritise and increase investments in child-focused sectors; not doing so poses immediate and long-term risks of greater poverty, inequality, crime, violence, and social and political instability.
- **Public spending is increasingly dominated by salaries.** Accounting for around 80 per cent of total spending and rising significantly in recent years, recurrent spending is crowding out social sector investments and threatening social progress.
- **Budget credibility is weak and underspending all too common, especially of the development budget.** On the one hand, attention must be devoted to minimising political instability, fiduciary risk and complex procurement processes, while on the other, donors need to provide more dependable grant and loan commitments.
- **The government remains overly dependent on South African Customs Union (SACU) revenue.** To ensure fiscal sustainability and greater predictability in budget planning processes, new, progressive measures should be identified to diversify the revenue base.
- **Lesotho's budget system is one of the least transparent in the world.** By providing more and better budget information in the public domain and introducing meaningful opportunities for civil society to contribute to the budget cycle, the government could foster an environment of greater accountability and citizen-state trust and potentially benefit from more donor funding and lower borrowing costs.
- **There are a variety of opportunities to create fiscal space for children.** Increasing revenue through introducing new taxes on 'sin' products and investing in tourism to boost economic growth, improving the efficiency of social sector budgets, such as through better budget execution, and reallocating funds away from the growing defence budget, all hold the potential to significantly expand investments in child-focused sectors.

1. MACRO AND SOCIO-ECONOMIC PERFORMANCE

Macro economy

Lesotho is a highly centralised, small open economy, in Sub-Saharan Africa with a recent track record of moderate economic growth. Lesotho's GDP is equivalent to roughly US\$ 3.2 billion in 2017/18. Over the last five years, average economic growth was 2.6 per cent¹. The rate of growth reached 3.6 per cent in 2016/17; and was forecasted to grow to 3.8 per cent in 2017/18. However, this projected growth is still 1.6 per cent less than that of 2012/13 (5.2%). The trend of real versus nominal GDP in absolute amount is shown in Figure 1. The real per capita GDP declined by 26 per cent from US\$ 1,352 per capita in 2013/14 to US\$ 998 per capita in 2016/17.

Inflation is moderately high in Lesotho. It might affect the living conditions of vulnerable families with children. Inflation is forecast to reach 6.6 per cent in 2017/18 up slightly from 6.3 per cent from the previous financial year; and is forecast by the IMF to remain moderate at 5-6 per cent for the remainder of the decade (IMF, 2016)² (see Figure 2). Inflation affects vulnerable children's access to basic social services. High inflation seriously affects the buying capacity of poor households' basic food items. As a result, poor households, in order to cope with the situation, either reduce the frequencies of food intake or adopt negative coping mechanism, such as engaging children in work, withdrawing them from school or reducing cost of health care³.

Lesotho's macroeconomic growth was the highest in the region in the 2016/17 fiscal year but with the lowest GDP per capita and with an inflation rate in line with the regional averages. Lesotho's growth in 2016/17 was the highest among Namibia, Botswana, Swaziland and South Africa. However, Lesotho's real GDP per capita was lower by 39 per cent when compared with that of the Sub-Saharan African Countries' average (Table 2).

Manufacturing dominated by textiles, trade and public administration remain the three largest sectors of the economy. Over the last three years, these three sectors, on average, contributed respectively to 14.1 per cent, 10.6 per cent and 10.6 per cent of total national outputs (Figure 3, page 5). Mining, on average, contributed to 8.2 per cent of GDP. Mining is expected to grow in the years to come mainly due to recapitalisation of Liqhobong Diamond Mine⁴. Agriculture is the fifth largest sector of the economy followed by construction, contributing to 5.3 per cent and 4.9 per cent of the GDP respectively. However, about one-third of household income is derived from the agricultural sector. Construction is dominated by investments in the Metolong Dam and health infrastructure.

Unemployment in Lesotho remains a structural problem. About 33 per cent of the population is unemployed; the

1. Government of Lesotho (2017) Budget Speech, Maseru

2. IMF (2016) Staff Report for the 2015 Article IV Consultation, Washington D.C.

3. Multi-stakeholder Rapid Drought Impact Assessment (MRDIA), 2016, Lesotho.

2 4. 2017/18 Budget Speech, Lesotho, Ministry of Finance.

TABLE 1:

Indicator	Value	Year
Nominal GDP (in million Maloti)	32,963	2017/18 (Projected)
Real GDP growth rate	3.8	2017/18 (Projected)
Nominal GDP per capita (US\$)	1,387	2016/17
Real GDP per Capita (US\$)	998.2	2016/17
Inflation Rate	6.6	(2016/17)
Remittances (in million US\$)	347	2016/17
Expenditure as % of GDP	51.4	2017/18
Fiscal Deficit as % of GDP	-7.8	2017/18

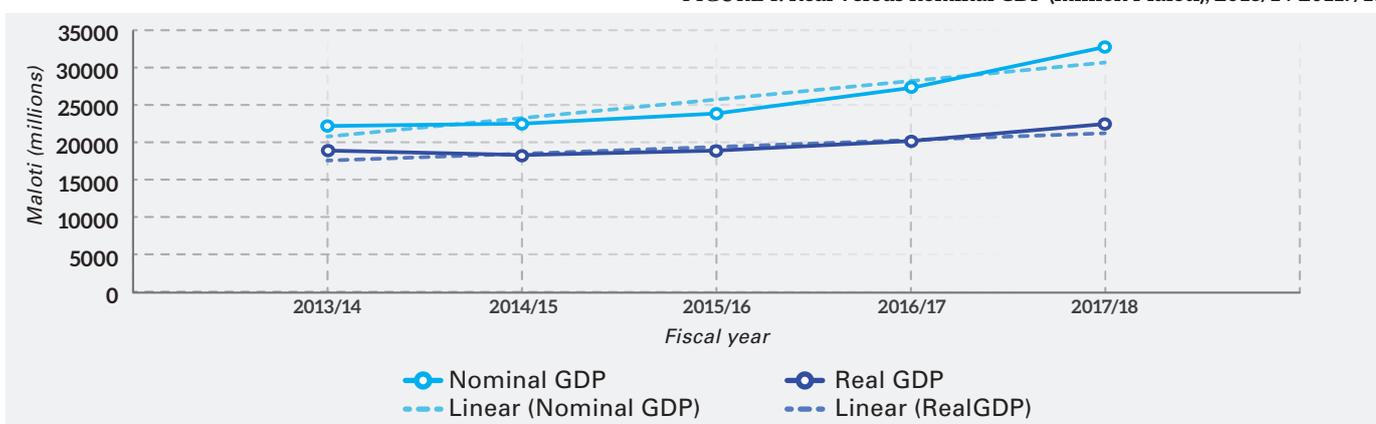
Source: Government of Lesotho BOOST data and International Monetary Fund (IMF) estimates and projections, 2016/17-2017/18

TABLE 2: Regional Macro Performance, 2016/17.

Indicator	Lesotho	Namibia	Botswana	South Africa	Swaziland	Sub-Saharan Africa (average)
Real GDP Growth (%)	3.6	1.2	2.9	0.3	-2.2	1.5
Inflation (%) average	6.6	6.7	3.8	6.3	7.8	5.5
Per Capita GDP Constant 2010 USD	998	6,021	7,383	7,504	3,911	1,632.1

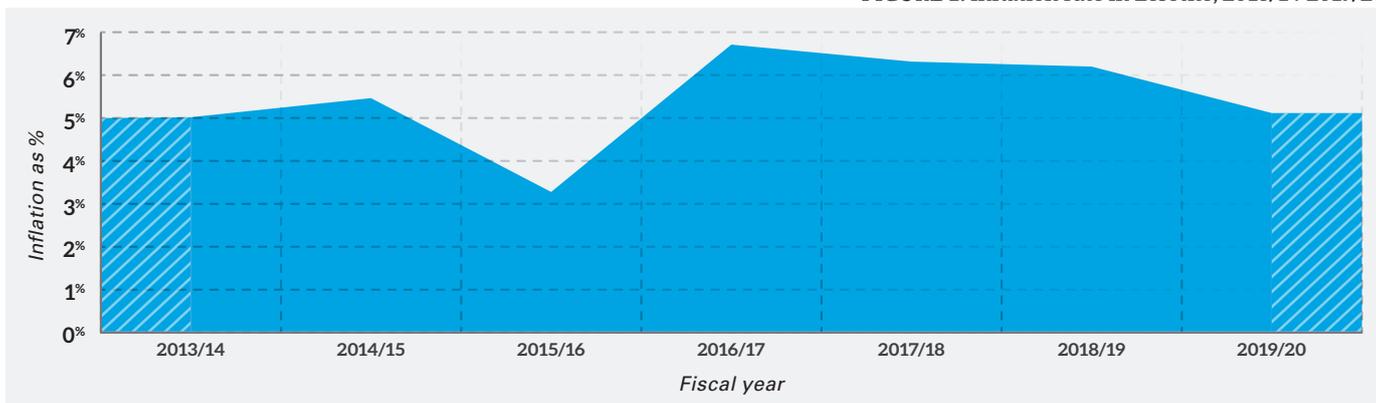
Source: World Development Indicators (WDI 2017); and GoL Budget Speech 2017/18 (2017) and Government of Lesotho National Budget 2017/18 (2017)

FIGURE 1: Real versus nominal GDP (million Maloti), 2013/14-2017/18.



Source: World Development Indicators (WDI 2017) and GoL Budget Speech 2017/18 (2017)

FIGURE 2: Inflation rate in Lesotho, 2013/14-2019/20.



Source: IMF (2016), GoL Budget Speech (2017/18) and Government of Lesotho National Budget 2017/18 (2017)

percentage of females being the highest, at about 40 per cent; males at 26 per cent and youth at 32 per cent⁵. Of the employed labour force, about 10 per cent are in formal employment, with most workers in subsistence farming and survivalist activities and in the urban informal economy. About 30 per cent of household incomes come from this sector while 29 per cent come from salaried employment⁶. Of the employed youth, almost 80 per cent work in the private sector.

Socio Economic Outlook

Despite relatively high economic growth, poverty and inequality remain structural problems. Lesotho is one of the poorest countries in Sub-Saharan Africa with over a million people (half the population), living in poverty. Of the poor, about 34 per cent are extremely poor, living below the national food poverty line of M138 (about US\$ 10) per adult per month. Disparity is one of the highest in the world with a Gini Coefficient of 0.53. The poverty is further exacerbated by a very high prevalence of HIV (25 % among adults), high unemployment (32 % among youth), and food insecurity caused by the effects of climate change, including droughts and floods⁷.

Lesotho population, particularly the children and women, are continually deprived of basic social services. Maternal mortalities are exceptionally high at 1,024 per 100,000 live births, and infant and under-5 mortalities are 59 and 85 per 1000 respectively. Among children under five years of age, 10 per cent are under weight and 33 per cent are stunted (Table 3). In terms of education, 41.8 per cent of primary school-age children have never enrolled in school⁸. About 10 per cent of the population is deprived of improved drinking water; and about 20 per cent of the population still uses open defecation⁹.

Growth of population in Lesotho is low and the total fertility rate is below the minimum replacement rates.

The total population of the country is 2.01 million, with a ratio of 49 per cent males to 51 per cent females¹⁰. The population growth rate is only 0.9 per cent. The total fertility rate per woman is 3.3 children and this has declined overtime to a degree where it is slightly below the necessary population replacement threshold of 3.4.

It is time for Lesotho to invest in social sectors or young people to achieve a demographic dividend.

In Lesotho, 38 per cent of the total population are children and 39 per cent are within the age range of 15-35 years. The proportion of working age population is 62 per cent. However, the youth are deprived of education and employment. The current population structure indicates that the country is in a demographic transition, which presents the opportunity to benefit from a demographic dividend¹¹. Lesotho is one of the first countries in Africa to close its demographic dividend window (Figure 3). Whether the rapidly changing working age population results in a demographic dividend or not, fully depends on the investment decisions of the Government. If the demographic dividend is not realised through adequate investment in social sectors or of the children and youth, the current poverty levels will be worsened, resulting in an evil circle of poverty and inequality, crime, violence, social and political instability, and so on.

National Strategy Commitments

The National Vision 2020 demonstrates its pathway of development to implement through National Strategic Development Plans (NSDP). The national vision for Lesotho states that Lesotho shall be a stable democracy, a united and prosperous nation at peace with itself and

TABLE 3: Socioeconomic indicators, Lesotho

Total Population ^[1]	2,007,201	Rank on Human Development Index ^[4]	160/188
Population < 18 years ^[1]	765,614	Poverty Rate (%) ^[5]	57.1
Children as a % of population ^[1]	38.1	Extreme Poverty Rate (%) ^[5]	34
Demographic Growth ^[1]	0.68	Gini Index ^[4]	0.53
% Stunted Children < 5 ^[2]	33	Urban Population (% of total) ^[2]	28.3
Life Expectancy (years) ^[1]	56	Unemployment Rate (%) ^[7]	33
Infant mortality rate per 1000 live births ^[2]	59	Under-5 mortality rate per 1000 children ^[2]	85
Maternal mortality rate per 100,000 births ^[2]	1,024	Access to Water (%) ^[1]	88.1
Adult literacy rate (% aged 15 and above, 2010) ^[1]	89.6	Open Defecation Rate (%) ^[1]	19.6
Primary School Net Attendance Rate (NAR) (%) ^[2]	93.6	Secondary School Net Attendance Rate (NAR) (%) ^[2]	42.4

Sources: [1] Lesotho Housing and Population Census 2016; [2] Lesotho Demographic Health Survey (2014); [3] UNESCO Institute for Statistics (2016); [4] Human Development Report (2013, 2016, 2017); [5] World Bank (2017); [6] Corruption Perception Index (2016); [7] Q1 2014/15 Continuous Multipurpose Survey.

5. Continuous Multipurpose Survey 2015 (Q1), Bureau of Statistics (BOS). Lesotho, cited in UN Common Country Assessment (CCA) 2017, Lesotho.

6. Lesotho Households Budget Survey 2011, cited in the UN CCA 2017, Lesotho.

7. UN Common Country Assessment 2017, UN Lesotho.

8. LDHS (2014)

neighbours, with a healthy and well developed human resource base, strong economy and technological base.

In order to progressively realise the vision, the NSDP prioritised six strategic areas:

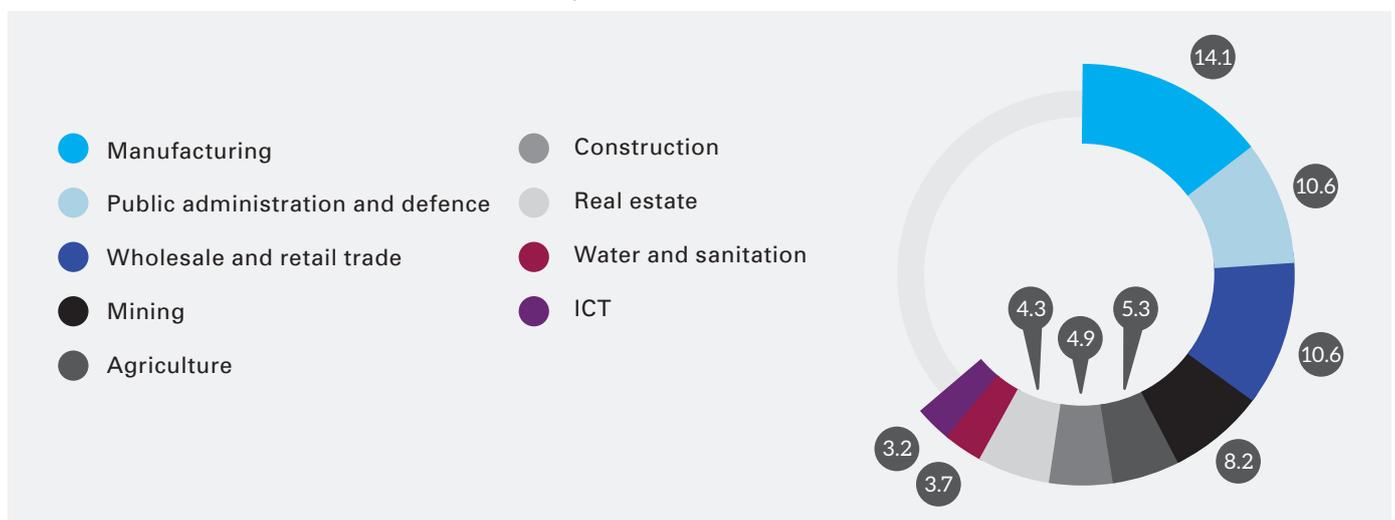
- Employment, creating growth
- Development of infrastructure
- Enhancement of the skills base, technology adoption and foundation for innovation
- Improvement in health, reduced HIV and AIDS and vulnerability
- Adaptation to climate Change
- Democratic governance and effective institutions.

Policy documents are used during the budget planning processes. However, budget lines for key policy areas have not been identified to match national policy goals. Annual budget documents refer to key policies identified in the NSDP, but in practice the alignment of budget allocations with the strategic policy direction has been a challenge. Regrettably, most of the Millennium Development Goals (MDG) and NSDP targets have not been met. Whilst there are some targets that are able to be monitored in the NSDP for macro fiscal out-turns, other policy objectives are neither costed, targeted towards specific beneficiaries, or linked to a fiscal-sectoral framework.

TAKEAWAYS

- **Growth slowed to an average of 2.6 per cent over the last five fiscal years (FYs), although it is expected to reach 3.6 per cent in 2017, reflecting more buoyant regional and global prospects.**
- **Manufacturing dominated by textiles, trade and public administration remain as the three largest sectors of the economy while mining has been the fastest growing industry.**
- **Inflation is moderately high at 6.3 percent, which is eroding the real value of household incomes with negative effects on children.**
- **Unemployment is very high, with most of Lesotho's population dependent on subsistence agriculture.**
- **In absence of adequate policies and implementation, progress towards shifting the country's dependence on agriculture to manufacturing and service sectors will remain limited.**
- **Children, youths and women are disproportionately affected by poverty and poor access to basic social services.**
- **It is necessary for Lesotho to invest in social sectors or young people to achieve the demographic dividend. Whether this happens for a rapidly changing working age population depends on the investment decisions of the Government.**
- **Whilst there are targets that can be monitored in the NSDP for macro fiscal outturns, other policy objectives are neither costed, targeted towards specific beneficiaries, or linked to a fiscal-sectoral framework.**

FIGURE 3: Key sectors' three-year average contribution to GDP (%) from 2014/15 to 2016/17.



9. Population and household census 2016

10. 2010 Population Census, Lesotho

11. Demographic dividend refers to the economic growth potential that can result from shifts in a population's age structure, mainly when the share of the working-age population (15 to 64) is larger than the non-working-age share of the population (14 and younger, and 65 and older).

2. AGGREGATE SPENDING TRENDS AND PRIORITIES

Size of Spending

Government spending (expenditure)¹² has decreased over the last five years, both in real terms and as a share of GDP. Government expenditure is not consistently increasing or decreasing (Figure 5). The nominal expenditure has grown by 16.5 per cent from M14,526 million in 2013/14, to M16,930 million in the 2017/18 fiscal year. However, the real expenditure shrunk by 5.5 per cent from M12,415 million in 2013/14 to 11,732 million in the 2017/18 fiscal year. Expenditure, as a share of GDP, was 64.7 per cent in 2013/14 and fell to 51.4 for 2017/18 (Figure 6). Lesotho's public expenditure as a share of GDP (Figure 6) is roughly 20 per cent higher than Botswana, Namibia, South Africa and Swaziland (Figure 6).

Spending is increasingly oriented towards recurrent expenditures, dominated by wages for civil servants. Recurrent spending commitments rose from 66.8 per cent of total budget expenditures in 2013/14 to 79.8 per cent in 2017/18 (Figure 8). In line with this expansion, Lesotho continues to have a highly bloated wage bill at 36.7 per cent of total expenditures (or 46% of the recurrent budget) in 2017/18 up from 27.4 per cent (or 41 % of the recurrent budget) in 2013/14.

Development (capital) spending was already very low and has been declining significantly for the last five years. Development expenditures have decreased from 33.2 per cent to just 20.2 per cent between 2013/14 and 2017/18 (Figure 8). If this trend is not reversed urgently, the social development indicators of the country such as the high level of poverty and inequality, high maternal and child mortality, and poor access to education, will worsen further, and thereby weaken the economic growth performance of the country.

Spending Priorities

The social sectors are the highest priority in the budget, although they remain below international targets. About one-third of the budget is devoted to key social sectors. However, total social expenditure as a share of total expenditure declined from 35.5 per cent in 2016/17 to 32.6 per cent in 2017/18 (Figure 8). Among the social sectors, the Government allocated 13.7 per cent of the national budget to Education followed by Health 12.0 per cent in 2017/18 (Figure 9, page 8). Nonetheless, the overall levels fall short of global spending benchmarks, including 20 per cent of the budget for Education and the initiative of Education for All (EFA), and 15 per cent for Health (the Abuja Declaration). Following Health and Education, the highest levels of public sector investment (Figure 7) in 2017/18, as a share of total investment, went to Public Works and Transport (5.6 %), and Defence (4.3 %). This is followed by Water (2.8 %) and finally Interest (2.1 %) and Agriculture (2.0 %).

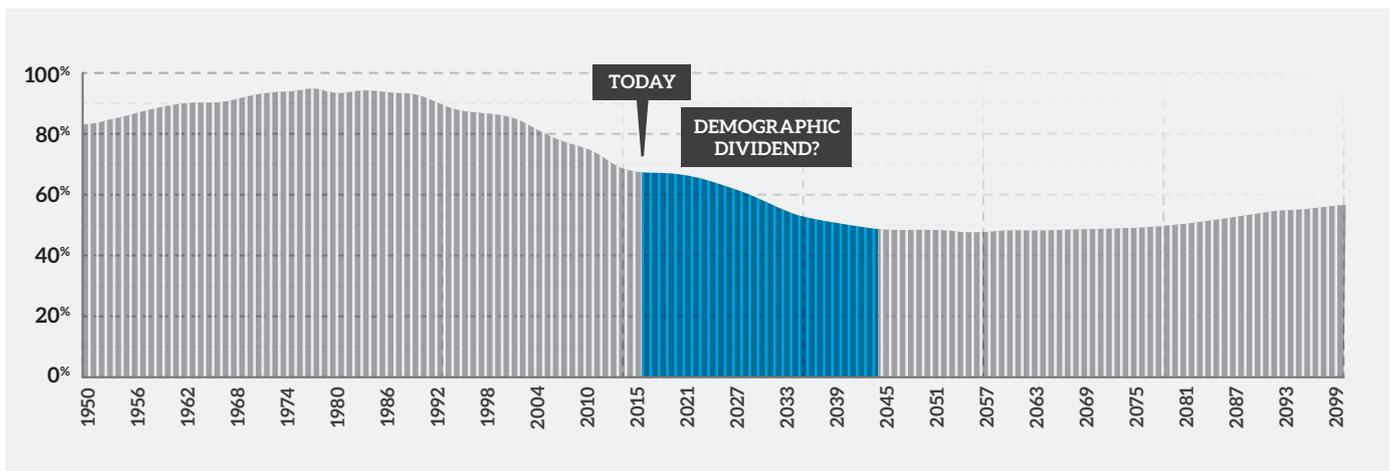
Although social sector investment in general shows an increasing trend, the investment in Education, Gender and Youth and Water has declined. While budget in Health, Social Development¹³, Wages, and Defence has gone up by 3.9 per cent, 23.9 per cent, 7.5 per cent, and 16.3 per cent respectively, the budget in Education, Gender and Youth, as well as Water, has gone down by 3.9 per cent, 2.9 per cent and 26.9 per cent respectively from last year's approved budget (Figure 11, page 8). **If it continues, this may undermine the effort to the realisation of demographic dividends.**

TAKEAWAYS

- Expenditure as a share of GDP in Lesotho is 20 per cent higher in comparison to that of its neighbours.
- The recurrent budget continues to grow in real terms, dominated by wages for civil servants.
- Large and growing recurrent expenditures are severely crowding out development spending, with major implications for growth, poverty, and social development performance.
- The proportion of allocation to social sectors, although the highest priority in the budget, declined in the current budget year.
- Health and Education spending is a priority in Lesotho but remains below international targets as neighbouring countries.
- Whilst Wages and Defence continue to expand as a share of total expenditure, Water, Education and Gender and Youth have declined since the last fiscal year (FY).

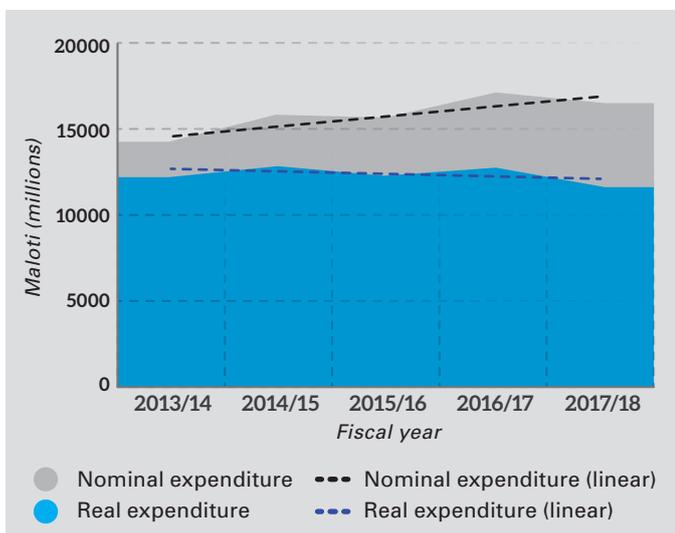
12. Government expenditure as a share of GDP is an important indicator. Government expenditure is in general a large contributor to GDP and hence is potentially growth enhancing because of its multiplier effect. Notwithstanding, there is very little available evidence on what constitutes an ideal level of government expenditure. This is because the impact and effectiveness of government expenditure depends on many variables which are country level dependent. Examples which might affect the appropriateness of government expenditures might include (i) the tax burden per citizen, (ii) the composition of expenditures (e.g. is the budget financing the apparatus of government (recurrent) or contributing to actual development (capital) outcomes?), (iii) the affordability of expenditures given different financing scenarios including debt financing, (iv) the inflationary impact of fiscal policy and/or (v) the impact of government expenditures on the private sector (crowding out or crowding in). This list is not extensive.

FIGURE 4: Dependency ratio in Lesotho, 1950-2100



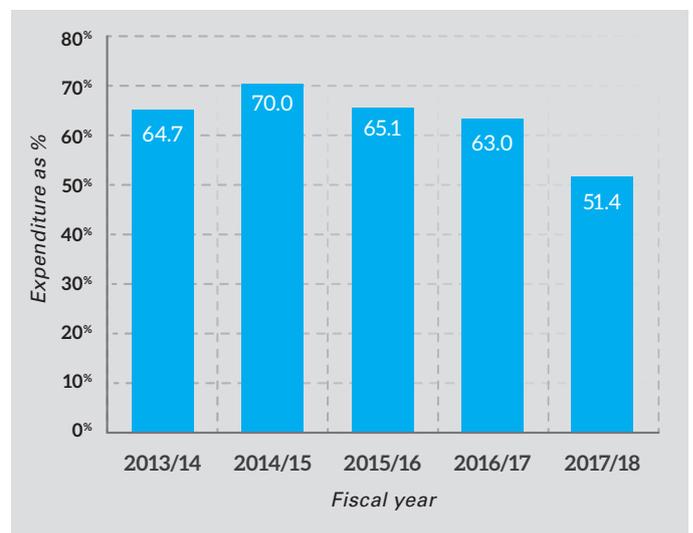
Note: The dependency ratio is calculated by adding the child population (under 14) and elderly population (over 65) and dividing that by the working age population (15-64). Source: United Nations, Department of Economic and Social Affairs, Population Division (2015), World Population Prospects: The 2015 Revision, DVD Edition

FIGURE 5: Real versus nominal expenditure, Lesotho, 2013/14-2017/18.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

FIGURE 6: Expenditure as percentage of GDP, Lesotho, 2013/14-2017/18.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

FIGURE 7: Expenditure as percentage of GDP, regional comparison, 2016/17 and 2017/18.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

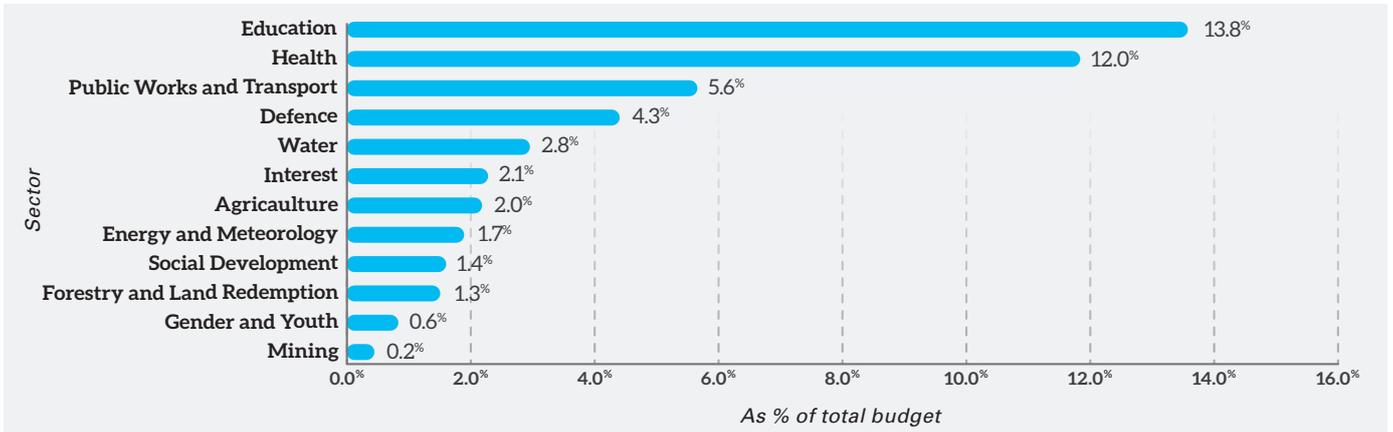
FIGURE 8: Recurrent, development and wages expenditure as percentage of total expenditure, Lesotho, 2013/14-2017/18.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

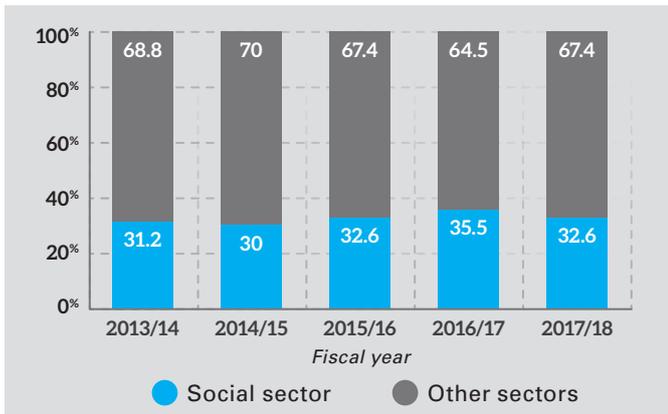
13. Although the Ministry of Social Development (MoSD) manages the implementation of the National Social Protection (SP) Strategy, SP programmes are executed across a number of Ministries including Health, Education and Water. As such the increase in the size of the MoSD budget does not reflect an equal increase in Social Protection across the board in Lesotho.

FIGURE 9: Top spending sectors as percentage of National Budget, 2017/18, Lesotho.



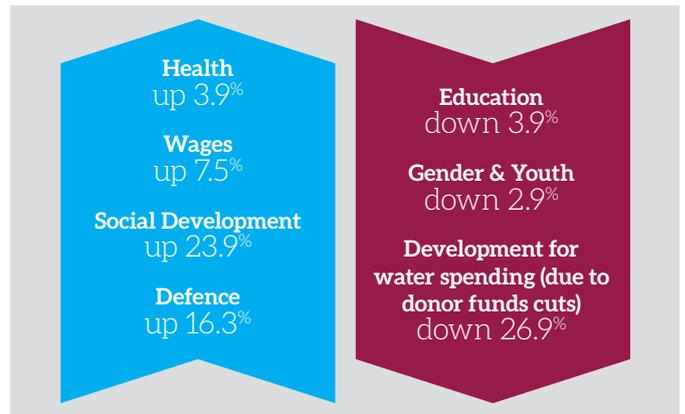
Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

FIGURE 10: Social sector expenditure as percentage of total expenditure, 2013/14-2017/18, Lesotho.



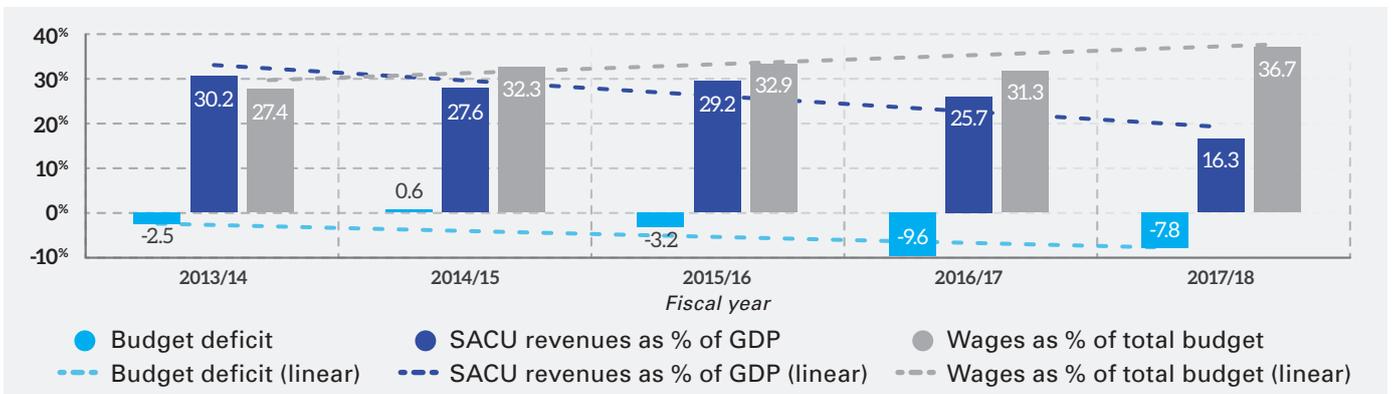
Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

FIGURE 11: Investment in key social sectors between 2016/17 and 2017/18, Lesotho.



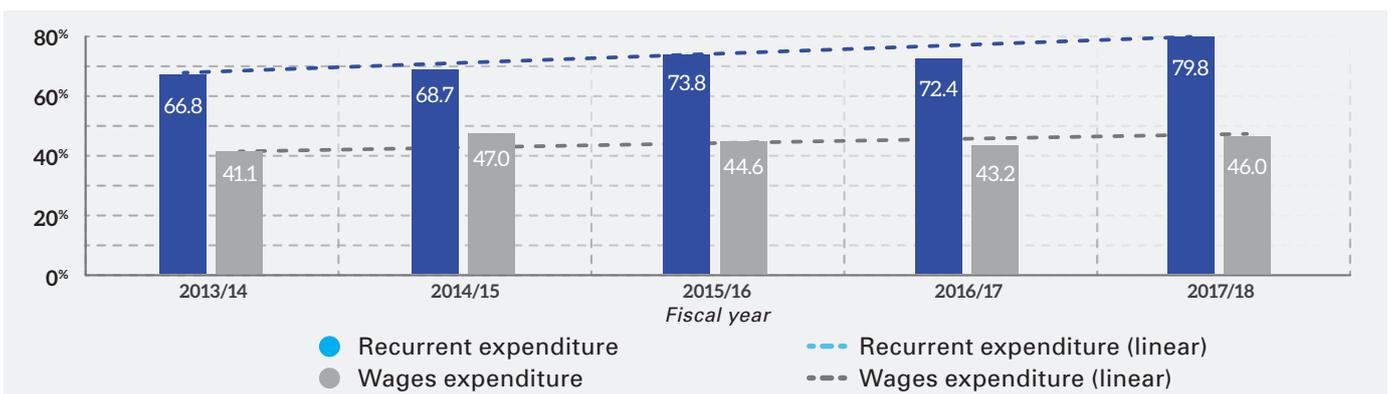
Source: GoL Budget Speech 2017/18 (2017)

FIGURE 12: Budget deficit (including grants), SACU revenues and wages as percentage of GDP, 2013/14-2017/18, Lesotho.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

FIGURE 13: Recurrent expenditures as a share of total, and Wages as a share of recurrent expenditure (%) 2012/13 and 2017/18.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

3. SPENDING IMBALANCES

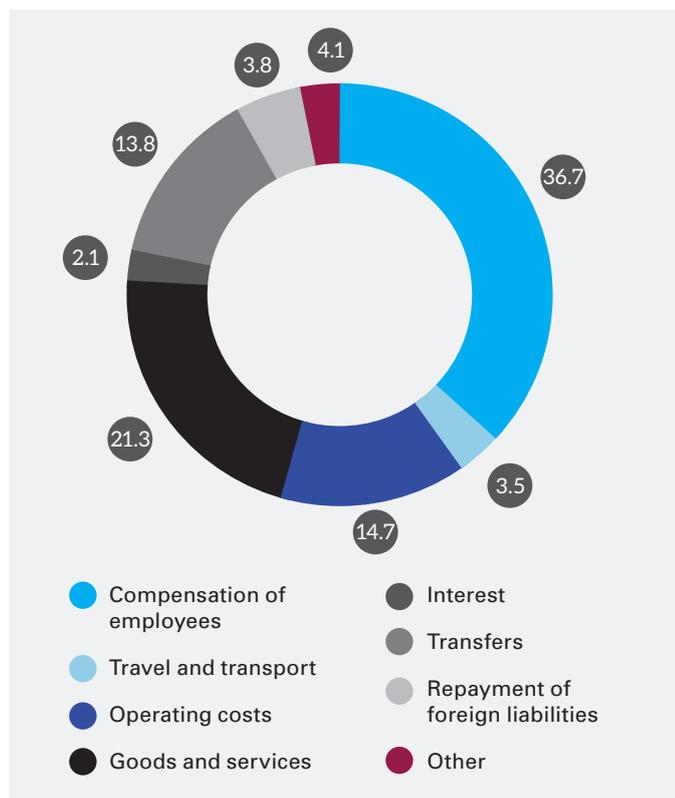
Government expenditure is dominated by a bloated wage bill and is dependent on volatile and declining Southern African Customs Union (SACU) revenues, leading to large fiscal deficits (FD)¹⁴. Wages account for 36.7 per cent of total expenditures in 2017/18 up from 27.4 per cent in 2013/14 (Figure 12). Over the same period SACU revenues have declined from 27.6 per cent in 2013/14 to 16.3 per cent of GDP in 2017/18. As a result, the fiscal deficit has widened from -2.5 per cent in 2013/14 to -9.6 per cent in 2016/17 and a forecasted -7.8 per cent for the 2017/18 FY.

More than half of Lesotho's budget is used to finance day-to-day operations. A total of 36.7 per cent of Lesotho's overall national budget is spent on compensation of employees, 14.7 per cent on operations and 4.1 per cent on travel and transport. Only 21 per cent is used for goods and services.

TAKEAWAYS

- Government expenditure is dominated by a bloated wage bill and is dependent on volatile and declining SACU revenues, leading to large fiscal deficits.
- Over half of public expenditure in Lesotho is used for maintenance of the government apparatus.

FIGURE 14: Expenditure by economic classification, 2017/18 budget, Lesotho.



Source: GoL National Budget 2017/18 (2017), and author's own calculations

4. BUDGET CREDIBILITY

The budget credibility¹⁵ in Lesotho is weak both at the aggregated and disaggregated budget levels. The total budget released as proportion of the approved budget, ranged from 95 to 53 per cent during 2012/13 to 2016/17. The lowest proportion of budget released, only 53 per cent of the approved budget, was observed in the 2016/17 fiscal year. At disaggregated levels, the proportion of recurrent budget released against the approved budget, ranged from 101-106 per cent, except for 2016/17. However, the development budget released, ranged from 74 to 34 per cent of the approved budget (Figure 15, page 10). Weak budget credibility for the recurrent budget in the form of over-released (except for 2016/17) was a result of a deterioration of aggregate fiscal discipline, principally due to significant budget overruns in salaries. The variation between commitment and allocation in capital budget was very high owing to very low out-turns of donor financed projects (Figure 16, page 10). The very poor turnout for 2016/17 is attributable to political complexities, and weak SACU revenue out-turns. Public Expenditure and Financial Accountability (PEFA) assessment (2017), corroborates the same findings. This situation is very concerning and needs to be rectified. Development partners need to take responsibility and work with GoL to strengthen the development activities.

Budget Execution

Budget execution in Lesotho is weak. The overall total execution rates during the 2013/14 to 2016/17 fiscal years ranged from the lowest, at 41 per cent, to the highest, at 90 per cent. But the execution rate of recurrent budget, ranges from 106 per cent to 60 per cent, indicating over execution, and the development budget ranged from 79 per cent to 34 per cent over the same period, indicating under execution (Figure 17, page 10).

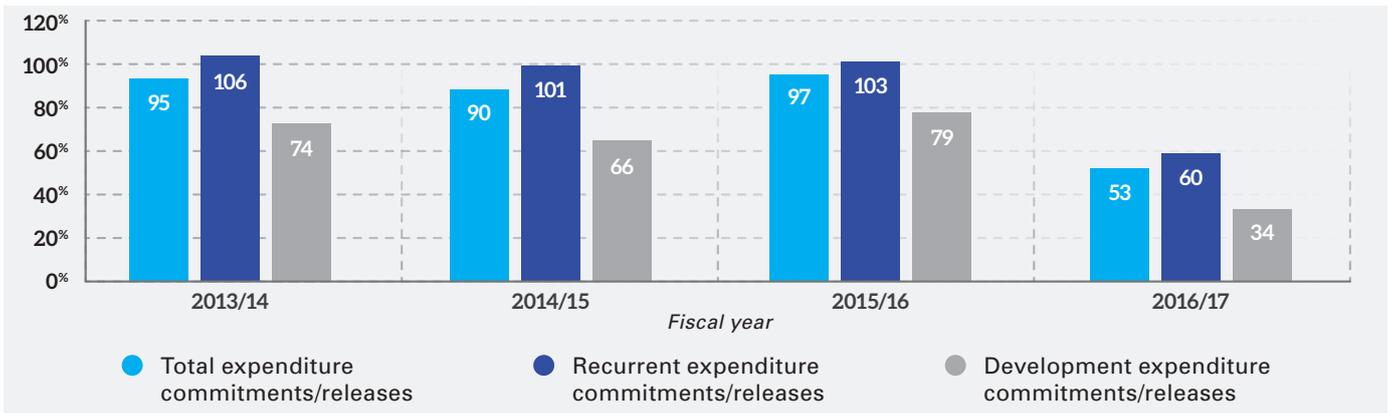
TAKEAWAYS

- Lesotho's budget was characterised by weak budget credibility and budget execution.
- The recurrent budget is not credible owing to unplanned, increased civil servant salaries and other forms of patronage.
- The Development budget is dominated by donor commitments and is severely under-funded by year end owing to a complex mixture of political uncertainty, high levels of fiduciary risk, poor donor reporting systems, and delays owing to protracted procurement delays on both the GoL and donor side.

14. Fiscal deficit occurs when a government's total expenditures exceed the revenue that it generates.

15. Budget credibility in Lesotho is assessed by comparing the approved budget to actual releases. Lower or higher rates indicate weak budget credibility regardless of the direction.

FIGURE 15: Proportion of budget released against approved budget, 2013/14 to 2016/17, Lesotho.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

FIGURE 16: Proportion of development budget released against approved budget, 2013/14 to 2017/18, Lesotho.

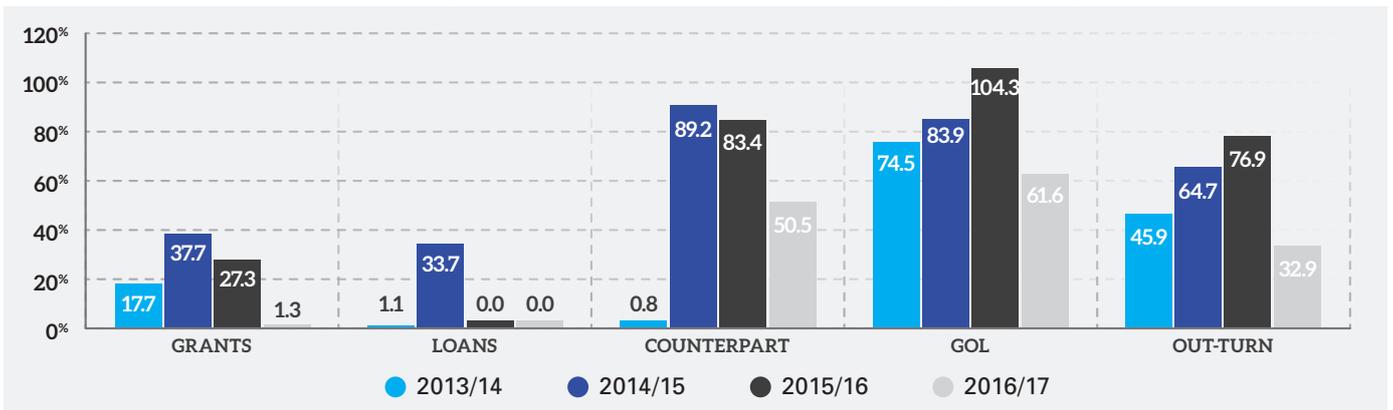
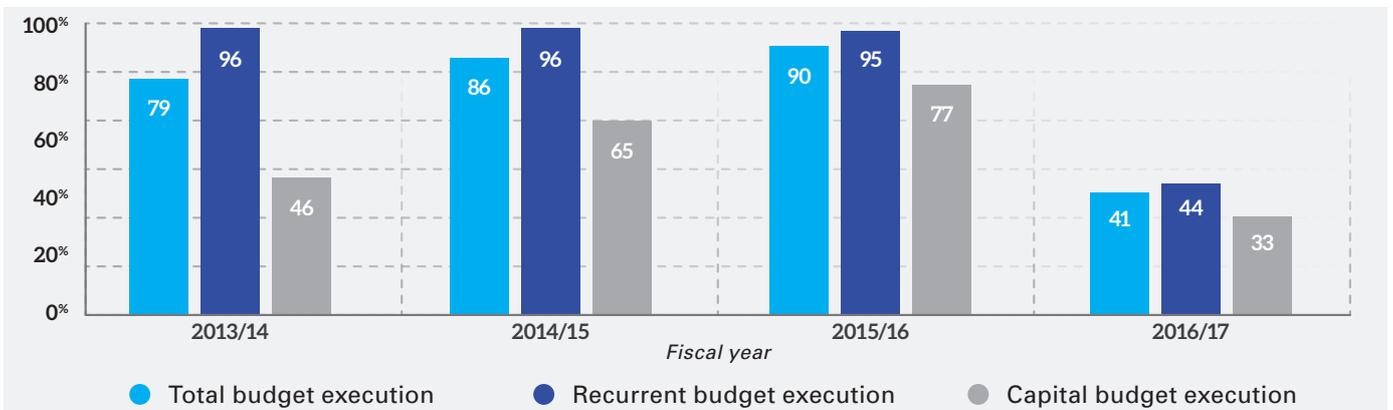
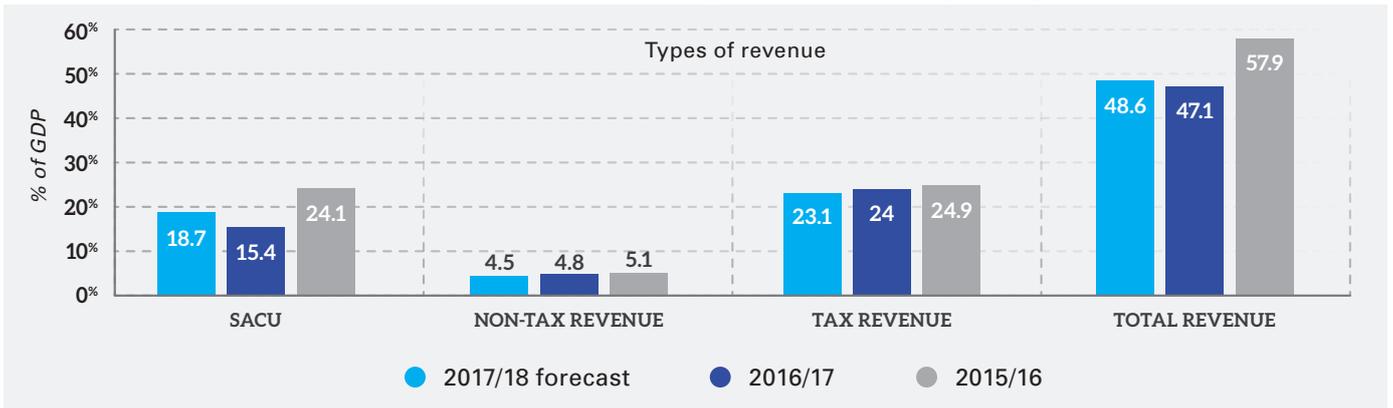


FIGURE 17: Budget execution rate, 2013/14 to 2016/17, Lesotho.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

FIGURE 18: Composition of revenues as percentage of GDP, 2013/14-2017/18, Lesotho.



Source: Author's estimation based on World Bank Boost Database (2017), Government of Lesotho National Budget, 2017 - 2018 (2017).

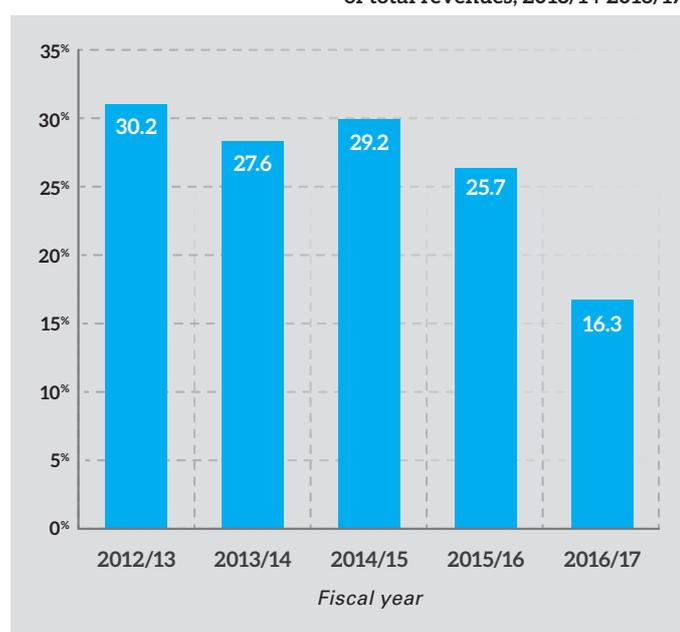
5. DECENTRALISATION AND SUB-NATIONAL SPENDING

The Government views an effective local governance system as a critical vehicle for accomplishing its efforts in reducing poverty and promoting inclusive economic growth. In 2014, the Government formulated and adapted the National Decentralisation Policy with the purpose of promoting equitable local development by enhancing citizen participation and strengthening the local government system, while maintaining effective functional and mutually accountable linkages between central and local governmental entities¹⁶. One of the key policy actions was the establishment of fiscal decentralisation and prudent public financial management; and the development of a framework for exercising local autonomy and intergovernmental relations¹⁷. However, the fiscal decentralisation, which is the best option to provide services to the people in remote communities, is yet to be realised.

TAKEAWAY

- Fiscal decentralisation remains, for the most part, a plan on paper. To be implemented, it will require significant reforms and investment to realise its objectives moving forward.

FIGURE 19: Trend of SACU revenues as percentage of total revenues, 2013/14-2016/17.



Source: GoL Budget Speech 2017/18 and IMF (2016) Staff Estimates

6. FINANCING THE NATIONAL BUDGET

Domestic Revenue

Revenue generation has fallen dramatically. Revenue generation fell from 57.9 per cent of GDP in 2015/16 to a forecasted 48.6 per cent in 2017/18. In line with a slowdown in economic growth, all revenue sources have shrunk in real terms over the last three years (Figure 18). Revenues continue to be dominated by taxes on income and SACU receipts at 23.1 per cent and 18.7 per cent of GDP respectively for 2017/18.

Lesotho depends heavily on South African Customs Union (SACU) and remittances from South Africa. SACU revenues are highly volatile (declining by almost 45.6% in the last five years and expecting to remain depressed)¹⁸. SACU revenues on the other hand contributed to 31.3 per cent of total revenues (16.3% of GDP) in 2016/17 (Figure 19) and a forecasted 38.3 per cent of total revenues (18.6% of GDP) in 2017/18. This is a significant reduction from a high of 45.3 per cent of total revenues (30.2% of GDP) in 2012/13. Declines in both areas are attributed to negative spillovers from slower growth and import demand in neighbouring South Africa, upon which Lesotho remains highly dependent. Remittances totalled US\$ 370m (15.6% of GDP) in 2016/17, down from a high of US\$ 554m (20.7% of GDP) in 2013.

IMF (in Article IV reports) also cautions that the sharp decline in SACU revenues due to sluggish growth in South Africa is a severe shock to Lesotho's public sector.

The development budget is largely financed by donors, through grants, loans and counterpart funds. Donor contributions to the capital budget, range from 55.3 per cent in 2013/14 to 54.7 per cent in 2016/17 based on the aggregation of three categories: grants, loans and counterpart funds. The contribution for each category to the development budget ranges widely by year (Figure 20, page 13).

Borrowing

Government debt increased from 2013/14 to 2016/17 but decreased in 2017/18. In 2017/18 gross debt is projected to be 53 per cent of GDP (Figure 21). The IMF considered this a moderate risk of distress. External debt, which is the main source of debt in Lesotho, stems from the GoL's intention to use debt financing for a major infrastructure project. Given international experience of such projects incurring delays and cost overruns, the IMF recommends a conservative approach to maintain debt sustainability. Depreciation of the Rand also affects Lesotho's debt sustainability outlook since most of its loans are South African backed. Finally, if Lesotho is not able to rein in public expenditure, such as for the bloated wage bill, debt will increase and macro stability will be threatened.

16. GoL (2015) National Strategic Development Plan 2012/13 - 2016/17

17. GoL (2015) National Strategic Development Plan 2012/13 - 2016/17

18. IMF (2016), Staff Report for the 2015 Article IV Consultation, Washington D.C.

Official development assistance (ODA)

ODA continues to decline. ODA (on budget) as a share of GDP, peaked at 8.1 per cent in 2013/14 but has gradually declined since (Figure 22). In the current fiscal year, total ODA is estimated at 5.5 per cent of GDP. At present there is no budget support in Lesotho. The trend indicates that aid levels are likely to remain depressed in the near term.

A significant share of aid is delivered outside the budget¹⁹. There are currently seven major development partners in Lesotho, namely, European Union (EU), WB, the African Development Bank (AfDB), IMF, the UN, South Africa, and USA. The Government of Lesotho and its development partners adopted a partnership policy in November 2013 to enhance the effectiveness of development cooperation through greater government ownership and partnership, increased transparency and accountability, and above all, to accelerate socio-economic development. This policy is currently under review. Despite efforts promoted to use national systems²⁰ such as procurement, banking, accounting and reporting, and auditing, interactions with Government Officials suggest that more than 50 per cent of donor-financed projects and programmes remain outside government budget, the bulk of which originate from USAID and China (PEFA, 2017).

Options to expand fiscal space

Government can create substantial fiscal space to invest in three key social sectors -health, education and social protection - to facilitate children to grow up reaching their full potential. A fiscal space analysis, conducted jointly by the Ministry of Finance and UNICEF in 2017, revealed that the Government can increase its investment to the priority social sectors by 14.8 per cent of GDP by 2021. To achieve this, three options

could be adopted, (1) increase tax on sin products such as alcohol and tobacco products; (2) support greater growth in tourism by attracting international tourists and mining industries to meet global demands of commodities from Lesotho and (3) enhance efficiency in the public sector administration in areas such as poor budget execution, the high public-sector wage bill and the inefficient implementation of grants and social protection. These are major challenges in Lesotho's public sector financial management system. Addressing these various issues could potentially reduce waste, leakage, and misuse of available resources, and thereby increase actual expenditure in priority sectors without requiring additional funding. For example, increasing efficiency in one programme (Old Age Pension), the Government could save 0.86 per cent of GDP with which all families in Lesotho with vulnerable children, could be covered through the child grant programme (Table 7).

TAKEAWAYS

- **Lesotho remains dependent on volatile and shrinking SACU revenues.**
- **Debt is high, but remains at only moderate risk of destabilising macroeconomic performance according to IMF assessments.**
- **Aid resources are drying up in line with Lesotho's unstable political environment.**
- **Lesotho has a variety of options to enhance fiscal space for priority social sectors by increasing sin tax, investing in tourism and mining, and increasing efficiency in public administration and programme management.**

TABLE 7: Amount of budget that can be saved through increasing efficiency in one social protection programme.

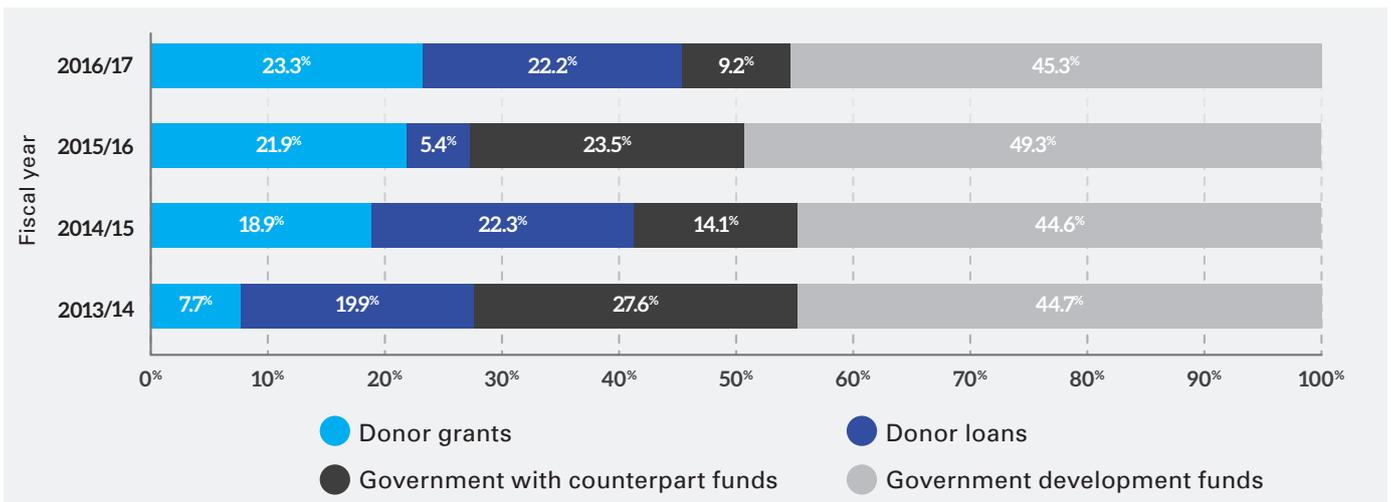
Programme and implementing Ministry	Beneficiaries		
	Recipients	Eligible**	Coverage
Old age pension (70+), Ministry of Finance	85,087	54,647	155.7
Child grant (0-17yrs)*, Ministry of Social Development	89,000	481,656	18.5
	Current cost for all the recipients		
	Total (US\$)	Per beneficiary (US\$)	As % of GDP
Old Age	36,000,000	423	2.39
Child Grant	3,360,000	38	0.22
	Cost for universal coverage		
	Total (US\$)	Difference	As % of GDP
Old age	23,120,947	12,879,053	1.53
Child grant	18,183,852	14,823,852	1.19

Source: **United Nations Department of Economic and Social Affairs (UNDESA, 2015); * 52 % of the children are poor.

19. PEFA 2017 report, Lesotho

20. Paris Declaration on Aid Effectiveness (2005), the Accra Agenda for Action (2008) and the Busan Partnership Agreement (2012)

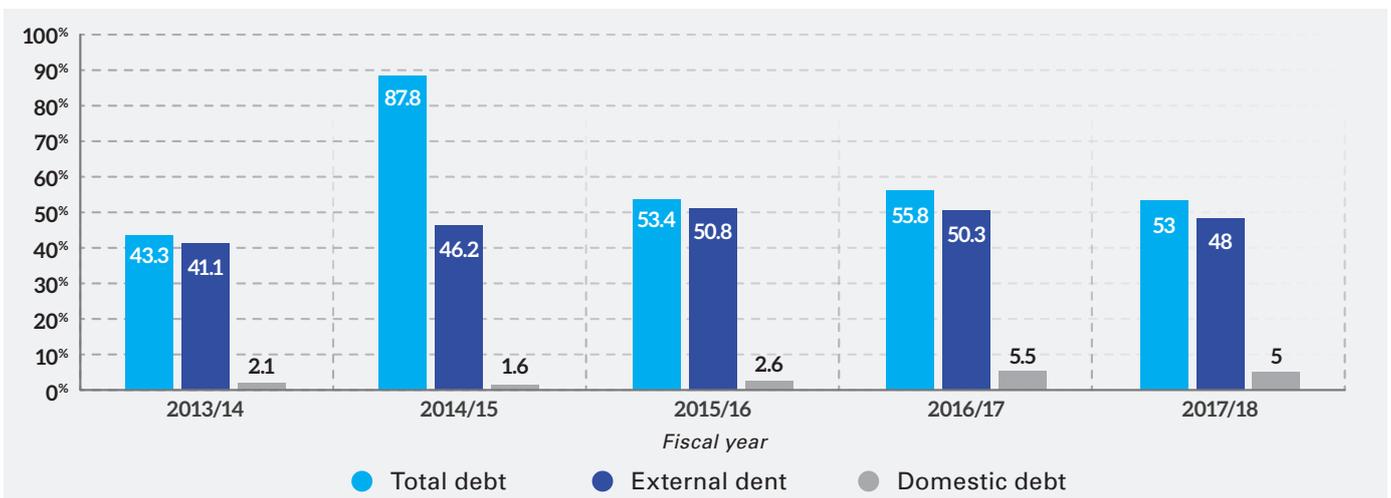
FIGURE 20: Contribution, as percentage, in development funds, 2013/14-2016/17.



Source: World Bank Boost Database (2017), and author's own calculations

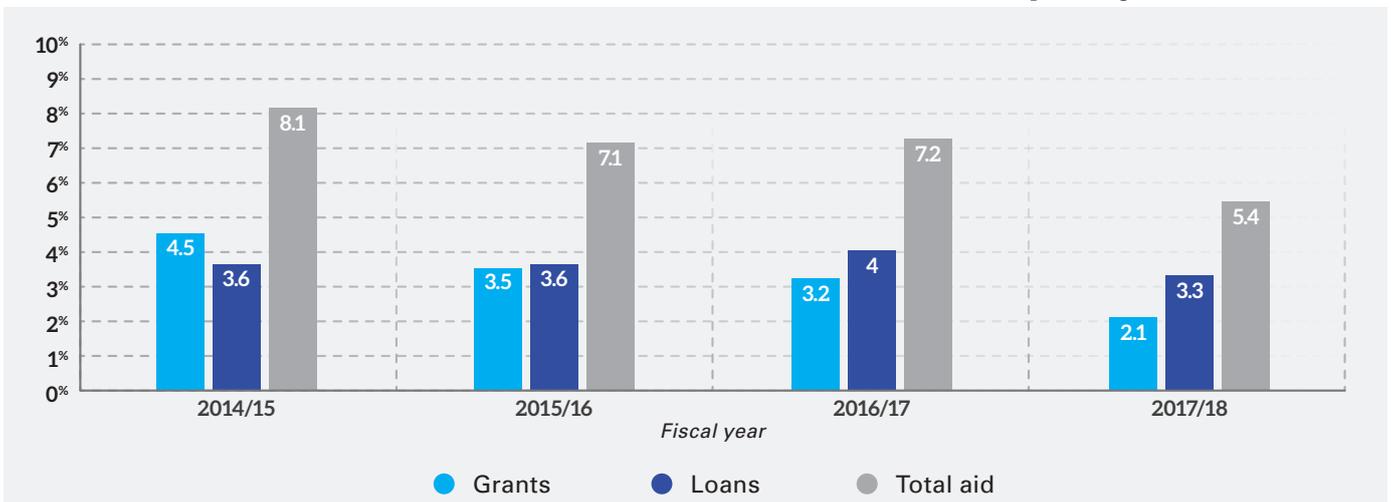
*The 2017/18 budget is not disaggregated to this level and is therefore not included in the figure (see text for additional details)

FIGURE 21: Debt as share of GDP, 2013/14-2017/18, Lesotho.



Source: IMF, 2016, staff estimates

FIGURE 22: Aid as percentage of GDP, 2013/14-2017/18.



Source: GoL Budget Speech 2017/18 (2017)

7. DEVELOPMENTS IN PUBLIC FINANCIAL MANAGEMENT (PFM)

The Status of PFM Reforms in Lesotho

The Ministry of finance is coordinating the implementation of a second generation of public financial management reforms with some notable progress. PEFA, 2017 and IMF, 2016 reveal that the budget is quite comprehensive, but reporting is poor, especially at the local government level. Contrary to international PFM ethics, public enterprises and development partners continue to use their own reporting procedures. This limits coverage of accounts and in turn impedes proper auditing of public accounts.

PEFA report (2017) highlighted the following:

On average Ministries are estimated to undershoot the capital budget by 30 per cent, while forecast errors for revenue are large, demonstrated by the Lesotho Revenue Authorities (LRA) surpassing targets very often.

While comprehensive representation of budget by function, sub-function, administrative unit and economic categories are available monthly, quarterly and annual reports are not always accessible or available.

Forecasting and monitoring of cash flows is not systematic. However, spending authorities usually make provisions for quarterly provisions (except in years where unforeseen expenditures are high).

The capacity to operate the new financial management system has been volatile, due to failure to retain trained staff.

The Independent Auditor General reports to Parliament, but the focus is on compliance failures, rather than assessing the efficiency and effectiveness of public spending.

Most donors provide budget information for inclusion in the annual national budget as they insist on using their own procedures, but do not provide reports on expenditures as required. The World Bank, EU and AfDB provided general budget support, but stopped due to failure to meet conditions of disbursement.

Budget Transparency

Government has taken a number of initiatives to enhance budget transparency such as the introduction of a citizens' budget, as part of transparency framework in 2016, publication of forecasts for the fiscal deficit, and previous year's budget out-turns, for both revenues and expenditures, as well as for the publication of bidding opportunities for procurement in weekly newspapers.

However, public access to fiscal information and participation in budget process have huge space to improve. According to the most recent PEFA (2017), public access to fiscal information is very limited, which is further confirmed by the 2017 Open Budget Survey (OBS). In particular, the OBS report confirms that the Basotho have no access to budget information or opportunities to be involved in the budget making process. Of worry, is that budget estimates and financial reports do not comprehensively capture central government revenues and expenditures including donor²¹ aid. Moreover, information on contracts awarded and resolution of procurement complaints are not publicised and annual financial statements (both audited and unaudited) may take years to reach the MoF website. Finally, the extent of oversight of the budget by the Parliament and the supreme audit institution is another major challenge.

TAKEAWAYS

- **The functionality of the Integrated Financial Management Information System (IFMIS) can be improved to better manage financial data, and reduce variations between data sources, whilst facilitating budget information into the public domain.**
- **Monitoring, reporting and evaluation systems can improve substantially to provide timely and accurate information to guide policy decision making.**
- **Although a PFM reform strategy is in place, implementation has been very slow.**
- **Overcoming the abysmally low budget transparency and participation should be one of the highest, near-term priorities.**
- **Budget transparency is a serious challenge in Lesotho, undermining citizens' capacity to monitor and engage in national and local planning and budgeting processes.**
- **There is little effective link between policy, priorities, planning and budgeting.**

21. It is estimated that non-tax revenues outside the budget (and financial reports) amount to at least 9.4 per cent of total government domestic revenues (excluding grants) (PEFA, 2017).

BUDGET CALENDAR

Month	Key Activities and Outputs
April	<ul style="list-style-type: none"> Public Sector Investment Committee quarterly meetings
May	<ul style="list-style-type: none"> Budget Book published
June	<ul style="list-style-type: none"> Discussion and approval of Physical and Financial Reports by Cabinet Budget Committee Baseline Medium Term Fiscal Framework (MTFF) prepared by Ministry of Finance (MoF) and the Ministry of Development Planning (MDP)
Strategic and Analytical Phase	
July	<ul style="list-style-type: none"> Cabinet Retreat (presentation of the key fiscal and budget policy, strategy and priorities)
August	<ul style="list-style-type: none"> Budget Framework Paper (BFP) Circular and Ceilings are issued by the MoF Line Ministry BFPs prepared
September	<ul style="list-style-type: none"> Review of BFP requests Ministry BFP hearings
October	<ul style="list-style-type: none"> Updated MTFF prepared Draft Ceilings finalised Budget Ceilings approved by Cabinet
Budget Finalisation Phase	
November	<ul style="list-style-type: none"> Budget Call Circular and Ceilings issued by MoF to line Ministries Budget Estimates prepared by all Ministries
December	<ul style="list-style-type: none"> Review of Estimates request by MoF and MDP
January	<ul style="list-style-type: none"> Ministry Budget hearings
February	<ul style="list-style-type: none"> Draft Estimates compiled Draft Budget approved by Cabinet Budget Committee Budget Speech prepared Budget Day District consultations on the Budget
March	<ul style="list-style-type: none"> Appropriation Bill approved by Parliament



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