2022/23 – 2024/25 BUDGET STRATEGY PAPER

MINISTRY OF FINANCE AND MINISTRY OF DEVELOPMENT PLANNING

SEPTEMBER 2022

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LIST OF ABBREVIATIONS AND ACRONYMS

1. ART – Antiretroviral Therapy
2. BEDCO - Basotho Enterprises Development Corporation
3. BSP – Budget Strategy Paper
4. COVID-19 – Corona Virus Disease 2019
5. CSOs – Civil Society Organisations
6. DFA - Development Finance Assessment
7. DSA – Debt Sustainability Analysis
8. DSSI - Debt Service Suspension Initiative
9. FY – Financial Year
10. GCI – Global Competitiveness Index
11. GDP – Gross Domestic Product
12. GoL – Government of Lesotho
13. HIV/AIDS – Human Immunodeficiency Virus and Acquired Immune Deficiency Syndrome
14. HDI – Human Development Index
15. IATI – International Aid Transparency Initiative
16. INFF - Integrated National Financing Framework
17. KPAs – Key Priority Areas
18. LEC - Lesotho Electricity Company
19. LHWP – Lesotho Highlands Water Project
20. LNDC – Lesotho National Development Corporation
21. LSL – Lesotho Loti
22. MAP - Making Access Possible
23. MDAs – Ministries, Departments and Agencies
24. MDP – Ministry of Development Planning
25. MF – Ministry of Finance
26. MPM – Macroeconomic Policy and Management
27. MSMEs – Micro, Small and Medium Enterprises
28. MTDS – Medium Term Debt Strategy
29. MTEF – Medium-Term Expenditure Framework
30. MTFF – Medium-Term Fiscal Framework
31. MTR - Mid Term Review
32. NSDP II – National Strategic Development Plan II
33. PSID – Public Sector Investment Database
34. SA – South Africa
35. SACU – Southern African Customs Union
36. SADC – South African Development Community
37. SADP - Small-holder Agriculture Development Project
38. SOEs – State Owned Enterprises
39. SWAP - Sector Wide Approach
40. TB – Tuberculosis
41. UN - United Nations
42. UNDP – United Nations Development Programme
43. USD – United States Dollar
44. WASCO - Water and Sewage Company
45. ZAR – South African Rand

ACKNOWLEDGEMENT

The 2022/23 – 2024/25 Budget Strategy Paper is part of the annual planning process, which facilitates the preparation of the 2022/23 – 2024/25 National Budget. The document forms the basis for discussion of the proposed national policies, strategies, and budgetary allocations for the next financial year through the medium-term by various stakeholders at the annual Cabinet Retreat.

The 2022/23 – 2024/25 Budget Strategy Paper follows after the fourth Coalition Government was formed which its main focus is national unity and reconciliation, stability, rule of law, national reforms and stimulation of economic growth.

The current Budget Strategy Paper is prepared during the time when governments are facing social and economic meltdown because of the COVID-19 Pandemic. Therefore, the Government intends to use its spending power during the coming financial year and in the medium-term to intensify efforts towards improving the livelihoods of Basotho.

THABO SOPHONEA (MP)
MINISTER OF FINANCE

1.0 INTRODUCTION

1. **The Ministries of Finance (MF) and of Development Planning (MDP) are mandated to produce the Budget Strategy Paper (BSP) that sets a platform for conversing issues and policy interventions for the upcoming budget year, guided by the National Strategic Development Plan (NSDP) II.** In preparation for the 2022/23-2024/25 BSP, the MF has conducted the 2022/23 Pre-Budget Consultations in four administrative districts namely Leribe, Mohale's Hoek, Qacha's Nek and Mokhotlong. The aim of the consultations was to seek policy direction from the grassroot, make the budget process transparent and inclusive to all stakeholders as well as the general citizens.

2. **The objective of the BSP is to facilitate discussions on policy direction that the Government will take in preparing the 2022/23 -2024/25 National Budget.** The policy direction is in line with the NSDP II and other strategic documents.

3. **The 2022/23 – 2024/25 BSP is designed to foster the recovery from the adverse effects of COVID-19 and ensure resilience to future shocks.** The pandemic has highlighted many longstanding pre-existing vulnerabilities in the economy, such as high public expenditure, low domestic revenue mobilization, low investment, low productive capacity, and high-income inequality, as well as a limited capacity to attract foreign investment. It is therefore necessary for Lesotho to implement measures to help reconstruct the economy in the wake of the COVID-19 pandemic and implement long overdue reforms to shift the economy to a stronger growth path. This will be achieved by reviewing and redefining Lesotho's sustainable development and growth path in the short to medium term to facilitate the post pandemic recovery.

4. **At a time of limited fiscal resources, the strategic thrust for 2022/23 -2024/25 National Budget should be to prioritize high value and high return public expenditures through the implementation of critical PFM reforms and the elimination of wasteful public spending.** The overarching aim is to help catalyse private sector-led growth and job creation and shift the economy away from one of dependence on the public sector. This will in turn boost both economic opportunity and inclusive, sustainable growth and for the betterment of all Basotho.

5. The Paper consists of nine (9) sections, including this introduction. Section II reviews the development context including the opportunities and challenges facing the economy, Section III specifies the key finding of the NSDPII mid-term review, Section IV analyses both the global and domestic economic performance and outlook. The Economic and Fiscal risks are outlined in Section V, while Section VI discusses the policies that the government intends to implement in pursuit of limiting the fiscal risk while ensuring fiscal sustainability. Section VII discusses the strategies and priorities for the 2022/23

Budget. Section VIII reviews the translation of policies into resource allocation, with a conclusion provided in Section IX.

1.1 Working Together for Better Future

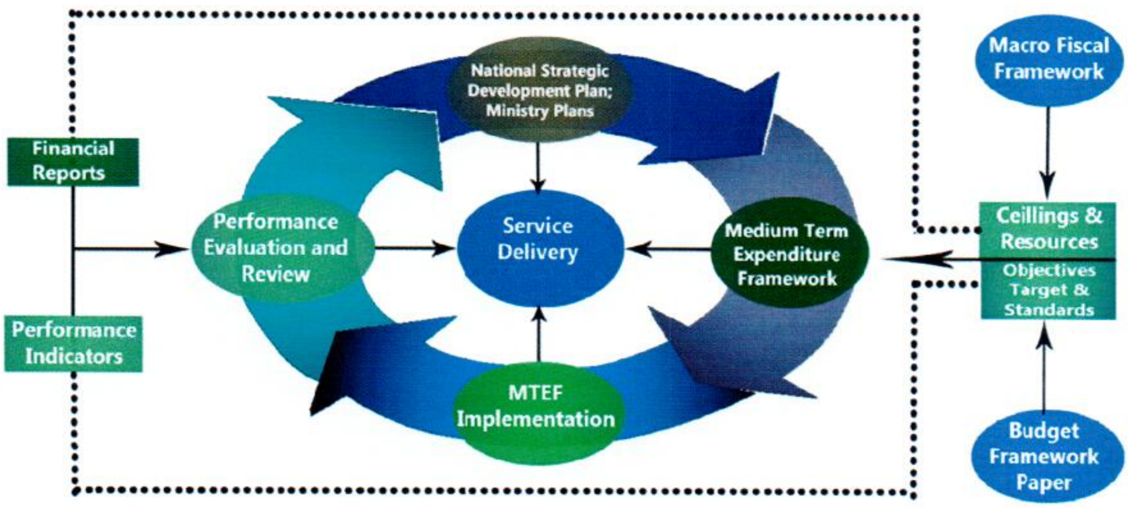
6. **The Government will continue with the implementation of cluster/sector budgeting approach which is anticipated towards achievement of improved service delivery.** The goal is to implement government's integrated planning, while improving decision-making and service delivery through proper coordination of all government programmes both at national and local government levels. The government intends to incorporate fiscal decentralisation in the Public Financial Management and Accountability Bill in order to improve service delivery.

7. **In the 2022/23 fiscal year, the MF and the MDP will harmonise the clusters/sectors used in budget preparation and in the NSDP II to ensure smooth allocation of resources and proper alignment of national priorities and budget through full implementation of Medium-Term Expenditure Framework (MTEF).** There is a call to include gender and climate-based budgeting in our MTEF in the 2022/23 fiscal year.

1.2 Budget Cycle

8. **The Budget Cycle is basically used to describe the processes that the Government undergo in preparing the National Budget.** Each process is valuable and requires careful consideration of the Government fiscus relative to expenditure. Adherence to timelines as contained in the Budget Calendar which has been approved by Cabinet is crucial as delay in achievement of one milestone has a significant impact on the proceeding milestone.

Figure 1 Budget Cycle



1.3 Budgetary Principles

9. **In response to consistent shortfall in cash and foreign reserves as well as the volatile SACU revenues, the depreciation of South African (SA) Rand against major world currencies and its negative impact on the external debt stock and strong recurrent expenditure growth which have put pressure on budget deficit, the Government will continue to adopt the following principles which will underpin and guide the 2022/23 – 2024/25 Budget:**
   - i. Adopt a Budget that is affordable, sustainable, and yet responsive to the needs of the country over the medium-term.
   - ii. Adopt austerity measures to control and curb expenditure waste.
     - a. Over the medium-term, bring the overall fiscal deficit to below 3 percent of GDP consistent with long-term GDP growth.
     - b. The Government's expenditure on wage bill should not grow as a share of GDP and must be reduced over the medium term alongside measures to streamline the civil service.
     - c. Consistently constraining the Government's recurrent expenditure not to grow more than the development expenditure.
   - iii. Improve monitoring, transparency, and accountability mechanisms to ensure expenditure efficiency.
   - iv. Prioritise the elimination and curtailment of accumulation of arrears.
   - v. Expand domestic revenue mobilization to reduce reliance on volatile and shrinking transfers from the Southern African Customs Union (SACU).
     - a. Introduce reforms, as needed, to broaden the tax base, boost taxpayer compliance, and improve revenue administration
     - b. A realistic degree of predictability with respect to the level of tax rates and tax bases shall be maintained, considering any future tax reforms.
   - vi. Over the medium-term, the Government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure.
   - vii. Expand the sources of public debt financing to enable the Government to restructure its public debt portfolio and to better facilitate the financing of deficit; and
   - viii. Achieve consistency of the Medium-Term Fiscal Framework (MTFF) and MTEF to the national priorities, efficiency, effectiveness, and value for money in public expenditure.

2.0 DEVELOPMENT CONTEXT

2.1 Background

10. **The achievement of Lesotho's development agenda will depend on the extent to which the Government, development partners, Civil Society Organizations (CSOs), the media, private sector, and communities work in partnership to address various challenges that have faced the country for decades.** The 2022/23–2024/25 Budget Strategy Paper is developed against the background of a difficult financial and socio-economic environment which will require strict prioritization of budget allocations and implementation.

2.2 Persistent Poverty and Inequality

11. **Lesotho has one of the highest poverty rates in the Southern African Development Community (SADC) region.** The level of poverty in Lesotho was 56.6 percent in 2002 and dropped to 49.7 percent in 2017. Poverty is higher, at 60.7 percent, in rural areas than in the urban areas and it is disproportionately affecting female headed households, with a poverty level of 55.2 percent, than male headed households at 46.3 percent. In 2017, 27.3 percent of Basotho were poor, living below the international poverty line of US$1.90/day (in 2011 PPP terms). Throughout the 15-year period (2002-2017) there was a slight improvement in poverty levels in the urban areas, which fell from 41.5 percent to 28.5 percent while poverty persisted in the rural areas adding to an already large rural urban divide.

12. **Poverty fell in four out of six regions. The Rural Mountains and Rural Senqu River Valley experienced poverty increase. For instance, 67.8 percent of Basotho living in Rural Mountains were poor in 2017-an increase of 10.9 percentage points from 56.9 percent recorded in 2002.** This shows that poverty will continue to be a rural phenomenon in the near future if developments are still focused only in urban areas. A profile of Lesotho's poor shows that poverty levels are highest among female-headed households, especially those headed by single women, who are less educated, unemployed and the caretakers of large families and children. This implies acute vulnerability and increased risk of food insecurity in female-headed households.

13. **There are high poverty levels despite huge investments in the social sectors that the Government, with the support from its development partners has made and is continuing to make.** This points to the need to better interventions that are sustainable and will make a significant impact on reducing poverty. Food insecurity is also very high, with 179,000 and 720,000 households in urban and rural areas respectively, registered food insecure in March 2020 and likely to have increased significantly due to COVID-19.

14. **Inequality has declined to a Gini coefficient of 44.6 percent in 2017/18 fiscal year from a Gini coefficient of 51.9 percent in 2002/03 fiscal year.** The improvement is due to expansion of the social protection programs and an increase in wage incomes among the poor. Lesotho spends 4.5 percent of Gross Domestic Product (GDP) on social protection programs, against the below 2 percent in other African countries or lower middle-income countries. Despite this improvement, Lesotho remains to be one of the 20 percent most unequal countries in the world.

2.3 Rising Unemployment

15. **Unemployment is high at 22.5 percent and even higher among the Youth at 29.1 percent.** The unemployment challenge is exacerbated by a small private sector. Its competitiveness has been limited

by skills mismatches and lack of entrepreneurship programs for growth-oriented businesses. The labour market performance remains disappointing due to relatively high levels of unemployment estimated at 22.5 percent (males 22.6 and females 22.2)[1]. Unemployment incidence is higher among youth population, estimated at 29.1 percent (males 27.4 and females' 31.1 percent). Employment in the manufacturing sector is likely to be affected as a result of the negative impact of COVID-19 epidemic. The hospitality, food and beverages sectors have suffered from reduced trading hours particularly accommodation, alcohol and beverages sub-sector.

16. **The unemployment is exacerbated by a small private sector. Its competitiveness has been limited by skills mismatches and lack of entrepreneurship programs for growth-oriented businesses.** The NSDP II seeks to foster job creation and inclusive growth and further reduce poverty. The plan targets gradual economic growth, from 0.4 percent in 2017/18 to about 5 percent projected in 2022/23 and creation of 49,000 private-sector jobs within the plan period. For this to be realised, the Government must ease regulations governing business and access to finance. However, the anticipated economic growth is likely to be affected by COVID-19, which has negatively impacted the global economy.

2.4 International Competitiveness

17. **Currently, Lesotho ranks 131 out of 140 countries in the Global Competitiveness Index (GCI) and 122 out of 190 countries with a score of 59.4 on the Ease of Doing Business in 2019**. Lesotho's international competitiveness ranking is low in comparison to other SACU countries in both Global Competitiveness and Ease of Doing Business Rankings. Lesotho's economy is highly dependent on trade, making it particularly vulnerable to international and regional shocks. To reduce this vulnerability, Lesotho must diversify into new economic activities and remain competitive in the region and beyond.

Table 1: International Competitiveness of SACU Countries, 2019

Country	Global Competitiveness Ranking	Ease of Doing Business
South Africa	60	84
Botswana	91	87
Namibia	94	104
Eswatini	121	121
Lesotho	**131**	**122**

Source: 2020 Global Competitiveness Report and World Bank Ease of Doing Business Report

2.5 Private Sector Development

18. **In Lesotho, the private sector is small and crowded out by a large government sector.** Development is hindered by multiple factors such as inadequate enabling policy frameworks and regulatory environment, poor functioning business development services, scarcity of domestic capital

[1] BOS Labour Force Survey 2019

markets, and weak private sector organisations. However, the potential is there for the sector to develop competitive and outward-looking entrepreneurs focusing on value addition for exports.

2.6 Human Development

19. **Lesotho continues to experience low levels of Human Development as compared to other developing countries in the region**. The country ranks 165 out of 189 countries on the 2019 UN Human Development Index (HDI), falling into the category of low human development with a score of 0.527. Lesotho is ranked the lowest among all SACU countries. There are high levels of communicable and non-communicable diseases, and the HIV/AIDS epidemic has had a devastating impact on the country, its economy, social structure and capacity of families to care for themselves and the situation will be worsened by the COVID-19 pandemic.

Table 2: Human Development Index of SACU Countries, 2019

Country	HDI Rank	HDI Value	Life expectancy	GNI Per Capita
Botswana	94	0.728	69.3	15,951
South Africa	113	0.705	63.9	11,756
Namibia	130	0.645	63.4	9,683
Eswatini	138	0.608	59.4	9,359
Lesotho	**164**	**0.518**	**53.7**	**3,244**

Source: 2020 UN Human Development Report

20. **The prevalence of HIV/AIDS is estimated at 25.6 percent among the adult population aged 15-59.** Furthermore, Lesotho remains on the WHO list of the 30 high TB burden countries in the world with an estimated annual incidence of 654 TB cases per 100,000 population in 2019, although this is a reduction from 665 TB cases reported in the WHO Global TB report of 2018. The TB/HIV incidence rate is at 398/100,000 and has declined from the 2018 incidence which was at 470/100,000. The mortality rate in TB/HIV co-infected patients is 155 per 100,000 populations (Global TB Report, 2019). The Sustainable Development Goal (SDG) 3 target to end both TB and HIV with ambitious targets of 90/90/90 were set to necessitate a strengthened and resilient health system.

2.7 Natural Disasters and climate change

21. **In recent years, Lesotho has been experiencing some recurrent and extreme natural disasters that are predominantly weather related and are as a result of a change in climatic conditions**. The most common natural disasters Lesotho is prone to are draughts, floods, and storms. Since most of the rural population depends on agriculture for livelihood, these natural disasters impede food production and exacerbate poverty among the rural population.

22. **Environmental degradation also represents a great threat to poverty reduction and to achieve NSDP II development objectives.** In the past ten years, Lesotho has experienced successive climate shocks such as

recurrent droughts, dry spells and floods which have negatively affected communities and households' livelihoods, with serious consequences for people's food security. The convergence of multiple vulnerabilities in Lesotho has created a complex risk profile, in which poor households and communities are continually exposed to a wide range of economic, health, environmental, income and climate risks and shocks. This exacerbates vulnerability among the poor and rural communities who tend to have lower coping capacities. Lesotho should strengthen its efforts to implement the climate change adaptation and mitigation strategies in order to lessen the effects of climate change.

23. **Increased use of natural resources for farming, grazing, and fuel has resulted in high environmental degradation, presenting both economic and governance challenges.** Access to grazing land fuels communal conflicts, particularly during periods of drought. Arable land suitable for agriculture is below 9 percent (279,773 hectares) of total land area (3 million hectares). Annual depletion of natural resources is estimated at 4.6 percent of gross national income and the country loses at least 2 percent of its topsoil annually due to erosion. About 66 percent of households live on degraded land which represents a direct challenge to agricultural production and food security.

2.8 Persistent Political Challenges

24. **Political developments in Lesotho have been marked by cyclic instability and insecurity.** The Ibrahim Index of African Governance (2019) ranks the country 16 out of 54 countries with a score of 57.1. The collapse of three successive coalition governments and three national elections between 2012 and 2017, demonstrate the extent of Lesotho's political volatility.

25. **Lesotho slipped in the ranking on the Corruption Perceptions Index from 78 (2018) to 85 out of 180 countries (2019).** This political climate has created a politicised public service with low public service delivery, poor accountability, and transparency. The efforts for economic growth, employment creation and poverty reduction have been undermined by increased political instability in the country.

2.9 Increasing Demand for Social Protection

26. **Lesotho is experiencing increasing demand for social safety nets from the poor and vulnerable groups such as orphans and people with disabilities, particularly those living in the rural areas**. With increased poverty, food insecurity, negative effect of climate change and COVID-19, many people will continue to need and demand social protection services and empowerment. It is, therefore, important to have a sustainable financing of social safety nets as a means of income for the vulnerable groups in the country.

27. **There is increasing evidence that social protection not only reduces poverty among direct beneficiaries and their households, but it also improves wealth distribution and economic growth within local communities**. This makes comprehensive social protection an attractive policy instrument for both social protection and economic point of view. It also enhances human dignity, social cohesion, and political stability.

2.10 Human trafficking

28. **The U.S. State Department's Office for Monitoring and Combating Trafficking in Persons has ranked Lesotho in "Tier 2 Watch list" in the 2021 Trafficking in Persons Report.** Lesotho has seen some improvement in the rankings of trafficking in persons. In 2021, Lesotho moved to Tier 2 Watch list from Tier 3 in 2020 in trafficking in persons. The improvement came at the back of enactment of a new anti-trafficking law and passing of a 2021-2026 anti-trafficking national action plan.

2.11 Declining Donor Support

29. **There is a decline in support from development partners which hampers support for development and social programs**. Following the global financial crisis of 2007-2008, there have been changes and shifts in the development finance landscape for most developing countries. This is due to changing international priorities such as climate change, increasing incidences of natural disasters and conflicts – which means that traditional sources of aid may well become scarcer. These changes and shifts meant that developing countries have been obliged to seek alternative opportunities and options to access finance for their investment priorities. This implies that it may no longer be possible to depend largely on traditional sources of finance. Lesotho is no exception, particularly as it is widely acknowledged that traditional sources will not be enough to meet the financial needs of development agenda, which may require huge amount of funds.

30. **The decrease of external assistance inflows observed in 2015 represented a 10-year low of US$120 million compared to 2014 inflows.** Given that external development assistance continues to play an important role in the development, such reduction of aid had an impact on development in Lesotho. For instance, the fall of donor support impeded the realization of some NSDP I strategies and goals. In 2017 the external assistance inflows increased more than two-fold as compared to 2016. This apparent increase may be due to using data from International Aid Transparency Initiative (IATI) as opposed to the Public Sector Investment Database (PSID).

31. **In this context, the Government with the support from the development partners has commissioned the Development Finance Assessment (DFA) study, to map the major financial**

development resources and outline the Integrated National Financing Framework (INFF). DFA, a conceptual model and methodology developed by UNDP, provides the snapshot of development finance, looking over a longer period of time and also assesses the development support infrastructure in the country, ultimately leading to the development of INFF, which should contribute to the better mobilisation of development finance and point out the areas where the Government and development community may achieve the best results in an effective and efficient way.

32. **The Government of Lesotho is at a final stage of completion of DFA exercise.** The findings of DFA are expected to among others inform GOL on possible avenues for domestic resources mobilisation and inform review of NSDP II Financing Strategy.

2.12 Financial Sector Development and Financial Inclusion to Promote Private Sector Development and Help the Recovery

33. **Financial sector development and access to a broad range of quality financial services for the private sector particularly the MSMEs is vital for employment and inclusive growth.** Specifically, NSDP I identified increasing financial inclusion and access to credit as priorities meant to kick start the productive sectors in the economy. A liquid, stable, competitive, and efficient inclusive finance sector is a necessary precondition for expanding agricultural production, eliminating financial constraints faced by several micro and small enterprise operators in manufacturing, tourism, and other growth sectors. Such finance would enhance their expansion thereby creating employment and increasing household income in a sustainable manner. Further, the provision of financial services, particularly to the excluded, would increase income in the wider economy by mobilizing savings and providing loans, which can be used to support the creation and expansion of small business in urban and rural areas. To reduce barriers to credit to the MSME sector, the Central Bank of Lesotho launched the collateral registry aimed at lessening collateral requirements for small businesses seeking credit in which different forms of assets can be pledged as collateral in accessing productive credit.

34. **Evidence- based research is very crucial to facilitate for responsive interventions through development of policies aimed at improving the functioning of financial markets; designing product strategies around the segmentation and trends highlighted by the data; and assisting donors and non-governmental agencies who wish to support increased financial inclusion to specific regions or population groups.** The Ministry of Finance in partnership with the Central Bank of Lesotho, Bureau of Statistics and FinMark Trust conducted the FinScope 2020 consumer survey which provides insights into the financial needs, preferences, and behaviours of people. Post analysis findings of the study are expected to provide useful insights of consumer financial needs and preferences beneficial to the supply side for optimal use as they develop their business strategies and

design new products and services. The Ministry also conducted a Making Access Possible (MAP) refresher 2020. MAP is a supply side diagnostic study. The refresher study intended to review the implementation of the 2014 diagnostic and milestones achieved by the National Financial Inclusion Strategy 2017 – 2021 considering key changes brought upon by different interventions in the financial sector.

35. **A correct and effective linkage of financial inclusion to the real economy is paramount in the quest for poverty reduction and improved livelihoods.** With respect to this, three scoping studies; Agricultural finance, MSME finance and Access to Basic Services through digitization were conducted to understand the challenges and enhance through conducive policy and infrastructure frameworks, delivery of products and services to consumers to support these sectors.

36. **For the current BSP, the Ministry plans to support the microfinance sector through finalisation of a Microfinance Policy and Financial inclusion Strategy,** which both aim to advocate for digitisation of financial services and support agriculture and green value chains including intensifying efforts to link financial sector to the real economy, provide capacity in microfinance MSMEs products and services development to the financial sector and strengthen the sector on corporate governance for continued and sustainable delivery of quality financial services.

3.0 KEY FINDINGS OF THE NSDP II MID-TERM REVIEW

3.1 Key Priority Area (KPA) I: Enhancing Inclusive and Sustainable Economic Growth and Private Sector-Led Job Creation

37. **Under this KPÅ, the Mid-Term Review (MTR) indicates that some progress has been realised in some sectors.** In the agriculture sector, data for 2018/19 shows that realised yields for sorghum and wheat for that year (0.6 and 1.04 respectively) exceeded the NSDP II targets (0.94 respectively). However, the same cannot be said for maize, where the realised yield (0.8) fell short of the target (0.89).

38. **In general, the SADP I facilitated the completion of several interventions that have driven some progress with particular reference to agricultural development, including access to critical financing and training.** The recognition of this is likely one of the reasons why SADP II is also included as an Objective 1 intervention under Priority Area 1 in the Government's 2020/21 – 2021/22 Strategic Framework. The project therefore offers a potential vehicle for success that can be expanded

on going forward through the continued implementation of SADP II, while also possibly functioning as a template to secure progress in other focus areas.

32. **Under manufacturing, the share of textiles, clothing, footwear, and leather as a proportion of manufacturing increased in 2019/20 to 13.8peDrcent, higher than both the target for the same year (10.2percent) and the baseline (11.4percent).** This proportion is a concern because it indicates that diversification in manufacturing sector is on a downward trajectory.

3.2 Key Priority Area (KPA) II: Strengthening Human Capital

32. **Under KPA II, in order to build human capabilities within the country, it is important to institute relevant forms of investment in health, nutrition, education.** This investment, in turn, will support the productive sectors and ultimately facilitate the achievement of job creation and inclusive economic growth through skills development. It is through this lens that an analysis of the implementation progress made towards NSDP II was made. After considering the available data and information related to this pillar, limited progress was made in some isolated areas.

33. **During the indicator analysis, it was revealed that focus areas such as Education and Skills Development, Health and Nutrition are characterised by either the absence of the requisite data needed to measure implementation progress, or information that indicated regression instead of progress.** In addition, there were instances identified where new Strategic Objectives (SOs) were included within the progress reports received from the ministries and are being pursued by the responsible entities, sometimes at the expense of the existing NSDP II interventions.

34. **Under social protection, in 2019/20, the percentage of households receiving Public Assistance that are in poorest two quintiles of the population were 64percent which is higher than target for the year and the baseline (both 56percent).** This indicates that this metric on track in contributing towards the success of NSDP II.

3.3 Key Priority Area (KPA) III: Building Enabling Infrastructure

35. **Lesotho requires a minimum infrastructure base which, if in place, will create a foundation and incentive for private sector investment in the economy.** Infrastructure has both a direct (through capital accumulation) and indirect (through raising total factor productivity gains) impact, while investments in infrastructure also have the role of facilitating private investments by lowering production costs and opening new markets, with the consequence of creating new production, trade, and profit opportunities. Effective infrastructure is therefore regarded as a key enabler for economic growth in light of its ability to enable trade, empower businesses and industries, and facilitate

movements between and connections to communities and their associated opportunities for goals such as employment, health care, and education.

36. **Based on these priorities, the available IO indicator data and information related to this KPA was canvassed to determine the extent to which progress in the implementation of NSDP II is being made.** Consequently, it is evident that no overall progress has been made under this KPÅ. Specifically, the MTR revealed that data and information was not available for any of the indicators under this KPÅ, which prevented a critical analysis of progress from being made.

3.4 Key Priority Area (KPA) IV: Strengthening National Governance and Accountability

37. **The weaknesses in Lesotho's institutional infrastructure and accountability mechanisms, if left unaddressed, can adversely affect the pursuit of socioeconomic outcomes, while also acting as impediments to potential foreign and domestic investment**. As a result, it is necessary to ensure that public sector management and administration is strengthened with a focus on accountability and responsiveness to citizens' needs, and these are some of the reasons why aspects such as governance, the rule of law, and credible leadership must be pursued and institutionalized to be a part of NSDP II's implementation. In recognition of this, two Results/Outcome indicators were specified for NSDP II.

38. **With respect to corruption, the Corruption Perception Index revealed that Lesotho obtained a score of 40 points for 2019/20.** This is below the target for the same year (44) and the baseline (42), while also being lower than the score realized in the previous year (41). Further, the country's Overall Governance Score defined within the Ibrahim Index of African Governance decreased markedly in 2019/20 with a score of 52.2percent against a target of 57.3percent. Based on the analysis of the progress made towards NSDP II implementation using these indicators, it is evident that the country has experienced a regression in its governance and accountability metrics. These findings suggest that urgent action needs to be taken to ensure the significant socioeconomic costs associated with corruption and weak governance are eliminated through political will and sustained action so that the country remains on track. It is clear that the GOL recognizes this point as it has prioritized KPA IV for the remaining two years of the NSDP II.

3.5 CROSSCUTTING ISSUES

39. **The cross-cutting topics of environment and climate change are seen as integral components of NSDP II, particularly given Lesotho's heavy reliance on climate-vulnerable sectors such as agriculture, water resources, and biodiversity to maintain livelihoods**. Youth and children-related issues are also cross-cutting, as they comprise a large segment of the population; while there is broad recognition that gender equality must be ingrained in policies, frameworks, and practical

implementation activities towards achieving transformation and development. Accordingly, sector impact indicators were specified to measure the progress made towards the mainstreaming of these issues into NSDP II policy and programming, and an assessment was made of these as part of the MTR. This assessment found some isolated instances of progress, which is listed below.

40. **Under environment and climate change, Lesotho's forest area as a proportion of total land area declined in 2019/20 to 1.6 percent.** This proportion is notable because it is not only below the targeted level for the same year (1.73 percent), but also below the baseline measured in 2015 (1.63 percent). While the significant reliance that some populations of the country have on biomass as a source of energy likely strongly accounts for decrease noted, the finding nevertheless represents a regression that, if not addressed, will not bode well for Lesotho's forestry.

41. **Under youth development, youth unemployment experienced an improvement during the year 2017/18, with 27.4 percent of Males and 31.1 percent of females unemployed, when compared to the higher baseline figures of 29 percent and 34 percent respectively.** The fact that targets were not specified prevented the Review from acquiring a more substantive picture of progress. Nevertheless, the decline in youth unemployment noted is consistent with the decline noted earlier in the Review with total unemployment over the same period.

42. **Under Investment Climate Reforms, Mining and Financial Sector Development, the mining sector growth rate of 14.11 percent exceeded the NSDP II baseline of 8.6 percent.** Secondly, in the following year, mining sector growth experienced a sharp contraction (-9.4 percent), a significant underperformance when compared to the targeted growth rate for that year (9 percent). Thirdly, although the mining sector experienced a resurgence of sorts in experiencing a much smaller contraction of -0.69 percent in 2019/20, this is also still a significant underperformance when compared to the target for the same year, 9.5 percent.

43. **Mineral revenue for 2019/20 was 342 million Maloti, which is significantly lower than the NSDP II target (528 million Maloti), while also being below the baseline (371 million Maloti).** These findings suggest that the sector is experiencing severe volatility that can be partially accounted for by weak macroeconomic conditions and the negative impact of COVID-19.

4.0 MACROECONOMIC TRENDS AND OUTLOOK

4.1 Background

44. **Lesotho's economy has been confronted by challenging economic outlook even before the pandemic hit. For several years, growth has been subdued, reflecting long-term structural bottlenecks and a weak regional environment.** Private-sector growth has been disadvantaged by political instability, crowding out by the big public sector, reluctance of the financial sector to provide financing, and skills mismatches in the labour force. Unemployment on the other hand, particularly among the youth, remains high and poses a major challenge. Health systems remain poor, as the population also suffers from one of the highest rates of HIV infections in the world. Farming practices remain traditional and agricultural production continues to subsistence and rain-fed.

4.2 Socio-Economic impact of COVID-19

45. **The COVID-19 pandemic has caused an extraordinary health and economic crisis.** It brought severe hardships including massive job and income losses, food insecurity particularly to poor and vulnerable communities, fuelled by trade and travel restrictions across the borders. Production and supply chains have been disrupted by travel and trade restrictions.

46. **In a struggle to limit the spread of the pandemic, Lesotho Government grappled with a difficult task of balancing the positive effects of lockdowns alongside economic costs of the lockdowns imposed on low-income and food insecure households.** In the case of South Africa, the lockdown policies were somewhat tough, and the economic impact was big.

47. **The decision to lockdown South Africa had resulted in most borders between Lesotho and South Africa being shut down.** This left many people cut off for supplies while all business and recreational facilities remained closed for the duration of lockdown. (Lesotho imports about 85 percent of its consumer goods and services from South Africa). Movement restrictions between Lesotho - RSA borders had resulted into disruption of local supply chains. This also increased food insecurity among households both living in the rural and urban arrears. The lockdown in South Africa and closure of borders also had a knock-on effect on remittances destined for Lesotho.

4.3 Real Sector Developments

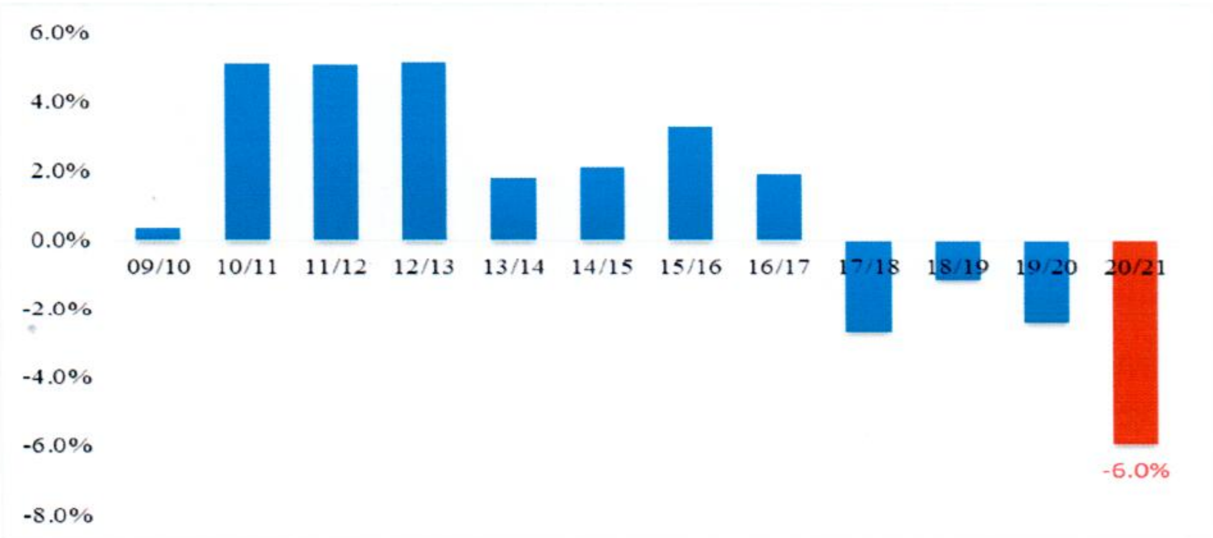
48. **The 2020/21 GDP growth has been revised down to -6.0 percent from previously projected 2.0 percent at the time of the 2020/21 Budget speech**, mainly reflecting weaker domestic demand and total investment, exports and global growth coming from COVID-19 health and economic shock.

Table 3: Selected Economic Indicators

	2019/20 Act.	2020/21 Est.	2021/22	2022/23 Projection
Nominal GDP (million Maloti)	**33,237.5**	**31,643.5**	**36,146.2**	**39,156.0**
Real GDP (% growth)	-2.4	-6.0	3.3	3.0
Inflation	5.2	5.0	5.2	5.4
Official reserves (months of imports)	4.1	4.7	4.4	4.0
Debt to GDP	46.4	50.7	47.5	48.3
GDP Deflator	3.1	4.3	5.1	5.0

The economy suffered two lockdowns as a result of the pandemic, which have severely disrupted the economic activity in 2020. In 2019/20, growth was estimated to have contracted by 2.5 percent from a yet another disappointing growth of -1.1 percent in 2018/19. A contraction of 6.0 percent is projected for 2020/21, driven by the adverse effects of the shutdown and scaling-down of economic activity in the textiles industries, mining, transportation, and accommodation and food services sub-sectors to be precise. The textiles industry, which remains the largest private sector employer, already faces competitiveness pressures and was further clogged by supply chain disruptions, as well as capacity constraints imposed by the national lockdowns. On the other hand, economic contractions in South Africa and the US had dampened diamonds and textiles exports. Construction activities related to the second phase of the Lesotho Highland Water Project (LHWPII) were also delayed due to the lockdowns, disruptions to input supplies, and flooding.

Figure 2: Domestic Economic performance (FY09/10 – FY20/21)

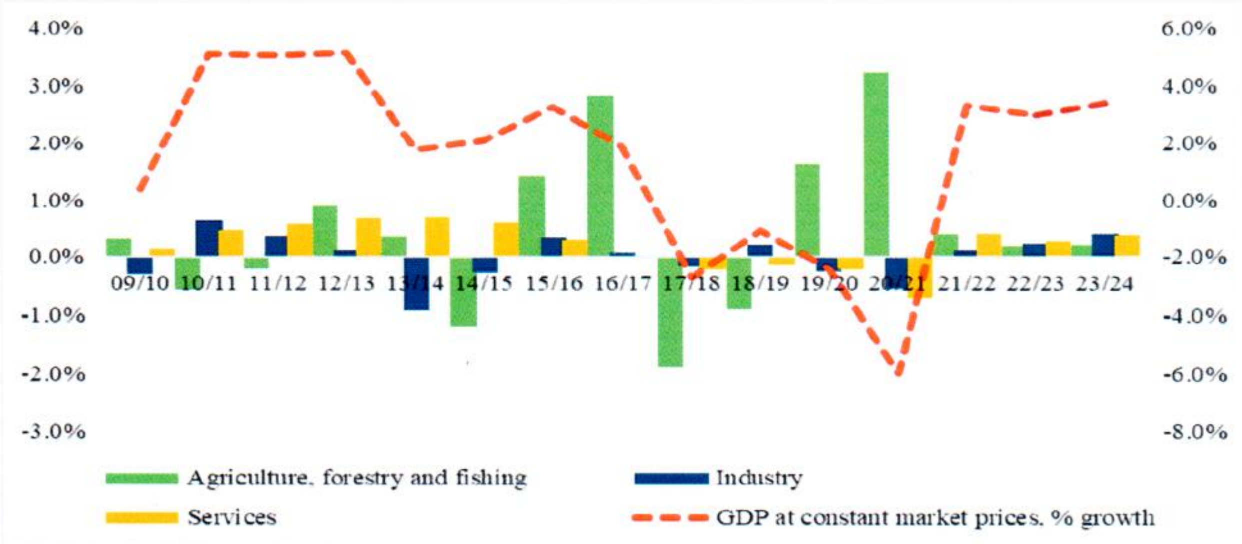


4.4 Macroeconomic Prospects for 2021/22 and Medium Term

49. **Beyond 2020/21, the recovery is projected to be solid with risks sloped to the downside. Growth is expected to recover to 3.3 percent in 2021/22 assuming the virus will be contained domestically**

during 2021/22. Pace of recovery in SA and the US, which is expected to be gradual, will be a key determinant of Lesotho's recovery. While major sectors will grow in 2021/22, with mining and textiles benefiting from recovering global demand and supply chains and resumption of construction activities related to LHWP-II and other delayed or postponed government investment projects, real GDP is expected to average 3.0 percent in 2022/23 before expanding to 3.4 percent in 2023/24.

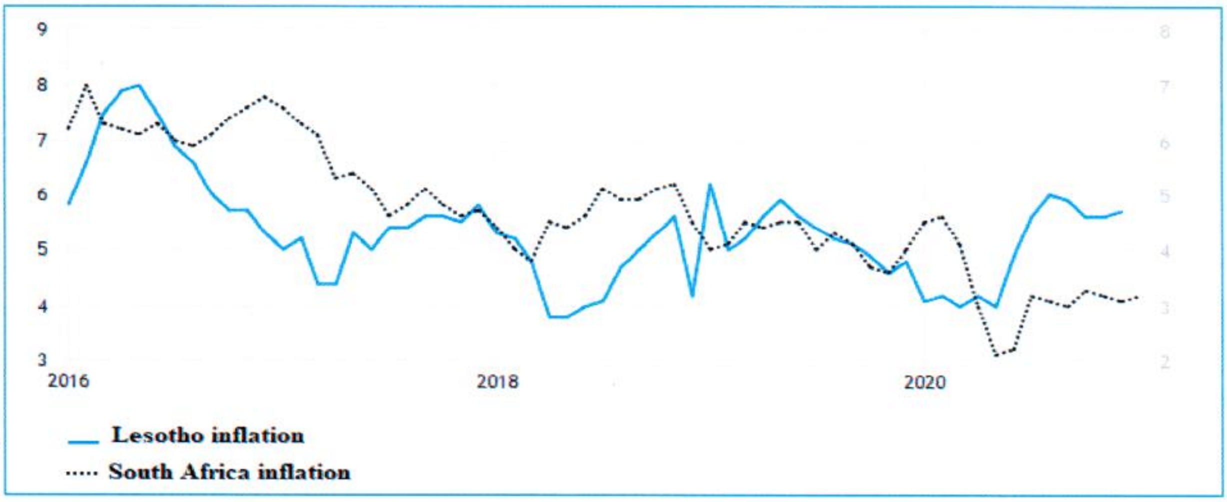
Figure 3: Domestic Economic performance and outlook



50. **Inflation in Lesotho is expected to be driven by price developments in SA, which remains the primary source of the country's imports.** The annual inflation rate is expected to average 5.2 percent in 2020/21. During the first three quarters of 2020, inflation outcomes averaged 4.8 percent driven by accelerating food prices and clothing and footwear. Food prices remained the key inflationary drivers during the period. In last quarter of 2020, inflation decelerated to 5.9 percent from 6.0 percent observed in previous month. For the remaining months of the year, inflation is expected to remain elevated due to high food prices and supply chain disruptions.

51. **In 2021/22, inflation rate is expected to average 5.5 percent before accelerating to 5.7 percent in the medium-term.** Food prices will continue to drive inflation due to the importance of food prices in the overall CPI basket. On the flip side, weaker aggregate demand and steadying of supply chains and normal delivery of consumer goods anticipated in the medium-term could counter the inflationary pressures.

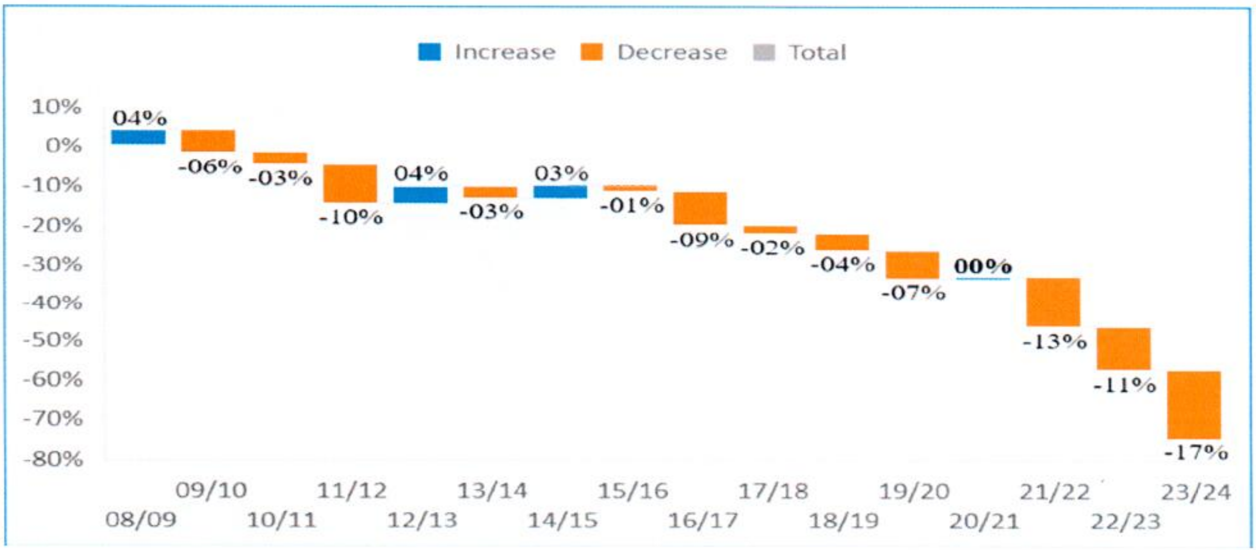
Figure 4: Annual inflation and outlook (%)



4.5 Fiscal Sector Developments

52. **Following an estimated fiscal deficit of 7.3 percent of GDP in 2019/20, the fiscal position is likely to improve in 2020/21 due to reduced government spending following COVID-19 related lockdowns coupled with temporary SACU windfall.** Overall fiscal balance is expected to record a surplus of M153.3 million which is equivalent to 0.5 percent of GDP. In 2021/22 through the medium term, the overall fiscal deficit is set to remain elevated and average 13.8 percent of GDP as SACU revenue is projected to fall significantly coupled with higher general government spending expected over the medium term.

Figure 5: Overall fiscal balance (FY08/09 – FY23/24)

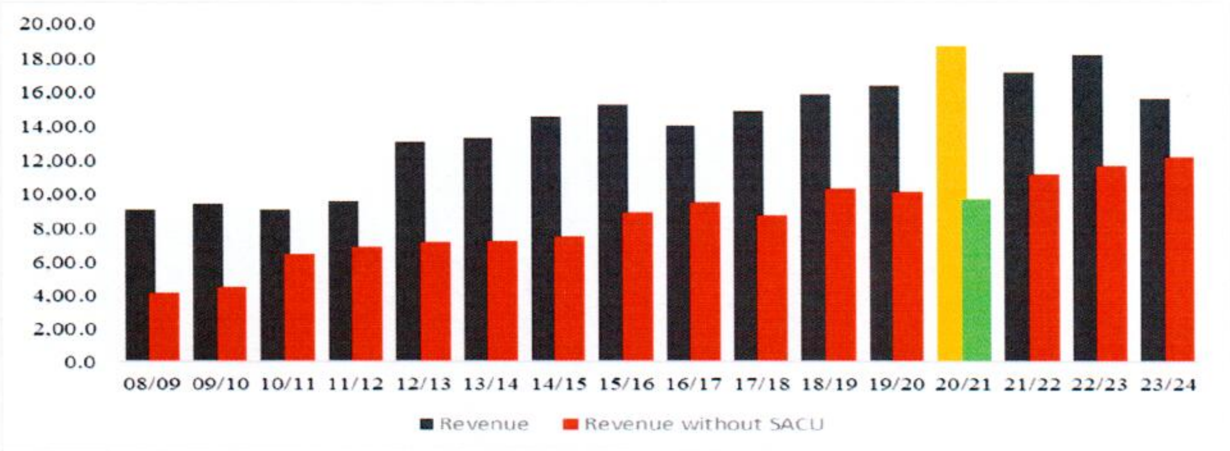


4.6 Revenue

- Tax revenue for 2021/22 is projected to contract by 8.0 percent compared with 2020/21 and M48.1 million lower than the 2021/22 budget speech estimate.
- A slow recovery in revenue is expected over the medium term. The tax-to-GDP ratio expected to be 20.2 in 2021/22 and averages 19.2 percent over the medium term.
- SACU revenue is expected to fall in 2021/22 and pick up in 2022/23 then plummet in 2023/24

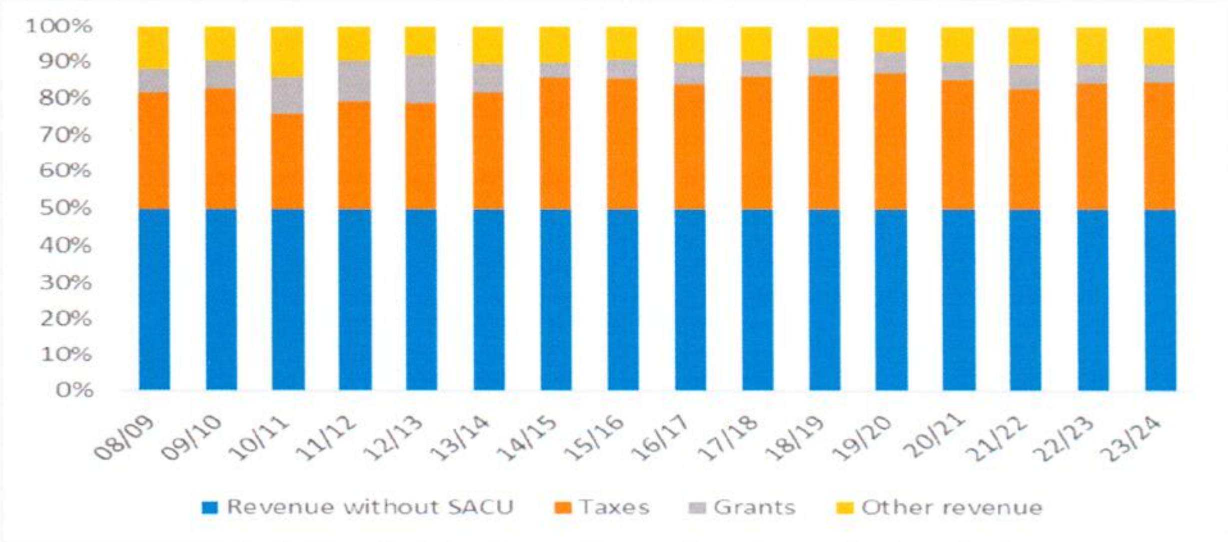
53. **SACU windfall received in 2020/21 offered a huge challenge to the fiscal operation in the medium term especially when there is potential for decline in member States shares beyond 2020, but the prospect attached to it was noticeable when tax revenue and other revenues were underperforming due to COVID-19 lockdowns.** While this windfall could have been used to build buffers to take care of expected shortfall in the future year, it fed higher public wages and other recurrent spending, which are not easy to reduce when SACU revenues fall. SACU revenue recorded a windfall of M2,627.5 million.

Figure 6: Total Revenue vs Revenue without SACU (FY08/09 – FY23/24)



54. **For fiscal year 2020/21 total revenue without SACU collected amounted to M9,718.9 million reflecting a reduction of M467.4 million from the 2019/20 collection.** This disappointing performance in domestic revenue was attributed to economic meltdown resulting from COVID-19 lockdowns. However, in 2021/22, domestic revenue performance is expected to improve as economic activity gets to normality. Domestic revenue is expected to grow by 15.2 percent. Nevertheless, total revenue including SACU is expected to slow to M17,205.7 million from M18,699.4 million recorded in 2020/21. The expected poor performance in total revenue is directly linked with decline in SACU revenue which fell by a staggering M2,972.8 million compared with the previous year's receipt.

Figure 7: Domestic Revenue performance and outlook



4.7 Expenditure

55. **The public sector spent a combined M18,182.5 million in 2020/21, a substantial M6,067.8 million was spent on compensation of employees, while M2,978 million was spent on use of goods and services.** However, the total public sector recurrent spending fell in 2020/21 by M85.6 million (0.61%) against the previous year. The reduction was mainly due to proposed consolidation measures implemented that year.

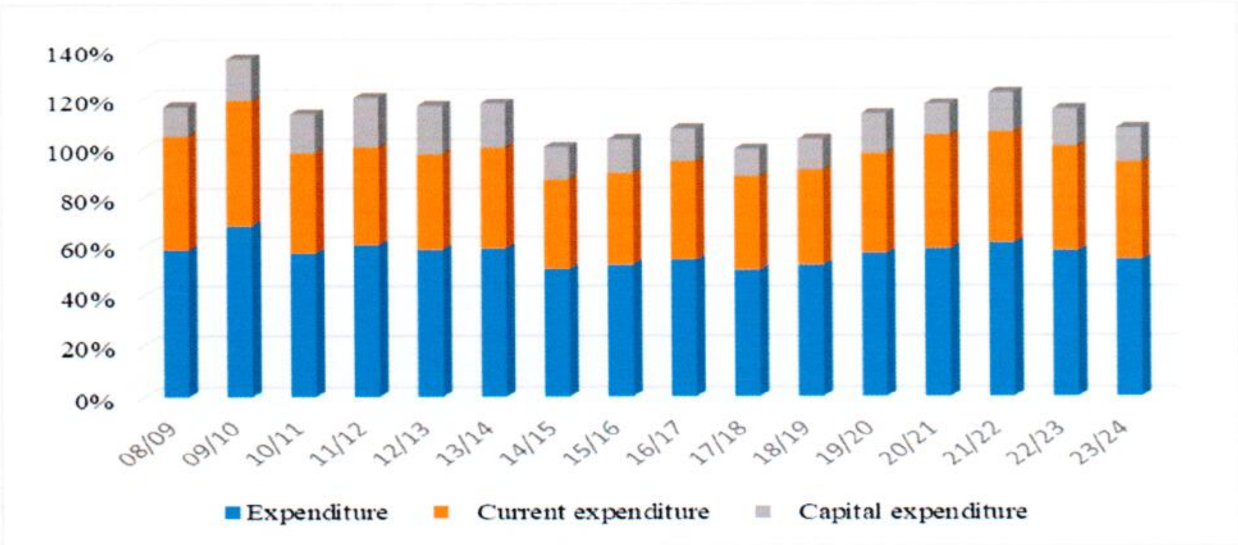
Figure 8: SACU revenue – Government spending relationship

56. **The 2021/22 budget was set to reach M23,774.7 million.** This mirrors a 0.1 percent (M12.5 million) decrease from last year's budget. However, this year's budget was premised on projected capital

spending of M5,737.7 million (24.1%) of the total budget, while recurrent spending was estimated to account for 75.9 percent (M18,037.0 million).

57. **Th overall fiscal deficit is projected drastically deteriorate from an observed surplus of 0.5 percent of GDP (M158.8 million) in 2020/21 to 13.1 percent of GDP (M4,784.9 million) this year** (budget speech 2021/22 Annex Table III**).** The fiscal deficit is set to worsen over the medium term while SACU revenue is expected to continue to disappoint.

Figure 9: Expenditure performance and outlook



4.8 Implementation of Expenditure Controls and Revenue Management

58. **A highly unstable SACU revenues and elevated expenditures make fiscal discipline hard to maintain;** this state calls for improvements in the expenditure controls and revenue management. A better and improved revenue management is key to reducing Lesotho's dependence on volatile SACU revenues, hence moving away from the current procyclical fiscal policy to countercyclical fiscal policy while at the same time maintaining macro fiscal stability.

59. **With an estimated general government spending of 65.0 percent of GDP and total revenue of 47.2 percent of GDP[i], it is evident that most of the adjustments ought to be made from the recurrent expenditure side**. However, with public administration contributing 20.6 to GDP growth, fiscal consolidation outcomes are likely to result into lower growth of GDP in the medium term, but the longer-term benefits are more plausible considering that the current macroeconomic situation requires long term solutions to achieve NSDP goals and SDGs bench marks.

60. **To ensure appropriate and transparent application of the required fiscal consolidation, the Government has sought IMF support under Extended Credit Facility (ECF) and Extended Financing Facility (EFF) arrangements which are consistent with the objectives of the NSDP**

II. The Government commits to address the shortcomings of the current government led growth model, while focusing on targeted reform actions to maintain macroeconomic stability and strengthening the inclusive growth agenda.

61. The Government will further commit to control recurrent expenditure in order to preserve fiscal space, while at the same time mobilizing domestic revenues. Public service delivery will be at the heart of this endeavour. The adequate level of Net International Reserves (NIR) will be maintained to safeguard the Rand/Loti peg.

4.9 Policy Recommendation

62. **Curb recurrent expenditure while mobilizing domestic revenues to create space for investment spending.**
    a) Aligning Expenditures to Available Resources
    b) Rationalize public-sector employment to generate wage savings
    c) Introduce a price-catalog system to aid lower the cost of government procurement
    d) Review and develop strict remunerations and benefits policies for Parastatals/SOEs.
    e) Removing misallocated and unproductive capital spending
    f) Rationalizing foreign embassies and missions by the end of FY22/23
    g) Reducing the size of the government vehicle fleet and eliminating travel subsidies starting over the medium term
    h) Strengthening the link between the budget releases and cash availability through resuming the cash-flow forecasting exercise at the Cash Management Unit

63. **These policy recommendations, if implemented in the 2022/23 budget, will bring the overall fiscal deficit down from budget estimation of 13.1 percent of GDP to at least 4.0 percent of GDP on average in 2022/23 through the MTEF period.**

Table 4: Fiscal Operations of the Central Government, FY17/18–FY23/24

	17/18 Act.	18/19 Act.	19/20 Act.	20/21 Act.	21/22 Est.	22/23 Proj.	23/24 Proj.
Revenue	**14 914.4**	**15 925.7**	**16 412.5**	**18 699.4**	**17 205.7**	**18 187.8**	**15 651.1**
Revenue without SACU	8 760.2	10 383.5	10 186.3	9 718.9	11 197.9	11 658.1	12 180.2
Taxes	6 314.3	7 528.9	7 501.4	6 778.6	7 292.0	7 905.3	8 324.5
Taxes on income, profits and capital gains	3 487.3	4 313.1	4 052.1	3 716.6	3 578.9	3 725.4	3 935.6
Taxes on goods and services	2 826.2	3 211.7	3 449.2	3 061.9	3 710.4	4 179.0	4 387.7
Grants	822.1	1 076.8	1 255.9	1 049.0	1 590.1	1 296.8	1 311.4
Other revenue	1 623.8	1 777.8	1 429.0	1 891.3	2 315.8	2 456.0	2 544.3
SACU	6 154.2	5 542.2	6 226.2	8 980.5	6 007.8	6 529.7	3 470.8
Recurrent Budget							
Expense	**12 113.0**	**13 102.7**	**13 521.0**	**14 632.4**	**16 301.0**	**16 755.4**	**16 952.6**
Compensation of employees	5 436.1	5 994.7	5 890.6	6 029.7	7 114.9	7 274.7	7 438.5
Wages and salaries	4 932.9	5 469.0	5 425.2	5 501.6	6 412.8	6 565.6	6 722.2
Social contributions	503.2	525.6	465.4	528.1	702.1	709.2	716.2
Use of goods and services	2 667.3	3 112.5	3 161.1	2 330.5	3 122.1	3 122.1	3 122.1
Travel and transport, domestic	343.9	361.5	310.6	275.9	400.4	400.4	400.4
Travel and transport, international	151.4	164.5	176.1	25.2	36.8	36.8	36.8
Operating costs	2 172.0	2 586.5	2 674.3	2 029.4	2 684.8	2 684.8	2 684.8
Interest payment	327.4	482.6	479.5	544.1	810.8	851.4	873.8
Subsidies	310.3	279.2	338.0	1 040.7	850.4	850.4	850.4
Grants to other general government units	1 111.7	839.5	1 098.4	1 871.7	855.3	1 109.4	1 120.4
Social benefits	1 568.2	1 734.3	1 687.4	1 846.9	2 460.7	2 460.7	2 460.7
Other expense	692.0	625.6	831.5	925.7	1 047.8	1 047.8	1 047.8
Students	641.1	577.0	761.5	891.4	951.0	951.0	951.0
Other	50.9	48.6	69.9	34.3	96.8	96.8	96.8
Capital Budget	**3 453.5**	**4 207.7**	**5 320.6**	**3 913.7**	**5 737.7**	**5 792.8**	**5 858.9**
OVERALL BALANCE	**-652.1**	**-1 384.8**	**-2 429.1**	**153.3**	**-4 833.0**	**-4 360.3**	**-7 160.5**
Avarall Balance as % of GDP	-2.1%	-4.1%	-7.3%	0.5%	-13.4%	-11.1%	-16.9%
Current Price GDP	31 363.4	33 528.8	33 237.5	31 643.5	36 146.2	39 156.0	42 325.1
Real GDP Growth	-2.7%	-1.1%	-2.4%	-6.0%	3.3%	3.0%	3.4%

4.10 Financing and Debt Management

64. **Total public and publicly guaranteed debt stock (incl. monetary policy treasury-bills) at the end of June was recorded at M18,041.3 million, a reduction of M1,084.9 million from the previous BSP period.** External debt amounted to M14,768.9 million, a decrease of M1,056.7 million from the previous year. The reduction of debt stock is mostly driven by exchange rate appreciation than actual cross borrowing. Year on year currency gains accounted for M2,199.3 million coupled with M743.6 million in external redemptions let to overall decline in debt across all currencies in the portfolio against new disbursements of M2,060.1 million.

65. **Domestic debt stock on the other hand decreased by M28.2 million to M3,665.8 million year-on-year after the redemption of short-term fiscal T-Bills to the nominal value of M430 million, this is short term decline as more T-Bills will be contracted later in the year.** However, medium to long term

domestic securities have increased by M400.7 million after unusually successful auctions in FY 2020/21 that raised almost M490 million from the offered M500 million. The Government is expected to issue M900 million to finance the development projects and continue to develop the domestic market. The first auction June 2021 has already been successful with M408 million raised from the offered M400.

66. **The DSA continues to assess Lesotho's risk of external and overall debt distress at moderate despite the impact of the COVID-19 shock, also risks to debt sustainability are improving since the last DSA.** The overall risk of debt distress is also assessed to be moderate. The moderate risk tool still suggests limited space to absorb shocks.

Table 5: Debt Indicators

	2019/20	August 2020/21	July 2021/22
Total Public Debt	**19, 460.7**	**19, 126.2**	**18, 041.3**
External Debt	**15, 651.7**	**15, 432.2**	**14, 375.5**
Bilateral	1, 223.4	1, 173.7	915.3
Export Credit	1, 176.7	1, 168.3	1, 525.0
Multilateral	13, 251.5	13, 090.2	11, 935.2
Domestic Debt	**3, 809.0**	**3, 694.0**	**3, 665.8**
Long term	2, 332.2	2, 382.6	2, 783.3
Short term (T-Bills)	1, 476.8	1, 311.3	882.5
O/W Monetary	876.8	881.3	882.5
In Percentage of GDP			
Total Debt	**58.6%**	**53.2%**	**49.9%**
External Debt	47.1%	42.9%	39.8%
Domestic Debt	11.5%	10.3%	10.1%
In Percentage of Total Debt			
External Debt	80.4%	80.7%	79.7%
Domestic Debt	19.6%	19.3%	20.3%
GDP	**3,3237.5**	**3,5971.3**	**3,6146.2**

67. **The Medium-Term Debt Strategy remains to develop the domestic market and attain a share of 70% external debt to 30% domestic debt in the long term.** Currently the share of external debt to domestic was recorded at 79.7 to 20.3 percent, a slight improvement from the previous year after appreciation of exchange rates. The bulk of external debt stock is concessional but the level of concessionally is expected to decline moderately, while remaining significant as Lesotho grows and graduates from some concessional borrowing openings and the domestic debt stock grow.

68. **On the April 2020, the G20 countries committed to suspend debt service on bilateral debt under the Debt Service Suspension Initiative (DSSI) from May 1, 2020, to December 31, 2020 to assist low-income countries have financial space to combat the impact of COVID-19.** Lesotho has benefited from this initiative which has since been extended by another year. The Country managed

to re-assign a total of M58.3 million towards combating COVID-19 out of a potential M109 million, as not all bilateral creditors complied with the DSSI initiative.

5.0 RISKS TO THE ECONOMIC AND FISCAL OUTLOOK

69. **Macroeconomic developments can cause fiscal results to diverge from forecasts for key macroeconomic variables such as total revenue, government expenditure, real GDP growth, consumer price inflation.** The current outlook is characterised by strong recovery of macroeconomic position over the medium term following an economic contraction of 2020/21, severe expenditure pressure and emergence of new waves of COVID-19 remain the major sources of uncertainty.

70. **Other sources of uncertainty include among others:**
    a) The 2022 general elections related spending
    b) Downgrades of South African debt and disruptions to the power supply could induce capital flight and weaken growth, which could in turn weaken SACU revenues and remittances.
    c) Failure to control rigid expenditure categories will prevent creation of fiscal space to support more efficient public investment levels.

6.0 POLICIES TO LIMIT FISCAL RISKS AND ENSURE FISCAL SUSTAINABILITY

71. **To forestall many of these risks, the government is committed to upholding macroeconomic stability and making a path for sustainable and inclusive growth through the current economic recovery initiative.** The government will have to bring expenditures in line with available resources by rebuilding budget credibility and investor confidence, improving service quality, restraining recurrent expenditure, and preserving fiscal space for investment spending.

72. **Specifically, the government is committed to:**
    i. Mobilize domestic revenues to gradually replace reliance on SACU transfers.
    ii. Scale back current spending prioritize capital spending and public investment to strengthen physical and human capital and crowd in private investment.
    iii. Employ measures which will strengthen institutions and enhance governance, while intensifying the fight against corruption.

73. **To achieve 64 (i), the government needs to implement robust tax measures and strengthen revenue administration to help mobilize greater domestic revenues.** These include increasing VAT on electricity to the standard rate in 2022/23 and improving the efficiency of tax administration. It is also essential not to tamper with the integrity of the tax system.

74. **To achieve 64(ii) and to improve the quality of and contain expenditure, we are committed to implementing critical fiscal reforms that include streamlining public-sector employment and pensions program and reforming wages to generate vital savings.** More broadly, the government is committed to review and adopt a new Public Service Employment Policy that aims to maintain a sufficiently lean, professional, and highly efficient civil service, alongside measures to curb the high wage-to-GDP ratio.

75. **Given that our capital expenditure remains relatively high as a share of GDP, with items of current spending misclassified as part of the capital budget, we are committed to** rationalize the capital budget. The government will request technical assistance from international development partners to improve investment planning and execution, notably project appraisal and prioritized selection. We will also ensure that capital spending continues to help us meet our SDG targets by eliminating misallocated and unproductive capital spending.

76. **To achieve 64(iii), we are cognizant that our public financial management (PFM) systems must be reinforced** to ensure robust expenditure controls that prevent abuse and the accumulation of arrears.

7.0 STRATEGIC PRIORITIES FOR 2022/23 – 2024/25 BUDGET

7.1 Key Policy Targets

77. **In view of the significant changes in both the macroeconomic and fiscal environment brought by the COVID-19 pandemic and other fiscal challenges, the 2022/23 budgetary plans will continue to focus on sustainable economic growth and job creation.** Thus, the strategic objectives are in line with the National Strategic Development Plan II as well as the Economic Recovery Plan being developed. The current developments in the macroeconomic and fiscal environment dictate that MDAs should practice utmost fiscal discipline and reprioritise their programmes towards mitigation and recovery from effects COVID-19 pandemic through achievement of the following milestones:

- Job creation (9,863 job per year)
- Increasing economic growth to at least 5 percent growth per annum over the budget period with gradual increase in average propensity to invest in capital formation from the current 28.2 percent to 50.3 percent over the budget period.
- Restoring macroeconomic stability to sustainable levels by reducing fiscal deficit to less than 5 percent of GDP.
- Accelerate implementation of National reforms
- Implement reforms to improve investment climate, which will improve Lesotho's rankings on

the World Bank's ease of doing business ranking scale

- Enhance capacity to respond to COVID-19 and other similar epidemics/pandemics and Disaster Risk Management
- Reduce TB incidence from 611 to 475 per 100, 000 population.
- Reduce Mortality rate in TB/HIV from 206 to 140 per 100,000 populations
- Reduce incidences of HIV/AIDS and increase coverage of Anti-Retroviral Treatment (ART) to 100 percent.
- Provide adequate infrastructure to support private sector projects.
- Increase fuel storage capacity from 6 days to 60 days to ensure security of fuel supply
- Increase electricity generation capacity from 72MW to 178 MW
- Increase energy access from 45 percent to 100 percent by 2038
- Improve the status of Lesotho in Trafficking in Persons from Tier 3 to Tier 2

78. **The NSDP II emphasizes private sector development and gives priority to pursuing people-centered development.** Annual national budgets provide an opportunity for Government to implement specific strategies and allocate appropriate resources to the relevant sectors of the economy to realize these national priorities. The 2021/2022 financial year is the fourth in the implementation of NSDP II, and therefore, the proposed policies and strategies for implementation during the year, as well as the resource allocations, should be aligned to the national priorities

7.2 Priorities for Productive Sectors

79. **The NSDP II has identified four productive sectors clustered under KPA I.** These productive sectors have been selected and approved based on the sector's job creation potential; GDP growth; comparative advantage; significant value-chain development; and the sector's multiplier effect or impact across multiple sectors. These sectors will pursue the following key priorities for 2021/2022 – 2023/24.

- Increase cereal crop production and enhance food and nutrition security.
- Promote climate smart agriculture and food security system
- Increase production of High value crops, livestock, and cottage industry.
- Increase irrigated crop production.
- Improve visibility of Lesotho as a destination of choice.
- Improve Digital content production.
- Enhance e-Governance solutions.
- Diversify products and market access for Lesotho's products and services.
- Strengthen investment and trade promotion.
- Diversify the Manufacturing sector.
- Build efficient special economic zones, industrial clusters for integrated supply chain.
- Accelerate establishment of the delivery unit (Office of the Prime Ministers' Delivery Unit and

Ministerial Delivery Units)

8.0 TRANSLATING POLICIES INTO RESOURCE ALLOCATION

8.1 2022 – 23 Development Budget Initiatives

80. **The Budget Strategy Paper for 2022/23 fiscal year will be realised by introducing the following initiatives.**

    i. Encourage the establishment and implementation of priority projects that would stimulate the economy.

    ii. There is an ongoing initiative on the enhancement of capacity of Ministries, Departments and Agencies (MDAs) on appraisal tools and techniques among others for better appraisal of development projects to ensure that the Public Sector Investment Programme (PSIP) contains bankable projects. There is also a concerted effort to improve the absorptive capacity of capital projects whereby the frequency of site visits coupled with progress reporting will be increased to enable taking corrective measures on time. The Government has introduced a project "Advanced Infrastructure Development for Economic Growth and Job Creation" which is meant to provide the necessary impetus for private sector-led economic growth. In addition, institutional capacity will be improved through resuscitation of sector working groups. The prerequisite studies will be done prior to implementation of development projects.

81. **Currently the Government of Lesotho (GOL) experiences no fiscal space for new projects. This makes it difficult to undertake projects/programmes geared towards implementation of the NSDP II.** This state of affairs is brought about by amongst others.

    i. projects that go beyond their completion date,
    ii. Projects that change scope during implementation and no longer address their intended goals,
    iii. Projects whose annual budget allocation is insufficient to implement scheduled activities,
    iv. Projects that are not capital in nature.

82. **The GOL realises that the project portfolio is too big (currently there are over 145 ongoing projects), there are so many projects all competing for attention to be funded which makes it necessary to have something to guide allocation of funds.** To compound the problem there are some new projects which have donor funding that may require being implemented immediately; this implies GOL counterpart contribution. It is obvious that we cannot do everything at the same time. We are highly constrained by budgetary resources and human resources.

83. **Given the foregoing, it is evident that we need a methodological process to determine what projects should be undertaken to deliver the most value, given budget and resource constraints.** This require a wide range of techniques that can help with the prioritization; they include (but not limited to) alignment to strategy, Job creation, Financial Analysis, Risk assessment, Cost, Value, etc.

84. **The GOL has formed a team comprising officers from the MDP and MF on the prioritisation of capital projects.** It is of utmost importance that projects contained in the PSIP are prioritised. The PSIP provides a 5-year program of ongoing and new investment projects for funding through Government budgetary resources, state owned institutions, loans and grants from development partners.

85. **Furthermore, the GOL will explore Sector Wide Approach (SWAP) to the four key priority areas as way to allocate funds to programme that will stimulate the economy and assist in creating much needed jobs.** Although this approach is widely recommended to pool the resources together from the Government and Development Partners to address set sector specific priorities, however, in Lesotho only Ministry of Water adopted this approach previously in their programme, so lessons learnt from their experience will be of utmost importance. To ensure that SWAPs are successfully implemented the consultant will be engaged to guide all the stakeholders in identification and implementation of programmes where SWAP method can be applied.

86. **With the surge of the COVID-19 Pandemic, Lesotho's economy plummeted, and the private sector suffered loss of business.** As the status quo continued so did the country continue to fall deep into worst economic turmoil. To address this situation, the government through MDP is in the process of developing a Recovery Plan which is expected to reconstruct the economy in order to achieve sustainable development. To this effect a concept note has been developed and has identified the following key areas that were deemed key to economic recovery:
    1) Increase investment in infrastructure development,
    2) Build a resilient and responsive Health system, and
    3) Enhance productive capacity of the key sectors.

87. There are a number of key ongoing projects that would contribute to the achievement of the recovery outcomes, these include Nutrition and Health System Strengthening Project, COVID-19 Emergency Preparedness and Response Project, Wool and Mohair Promotion to name a few.

8.2 State Owned Enterprises

88. **For the purposes of this paper, State-Owned Enterprises (SOEs) are legal entities established to partake in commercial activities on behalf of Lesotho Government.** They can either be wholly or partially owned by a government and are characteristically earmarked to participate in specific commercial activities.

89. **In the absence of a well-developed domestic private sector, the government acquired shares in private companies and established the SOEs. Currently, there are six (6) wholly owned SOEs and thirteen (13) partially owned by the government.** The wholly owned SOEs are in sectors of power generation, water and sewage, investment promotion, tourism development and banking. The government expectation on these SOEs is for them to contribute significantly into the national budget and overall economy. However, their performance has been heterogeneous. In recent past, the only significant contribution to the economy has always been made by the partially owned companies in the mining sector to be exact. At the same time, most wholly owned SOEs contribution to domestic revenue mobilization have been marginal and non-existent to others.

90. **Tax and dividend revenues from SOEs, have been showing a disappointing trajectory trend between FY14/15 and FY20/21, with Letšeng Diamonds accounting for a lion's share of dividends and of taxes.** Dividend payments for some wholly owned SOEs and partially owned SOEs have been sporadic, and some SOEs have not paid any dividends for some time, putting more pressure on the fiscal account. In the same manner, government has not received any dividends from LNDC through their indirect shareholding. With regards to outflows from the budget to the sector, WASCO, the Lesotho Electricity Company (LEC), LNDC and BEDCO have been receiving in the form of capital grants.

9.0 SUMMARY CONCLUSION

91. Contingent risk to the government emanating from SOEs is marginally high following highly pro-cyclical SOEs turnovers

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[i] Ministry of Finance: 2021/22 Budget speech Annex Table II and V