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LESOTHO

BUDGET STRATEGY PAPER

GOVERNMENT OF LESOTHO

MINISTRY OF FINANCE AND MINISTRY OF DEVELOPMENT PLANNING

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1 INTRODUCTION

The Medium-Term Expenditure Framework (MTEF) and National Budget provide the framework through which public resources are programmed and allocated to support the realisation of the strategic goals of the National Strategic Development Plan (NSDP), 2012/13 – 2016/17 and the National Vision 2020. Lesotho has made significant progress in budget reforms and in recent years there was an introduction of a strategic phase to budget preparation that involves the development of Budget Framework Papers (BFPs) by all Ministries, with the aim of ensuring better linkage between development policies and strategies and budgetary allocations. However, the preparation of the BFPs has not yet been based on clear policy priorities and resource constraints. Therefore, this budget strategy paper serves to close that gap.

The purpose of the Budget strategy paper is to set preliminary fiscal targets and budget constraint/ceiling and define strategic priorities that will direct resource allocation within the set budget ceilings. The Budget Strategy Paper, therefore, contains:

- Highlights of recent economic performance and provides an updated medium-term economic outlook.
- The initial macro-fiscal framework for 2015/16-2017/18 and the fiscal strategy from which ministerial budgets will be developed.
- Strategic policy priorities and public expenditure strategy that should guide the preparation of Budget Framework Papers (BFPs) for all Ministries.

2 DEVELOPMENT CONTEXT

2.1 Human Development

Lesotho ranks 158 out of 187 countries on the UN Human Development (Life expectancy, per capita income and literacy) ranking, falling into the category of low human development. 57.1 per cent of the population lives below the national poverty line and far from the target of reducing it to below 29 per cent by 2015. The unemployment rate of 25.3 per cent is significantly below the target of 15 per cent for 2015. In terms of income inequality, there are no recent data to confirm the current level of the Gini coefficient, although it improved from 0.57 in 1994/95 to

0.53 in 2002/03 and is believed to be moving in the desired direction. 39 per cent of the households are vulnerable to food insecurity, despite measure agricultural support programmes, including input subsidy schemes and crop sharing schemes. 70 per cent of the population reside in rural areas and most of which are subsistence farmers. Household for security is low due to low productivity in agriculture as a result of, among others, low adoption of high yielding technologies and poor adaption to climate change.

Maternal and infant/child mortality are off track towards achievement of 2015 targets at 1,155 and 91 respectively. The HIV prevalence of 23% ranks Lesotho as the third country most impacted by HIV/AIDS in the world and 144 out of 148 countries on HIV impact on businesses. Currently the condom distribution coverage is 70% in the urban areas and 30 per cent in the rural areas of the country. The government is developing strategies to reach the target of 80 per cent and 30 per cent for urban and rural areas respectively. Coverage for adult anti-retroviral treatment has reached 59 per cent and for children is 24 per cent. The target is to increase coverage to 80 per cent for adults and 94 per cent for children by 2015. Currently the condom distribution coverage is 70 per cent in the urban areas and 30 per cent in the rural areas of the country, with the target of 80 per cent and 30 per cent for urban and rural areas respectively, by 2015. Access to health services is constrained largely by high out of pocket expenses, especially in the rural areas and critical human resources for health are still limited. The number of orphaned and vulnerable children is still high and one of critical responses has been through Child Grant Programme (CGP), which has reached 19 800 households and provided benefits for approximately 65 000 children across the 10 districts.

Trends in access to water and sanitation are moving in the right direction with 82 per cent of the population having access to safe drinking water and 55 per cent having access to basic sanitation. Approximately 77 per cent of the population in Lesotho resides in the rural areas. Access to electricity is also low at around 25 per cent.

2.2 Economic Development and Management

Economic growth averaged 5 per cent between 2010/11 and 2013/14, which is within the desirable range. However, close to a quarter of the labour force is jobless and the economy is still spurred by Garment manufacturing and mining. The need for economic diversification and stimulating job creating growth remains critical to the economic agenda. In terms of credit ratings (98/148) it is within the best group (the first 100 countries) and also scores well in terms of budget balance, debt situation and inflation rate.

Currently, the country is ranked 136 out of 189 countries under the ease of doing business index of the World Bank. There is low investment in new areas of the economy to diversify the production base as a consequence of low competitiveness of the business environment and limited access to finance. Limited diversification of production base and export markets implies that economy has limited resilience to negative external shocks.

The world competitiveness report, 2012/13 ranks Lesotho at 121 and 141 out of 148 countries in terms of secondary school and tertiary education enrolment, respectively. The overall quality of higher education system is ranked relatively better at 73/148. However, the level of technology adoption in Lesotho as measured by total Factor Productivity is slow. Lesotho occupies 132^{nd} position out of 148 countries in terms of availability of the latest technologies. This, coupled with low technical skills base, results in low growth and slow structural transformation of the economy. In relation to labour market efficiency, Lesotho falls at 120/148 when looking at cost of labour viz a viz productivity.

Lesotho stands at 109/148 in terms of quality of overall infrastructure, 115/148 for quality of roads and 148 (the worst) for availability of seats in air transport. The need to increase power generation capacity to support envisaged economic developments remains a priority and firm commitments should be made for absorption of surplus clean energy into the regional power pool.

2.3 Political Governance and Management

Lesotho is ranked relatively high in terms of political stability and fighting corruption. In terms of the Corruption Perception Index, Lesotho ranks 112 out of 174 in 2013 (1 is most corrupt and 174 is the least corrupt). However, the main threats to political stability are conflicts that arise between political parties and intra-party clashes. At community level conflicts still arise, especially over communal grazing and stock theft. A new forward looking national conflict management strategy is needed to consolidate the democratic and peace architecture.

In relation to decentralisation and service delivery, a new decentralization policy has been adopted and new district economic strategies are being developed to identify areas of comparative advantage for each district to create growth and jobs. The approved governance structures should set the districts in the right standing to champion their own programmes. The greatest challenge is to create a cadre of entrepreneurs in each district to convert potential commercial opportunities into jobs and propel economic growth. Major improvements have been realised in terms of licensing, getting passports, identification cards, water and electricity connections, reducing back log of cases and others, however, there is much more room for improvement. Service delivery reforms require long-term commitment and dynamism to obtain the required results. The critical oversight institutions should continually improve to ensure transparency and accountability. Human trafficking is also becoming an area for concern. It is also important to improve the capacity to generate statistics, analyse policies and establish the approved national monitoring and evaluation system.

Lesotho continues to perform better than most African countries in terms of gender equality, as a result of efforts made to increase women participation in politics and economic development. Some of the key areas of concern are primary school enrolment for boys, gender-based violence and low occupation of leadership positions by women both in the public and the private sector. The underlying causes have to be addressed to address the issues in a more effective way. Although expenditure on education is one of the highest relative to GDP, youth unemployment is high.The economy therefore, has be pushed to perform towards its potential in order to use the demographic dividend, which would otherwise be a destabilizing factor.

2.4 Environmental Sustainability

State of the environment is still an intra and inter-general concern. The major concerns are soil erosion and desertification, limited capacity to adapt to climate change, poor natural resource management, especially the fragile mountain ecosystems with wetlands alongside rangelands. Forest cover is also not growing rapidly due to low survival rates. Consolidation of programmes and coordination is necessary to have meaningful and sustainable impact.

3 MACROECONOMIC TRENDS AND OUTLOOK

3.1 International and Regional performance

The global economy is projected to be slightly higher in 2014 at around 3.7 per cent from average growth of 2.9 per cent recorded in 2013, rising to 3.9 per cent in 2015. This should impact positively on the domestic economy, particularly in sustaining demand for the country's exports.

Similarly, the projected world inflation of 3.2 per cent in 2014 is expected to anchor some level of stability in Sub-Saharan Africa.

On the other hand, Sub-Saharan Africa growth is projected to pick up from 4.9 per cent in 2013 to 5.5 per cent in 2014, reflecting positive developments on domestic supply-side and the strengthening global recovery.

In South Africa, growth is forecasted to rise moderately by 2.7 per cent in 2014 from 2.5 per cent in 2013, driven by improvement in external demand, and it is expected to grow by 3.2 per cent and 3.5 per cent in 2015 and 2016 respectively.

It is therefore critical that management of the economy enhances industrial competitiveness in both the regional and global market places in line with country's NSDP goals.

3.1.1 Lesotho's Economic Performance

The economy has been growing at an annual average rate of 5.1 per cent between 2010/11 and 2013/14 fiscal years and has been above the expected NSDP target of 5.0 per cent per annum. It is expected to grow at a rate of 2.4 per cent in 2014/15 and 4.3 per cent in the medium term respectively, which is below the NSDP target. This fall is attributed to a decline in the manufacturing, which is brought about by closure of major electronic exporting firm (Phillips) in 2013 as well as uncertainties surrounding the renewal of AGOA in 2015/16.

Mining, agriculture and manufacturing remain the major contributors to overall growth, with other sectors such as financial intermediation, tourism and construction also increasing their share.

3.1.2 Real Sector Performance and outlook

Table 1: The Macroeconomic trend and outlook

Macroeconomic Indicators	FY10/11	FY11/12	FY12/13	FY13/14	FY14/15	FY15/16	FY16/17
		Actual		Est.		Projection	
Agriculture	**11.4%**	**-2.1%**	**0.9%**	**3.1%**	**3.1%**	**3.4%**	**3.2%**
Crops	*32.0%*	*-1.5%*	*-3.9%*	*3.1%*	*7.0%*	*10.0%*	*9.5%*
Livestock	*4.8%*	*-5.9%*	*2.4%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*
Forestry	*8.6%*	*12.7%*	*4.6%*	*11.7%*	*4.8%*	*1.4%*	*0.7%*
Services	*-5.6%*	*4.0%*	*3.2%*	*11.6%*	*4.8%*	*1.4%*	*0.7%*
Mining and quarrying	**7.7%**	**19.2%**	**20.8%**	**-14.2%**	**3.9%**	**0.1%**	**3.6%**
Manufacturing	**6.9%**	**-10.0%**	**-3.9%**	**6.1%**	**3.2%**	**-3.8%**	**1.3%**
Textiles, clothing, footwear and leather	*8.4%*	*-9.2%*	*-5.3%*	*7.5%*	*3.0%*	*-7.6%*	*0.0%*
Other manufacturing	*-0.3%*	*-30.4%*	*-4.0%*	*6.3%*	*6.3%*	*6.3%*	*6.3%*
Electricity and water	**-0.6%**	**2.2%**	**3.8%**	**2.7%**	**4.8%**	**6.2%**	**6.2%**
Electricity	*2.9%*	*5.9%*	*7.5%*	*6.9%*	*4.7%*	*7.2%*	*7.2%*
Water	*-2.3%*	*0.5%*	*1.9%*	*0.4%*	*4.8%*	*5.5%*	*5.7%*
Construction	**11.1%**	**11.4%**	**34.4%**	**-9.5%**	**-13.6%**	**-7.5%**	**14.1%**
Hotels and restaurants	**3.0%**	**3.8%**	**2.7%**	**3.0%**	**3.0%**	**3.0%**	**3.0%**
GDP at purchasers' prices	**6.0%**	**3.8%**	**6.8%**	**3.8%**	**2.4%**	**3.4%**	**5.1%**

Source: Macroeconomic Policy & Management Unit

Primary Industry

Agricultural production has been very unpredictable in recent years. However, it is expected to recover in the medium-term. Between 2010/11 and 2013/14, agricultural sector has been growing at an annual average rate of 3.3 per cent. This growth was attributed to a significant fall in agricultural production in the last quarter of 2010/11 due to heavy rains that resulted into floods.

Recovery is expected in the medium term with agriculture expected to grow at a rate of 3.1 per cent in 2014/15 and 3.3 per cent in the medium term as government continues to support the sector resulting in expansion in investment and efficiency in productivity.

Mining and quarrying industry grew at an annual average of 13.5 per cent between 2010/11 and 2012/13. This recovery was supported by growth in global demand for diamonds in 2011/12. In 2013/14, there was significant fall in mining due to reduction in Letšeng mine production.

Mining industry is expected to grow at the rate of 3.9 per cent in 2014/15 and a 1.9 per cent annual average growth in the medium term is expected.

The domestic Economy is expected to grow at an annual rate of 2.4 per cent in 2014/15 and to average 4.3 per cent in the medium term. This growth is attributed to expected growth in agriculture and mining industries. However, slow growth in manufacturing will suppress growth in the medium term due to uncertainties surrounding the renewal of AGOA in 2015/16.

Secondary Industry

The secondary industry has grown by an annual average of 1.45 per cent between 2011/12 and 2013/14. Electricity and water accelerated due to increased demand even though there is capacity constraint resulting in importation of electricity. Construction also grew at an average rate of 12.08 per cent over the review period as a result of increased investment in the Millennium Challenge Account (MCA) projects in the health and water sectors and Metolong Dam construction, coupled with increases in government capital expenditure and private sector investment in construction of shopping malls and estates.

On the other hand, growth in manufacturing industry decelerated by an annual average of 2.58 per cent, as a result of uncertainties evolving around the renewal of the Third Country Fabric Provision (TCFP). The closing down of Kiota Electronics and Phillips in 2011 and 2013 respectively further adversely affected the sector.

The secondary industry is expected to grow at an annual average rate of 0.35 per cent between 2014/15 and 2016/17. The construction activities to support infrastructure of the Lesotho Highlands Water Project (LHWP) phase II are expected to ease the impact of the termination of the MCC projects. The manufacturing industry is expected to grow by an annual average rate of 0.23 per cent from 2014/15 to 2016/17. This slow growth includes an offsetting decline resulting from expected expiry of the African Growth and Opportunity Act (AGOA) trade preferences in 2015/16. However, the on-going infrastructure development (Tikoe Industrial Estate) is expected to attract further Foreign Direct Investment (FDI).

Tertiary Industries

The tertiary sector has grown at an annual rate of 6.87 per cent on average between 2011/12 and 2013/14, due to significant developments in health and social work (28.08 per cent), transport and communication (8.91 per cent) and financial intermediation (10.92 per cent). The opening of the new referral hospital in 2011/12 boosted the growth in health and social work. Transport and communication grew at an annual average rate of 13.78 per cent attributed mainly to significant developments in the post and telecommunication industry, which resulted in increased coverage of the telecommunications and mobile services. Financial intermediation grew at an average of 13.78 per cent at the back of the improvements and reforms relating to the financial sector and eligibility to acquire credit as well as the availability of financial services extending into the remote areas through the Post Bank.

The tertiary industry is expected to grow at an annual average rate of 5.46 per cent from 2014/15 through the medium term boosted mainly by growth in wholesale and retail industry, real estate and services, financial intermediation and transport and communication.

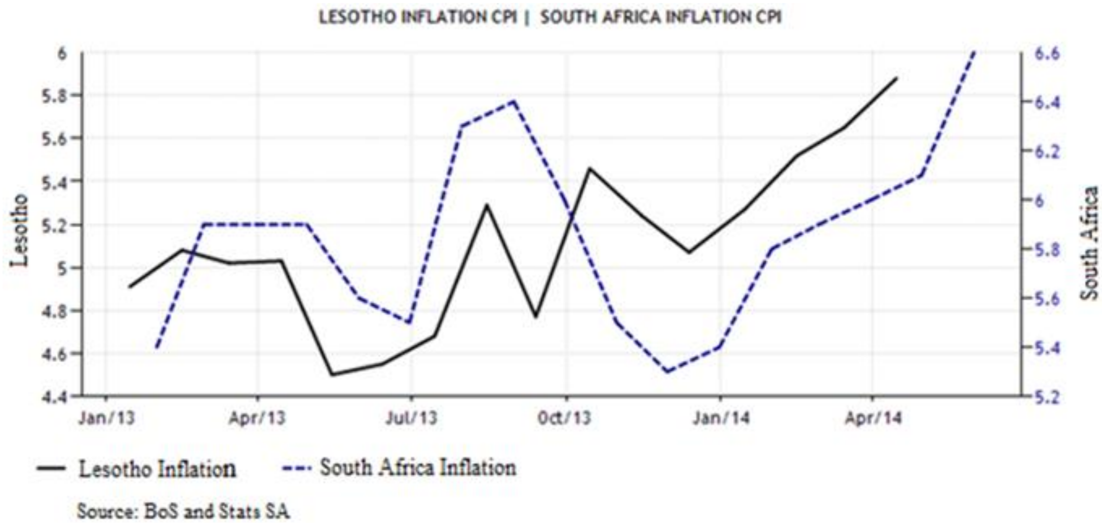
3.1.3 Prices and external sector

Inflation

Inflation and price developments in Lesotho are expected to continue to be in line with those in South Africa over the short to medium term. (Figure 1)

Inflation as measured by percentage change in Consumer Price Inflation (CPI) over the past three years averaged 5.6 per cent. Inflation has increased to 5.9 per cent in March 2014 from 5.6 per cent in April 2013. This development was brought about by higher prices of food, clothing and footwear, housing, electricity, gas and other fuels. It is therefore, expected to average 6.1 per cent through the medium term. This forecast is expected to increase slightly due to supply shocks in agriculture output and the continuing high oil prices coupled with exposure from fluctuations of the South African Rand against the US dollar.

Figure 1: Lesotho Consumer Price Inflation



Exchange Rate

The exchange rate is fixed between Lesotho and SA (and CMA area) but flexible with the rest of the world as the rand fluctuates due to a peg.

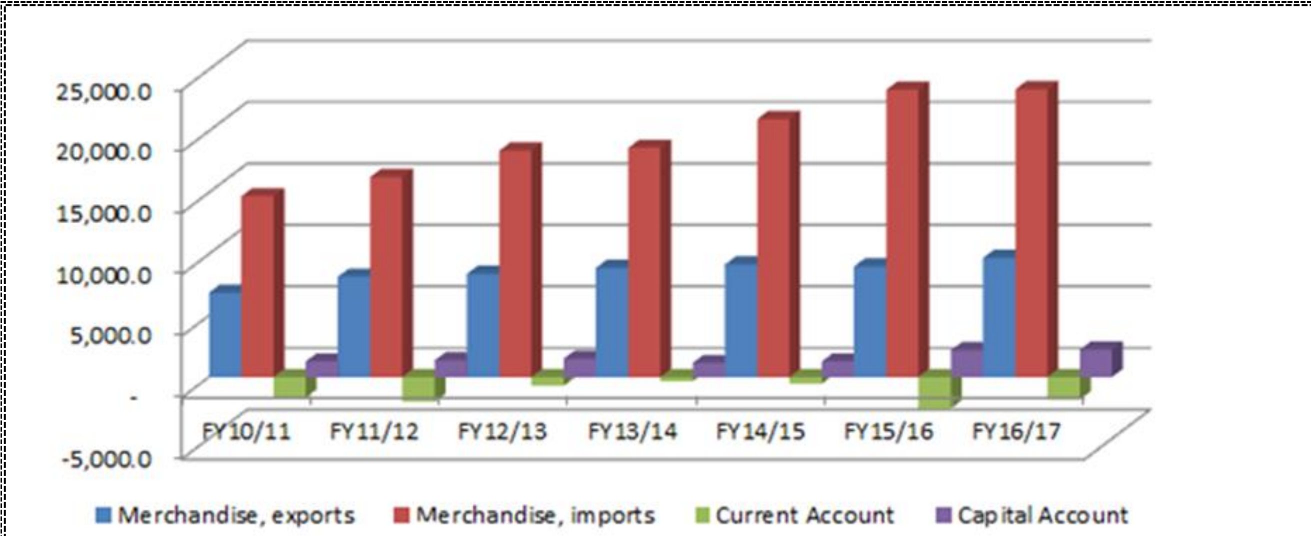
Between 2010/11 and 2012/13 Lesotho Loti averaged M8.08 to US dollar and it remained within that range up to the last quarter of 2011/12. In 2012/13 exchange rate volatility remained elevated as global risk appetite responded to continued uncertainty in the euro area, weak global economic data and concerns over US fiscal policy. Loti continued to depreciate against major trading currencies in the second half of the year as risk appetite returned. The exchange rate of Loti against major trading currencies is expected to remain subdued in 2014/.15 and through the medium term.

The External Sector

The Current Account balance registered an annual average deficit of M1, 477.4 million between 2010/11 and 2012/13. The massive decline was as a result of the global financial crisis which led to slow global demand thus impacting negatively on the merchandise exports and high imports. The deficit was further increased by a decline in income account due to lower compensation of Basotho miners in South Africa. There was also a substantial drop in current transfers driven by a decline in SACU receipts. However, the current account deficit narrowed considerably in 2012/13 on account of improvement in SACU receipts which grew by 120.5 per cent.

In 2013/14, the current account deficit is expected to improve marginally to M332.7 million due to expected narrowing of the trade deficit, depreciation of exchange rate, increase in income and current transfers' accounts. A surplus of 1.3 per cent of GDP is forecasted in 2014/15 due to supposed improvement in exports, income account and current transfers. It is however, projected to decline to the average deficit of 6.7 per cent of GDP between 2015/16 and 2016/17. This stems from the expected broadening trade deficit coming from investment activities related to Phase II of LHWP and the anticipated implementation of NSDP.

Figure 2: External Sector 2010/11-2016/17



Source: MoF, Macro Unit Forecasts

4 MEDIUM-TERM FISCAL FRAMEWORK AND FISCAL STRATEGY

Table 1 set out the preliminary medium-term fiscal framework (MTFF) for 2014/15-2016/17. Key points to note are that:

- The overall fiscal balance is expected to register deficits of above 3 per cent of GDP throughout the medium term. This will have to be revised as it might be unsustainable going forward.

• Over the period non SACU revenues are forecast to increase from M7, 984.9 million in 2014/15 to M8, 251.10 million in 2016/17.

• Expenditures are forecast to increase from M11, 869.27 million in 2014/15 to M13, 007.54 million in 2015/16

Table 2: FY2011/12 to FY2016/17 Fiscal Table

Million Maloti	2011/12 Outturn	2012/13 Outturn	2013/14 Outturn	2014/15 Budget	2015/16 Projection	2016/17 Projection
Revenue	**9,627.18**	**13,150.95**	**13,280.07**	**15,142.31**	**15,812.13**	**16,392.94**
1. Tax revenue	4,282.81	4,596.30	4,996.19	5,720.68	6,007.95	6,581.61
3. Grants	1,436.78	1,703.46	1,198.27	1,043.90	1,043.90	1,096.64
4. Other revenue	1,154.94	884.86	1,031.05	1,343.63	1,384.03	1,450.49
5. SACU	2,752.65	5,966.33	6,054.55	7,034.10	7,376.25	7,264.21
Recurrent Budget						
Expense	**8,519.05**	**8,794.46**	**10,268.57**	**11,869.27**	**13,007.54**	**13,856.11**
1. Compensation of Employees	3,640.17	3,748.80	4,491.97	5,503.52	6,092.65	6,611.58
2. Use of goods and services	2,042.11	2,385.04	2,824.52	3,319.63	3,733.32	3,919.46
4. Interest Payments	137.08	165.89	231.45	240.08	253.29	266.12
5. Subsidies	238.82	252.94	235.24	275.02	268.54	275.25
6. Grants	894.36	881.77	898.07	695.58	745.83	796.71
7. Social Benefits	586.10	613.04	816.82	886.19	920.90	966.05
8. Other expense	980.41	746.99	770.50	949.25	993.00	1,020.93
Capital						
Budget	**4,432.09**	**5,422.61**	**4,961.09**	**5,001.57**	**5,267.39**	**5,819.27**
Of which GoL	*2,532.48*	*1,981.33*	*2,793.90*	*2,984.47*	*3,317.79*	*3,521.23*
Of which loans	*358.78*	*648.90*	*625.49*	*1,123.20*	*1,055.70*	*1,351.40*
Of which donor grants	*1,146.85*	*1,507.06*	*898.27*	*893.90*	*893.90*	*946.64*
Overall fiscal balance GoL	-10.2%	4.9%	0.7%	-2.7%	-3.9%	-6.2%
Debt	37.3%	48.9%	47.4%	48.6%	49.2%	48.3%
FR Monthly Import Coverage	4.0	4.9	5.1	4.8	4.3	4.0
Inflation (%)	6.0%	6.0%	6.4%	6.0%	5.9%	5.9%

Source: MoF-Macroeconomic Policy & Management Estimates 2014

4.1 Revenue

Revenue has been growing at an annual average of M11, 289.03 million between 2010/11 and 2013/14. It is therefore, projected to total M15, 142.31 million in 2014/15. This growth is expected to be M1, 862.24 higher relative to 2013/14, on account of on-going tax reforms focusing on Lesotho Revenue Authority (LRA) restructuring among others which is expected to improve efficiency in tax collection.

Taking account of this, Tax revenue is estimated at M5, 720.70by 2014/15 reflecting growth of M724.49 million (14.5 per cent) relative to 2013/14 and in the medium term it is projected that tax revenue will average a sum of M6, 294.8 million.

With Global economy expected to grow at around 3.7 per cent and 3.9 per cent in 2014 and 2015 respectively, SACU revenues are expected to continue to grow. In 2014/15 SACU revenue is estimated to be around M7, 034.10 million, and to average M7, 320.23 million in the medium term.

4.2 Expenditure

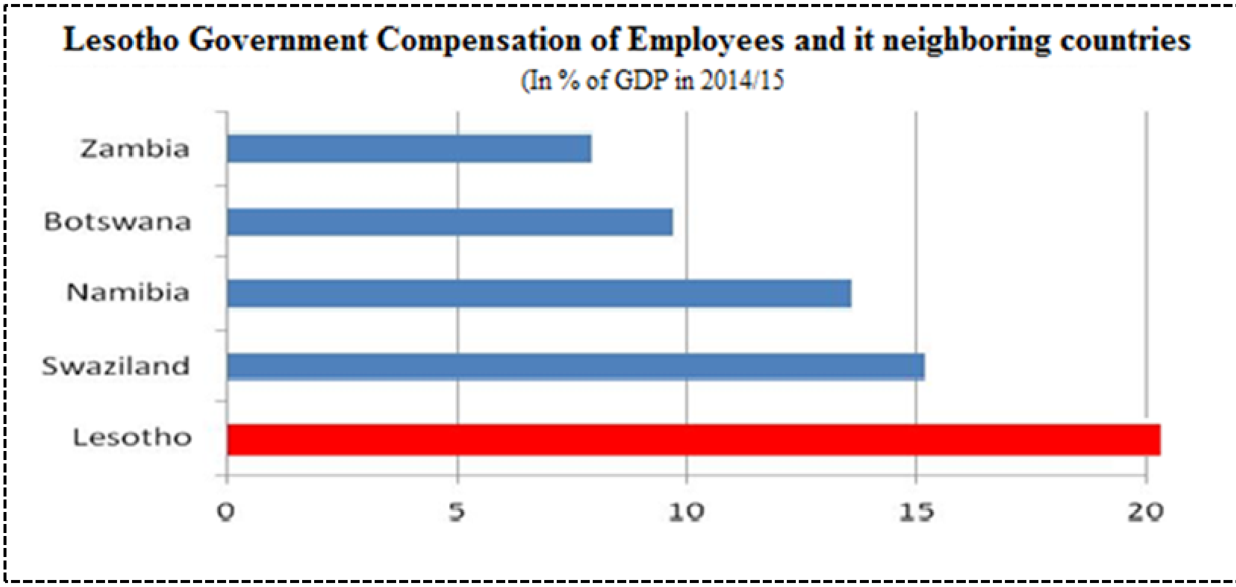
The public sector spent a combined M8, 794.46 million on recurrent expenditure in 2012/13, a substantial M3, 748.8 million was spent on compensation of employees, and M2, 385.04 million was spent on use of goods and services.

However, the total public sector recurrent spending has grown in 2013/14 by M1, 474.10 million (16.8 per cent) against 2012/13.Compensation of employees has grown by M743.167million in 2013/14 against the previous fiscal year as a result of the Government salary review which took effect from April the same year.

4.2.1 Compensation of Employees

Compensation of employees accounted for an about 43.1 per cent of the total recurrent expenses between 2010/11and 2013/14 and it is one of the highest as a percentage of GDP when compared with neighbouring countries, (Figure 2). In 2014/15 it projected that total expenditure on government compensation of employees will total M5, 503.52 million, which is M1, 011.55 million (22.5%) higher relative to the previous year. Medium term projections show an annual average increase of 13.9 per cent from 2014/15 through 2016/17, largely influenced by the salary review which took effect in 2013/14.

Figure 3:Lesotho Government Compensation of Employees against its enamoring countries



4.2.2 Use of goods and services

In line with the projected revenues, total expenditure on government use of goods and services in 2014/15 is estimated to total M3, 319.63 million, reflecting 17.5 per cent growth against 2013/14. It is projected that in the medium term expenditure on use of goods and services will average 8.7 per cent.

4.3 Capital Expenditure

Capital expenditure share in the total budget is expected to improve from M2, 534.3 million in 2013/14 to M2, 984.5 million in 2014/15 and to average M3, 253.8 million in the medium term. Taking into account implementation of NSDP in 2015/16 and 2016/17, capital expenditure is projected to average M3, 483.2 million.

4.4 Overall fiscal balance

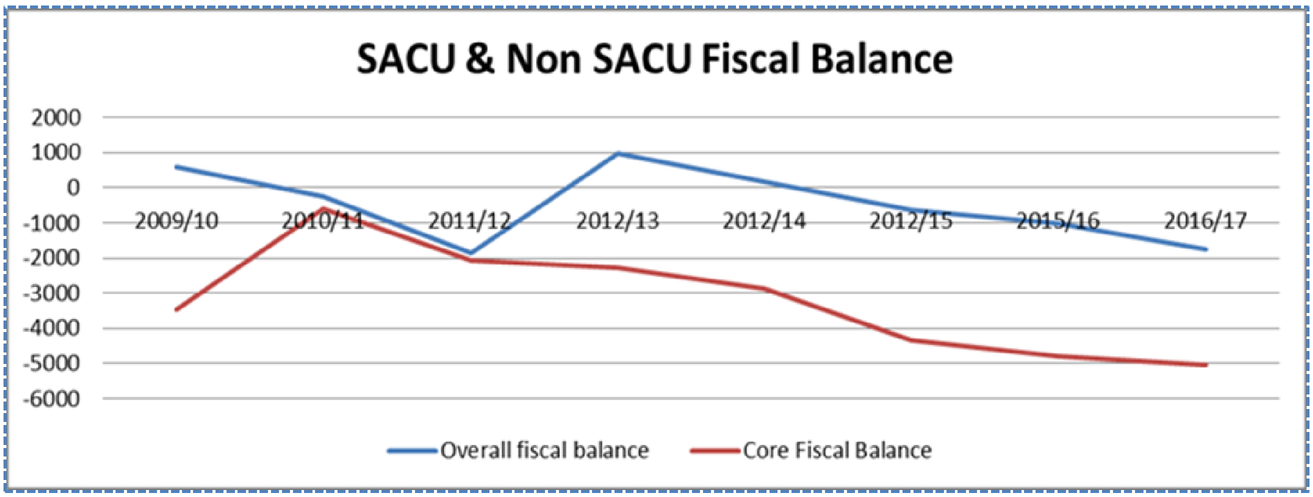
The overall fiscal balance is considerably affected by the volatility of SACU receipts. The GoL ran deficits from 2009/10, as SACU receipts declined due to the impact of the 2008 global crisis.

Government fiscal position only improved in 2012/13 to a surplus of 4.6 per cent of GDP as a result of fiscal consolidation implemented by government after it entered into a three-year Extended Credit Facility Arrangement with the IMF. Government continues to be committed to its policy of fiscal prudence and thus will continue to ensure fiscal stability by recording fiscal surpluses and or deficits that are sustainable in order to continue to build reserves to maintain the peg and defend the country against any balance of payment shocks.

Government ran fiscal deficit of around 2.6 per cent of GDP in 2013/14 and is expected to register deficits in the medium term as it continues to intensify its implementation of the NSDP. The deficits are however expected to be around sustainable levels so as to guard against any balance of payment shock and possibility of floating the exchange rate.

Figure 4 below, demonstrates the close relationship between SACU revenues and the fiscal balance.

Figure 4: Non SACU and SACU Overall Fiscal Balance



4.5 Fiscal space

The 2013/14 and the expected 2014/15 fiscal position will result in the narrowing of fiscal space in the 2015/16 Budget. This will continue to put pressure on government's commitment to maintain fiscal deficit on sustainable levels but at the same time continuing to create enough fiscal space to continue the implementation of the NSDP. This means that ministries would have to identify the scope for freeing up fiscal space from within their recurrent budgets through cutting back redundant or low priority activities and generating savings that would enable them to deliver public services at lower costs.

4.6 Private sector investment and financing

Private sector development remains a high priority for economic development and poverty alleviation. The government will continue with policy development and institutional reforms to address all the bottlenecks impeding development of the sector. Access to finance for SMMEs still remains a challenge despite the fact that Government has embarked on a number of reforms that are intended to address these obstacles. There is still mismatch between the demand and supply: expectation that government rather than private sector provides credit (e.g. agricultural financing) and limited number of players focusing on productive credit. Traditional lack of appetite for risky credit by banks also deters potential entrepreneurs and key player in the private sector. The delay in development of appropriate regulatory framework is stills a challenge.

In order to address these challenges the Government will embark on the following reforms:

- Leverage existing channels (e.g. farmer's networks, sectoral groupings, BEDCO, MoF, LNDC credit guarantee schemes.
- Review of legal and policy framework relating to private sector development.
- Establishment of new supporting structure such as MFA, credit provider Association and strengthening the existing ones.

The Government is determined to escalate a private sector participation in economic growth. This will be realised through policy reforms, Institutional capacity building and exploitation of diverse financing solutions for the private sector.

Increasing financial inclusion for SMEs is a high priority as they play a key role in providing employment as well as growing the economy. Government will explore alternative financing options (issuing bonds, PPP) to address the issue of back log in infrastructure development. Government also will facilitate for financial institutions to design targeted products for SMME and Agricultural sector.

4.7 Debt sustainability

Lesotho remains at moderate risk of external debt distress. This implies that to maintain this level of debt sustainability, government needs to continue to exercise caution. It is anticipated that government's external financing would be 3 – 31/2 per cent of GDP a year over the medium term. However, IMF recommended limiting government annual net external borrowing to 11/2 – 2 per cent of GDP to provide a more comfortable margin for debt indicators and macroeconomic stability.

The large financing needs of the forthcoming LHWP – 2 Project, would drive the debt indicators towards the corresponding thresholds for debt sustainability. It is therefore recommended that government external borrowing would need to be limited to loans only on concessional terms. External Creditors strictly finance projects whose detailed feasibility studies are complete and recent to enable the creditors to provide funding immediately. What have been mostly approved by the PSIC are project concepts and not feasibility studies. It therefore remains a challenge as to how fast such concepts are going to be turned into project proposals with detailed feasibility studies that will come up with acceptable costs. Such studies are mostly funded by government which may even take time, to the extent that they may even go beyond the end of NSDP timeline.

Although there is some scope for domestic borrowing, government needs to be clear of the projects to be financed through domestic borrowing and should also be very strict on ensuring that such projects are implemented quickly and within the agreed timeframe so that the investment returns can be realized quickly to generate the income to assist in paying the coupon / interest as the rate is higher with much shorter maturity. The IMF also encouraged government to submit the new Public Debt Management Bill to parliament without further delay as well as make the medium term debt strategy operational.

4.8 Fiscal strategy

The fiscal strategy over the next three years aims at reinforcing long-term fiscal sustainability and providing a sufficient fiscal and/or foreign reserve buffer against domestic and external shocks and imbalances. Prudent fiscal management will also help to sustain confidence of investors and development cooperating partners and help to secure financing for investment by the private sector and for infrastructure projects.

This objective will be achieved through a reduced dependence on volatile and pro-cyclical SACU receipts by moving to a situation where current expenditures can be covered by tax and non-tax revenues, with SACU revenues and donor funding being used to finance infrastructure and other capital expenditures and maintain sufficient reserves for financing forward capital spending commitments.

Key measures to achieve this outcome include:

- Maintaining adequate reserves to provide 5 months of import cover as a buffer for ameliorating fiscal shocks and imbalances.
- Reducing the very high and unsustainable level of recurrent spending. This will require tighter control over recurrent expenditure budgets linked to measures to ensure that existing resources are utilised more effectively and efficiently as well as targeting no real increases in recurrent spending over the next three years (excluding maintenance of assets).
- Improving mobilization of domestic non-tax revenues. This will require identification and assessment of new revenue sources and adjustment of selected fees, penalties and charges that have not been increased for several years.
- Mobilising additional resources, especially grants to finance public investments and crowding- in private investment.

5 STRATEGIC PRIORITIES FOR 2015/16 – 2017/18

5.1 Key Policy Targets

It is proposed that in developing the government's budgetary plans for 2015/16 to 2017/18 the focus should be on the following policy targets that will contribute to the realisation of the MDGs and NSDP strategic goals:

- Increasing economic growth towards a sustainable level of between 5 and 7 per cent per annum and create 10 000 jobs per year on average;
- Reducing food insecurity by increasing production on average by 16Ha per year by the end of plan period (2017/18);
- Reducing child mortality by 2/3 and maternal mortality by 3/4 by 2017/18;

- Reducing incidence of HIV and increase coverage for anti-retroviral treatment (ART). (1/4 by 2016/17, 80 per cent coverage)

In order to achieve the above policy targets, interventions will be grouped under three clusters: (i) facilitating job creation, inclusive growth and economic diversification; (ii) reducing economic and social vulnerabilities; and (iii) improving public sector efficiency and service delivery.

5.2 Public Sector Expenditure Strategy

This section shows specific interventions that will be implemented to achieve the above-mentioned policy targets. Therefore, the selection of interventions was based on their contribution to employment creation, productivity, economic diversification, trade facilitation, food security and reduction of economic and social vulnerability. Further prioritisation of the accelerated action plan will be made in relation to maternal mortality as well as child mortality prevention programmes.

5.2.1 Intervention Cluster 1: Facilitating Job Creation, Inclusive Growth and Economic Diversification

The major medium to long term challenge for government is developing and empowering the private sector as a necessary instrument for high and sustainable growth. This will involve expansion and diversification of the economic base and increase productivity in key growth sectors and in the green economy.

The NSDP identifies mining and water projects as two growth accelerators due to large investments that are expected during the plan period. However, ancillary activities will have to be promoted so as to sustain the growth and increase employment.

Investment climate reforms are regarded as the foundation for attracting private investment, with an impact of more than 2 per cent on GDP over the 5 years, through efficiency gains. Commercial Agriculture, Manufacturing, tourism and Technology based industries and creative arts reforms are regarded as major sources of jobs and growth.

In order to unlock potential in these growth sectors, the Government undertakes to provide:

Enabling Investment Climate and Regulatory Framework

Accelerate implementation of investment climate reforms under the guidance of the Cabinet Committee on Investment Climate Reform. This will require the following:

- **Ease doing business:** Accelerate implementation of investment climate reforms under the guidance of the Cabinet Committee on Investment Climate Reform. The areas to address include, reducing time and costs **to start a business, deal with construction permits, getting electricity, registering property, enforcing contracts, protecting investors, paying taxes, trading across boarders and closing a business.**
- **Improve obtaining Visas and Work Permits:** Visa and work permit laws and processes will be reviewed particularly to ease travel by business persons and tourists.
- **Improve access to finance:** Operationalise the credit guarantee facility and ensure that all approved projects access finance, implement transformation plan of the post bank and facilitate the establishment of the stock exchange
- **Reform Land tenure:** Facilitate the development of required policy and legislation for land reforms, including the consideration of establishing Special Economic Zones, especially to support commercial agriculture and foreign private investment in industrial infrastructure and tourism.
- **Broker investment climate reform Legislation package:** Develop a body/package of legislation to support the investment climate reforms for consideration by Parliament

Priority Sectors to Develop as Sources of Growth and Jobs

Commercial Agriculture: Measures to increase agricultural productivity, commercialization and diversification will involve:

- Investment in expansion of water harvesting and irrigation capacities with a target of developing 200 ha per year
- Stimulate private participation in trading in agricultural inputs and farm machinery
- Develop and/or facilitate development of public marketing infrastructure for trade and to maintain public health; and

- Promote private investment in building integrated supply chains of existing sub-sectors (vegetables, fruits, potato, poultry, piggery, mushrooms, wool and mohair, organics and others)
- Promote commercial fruit production and increase by 100 ha per year
- Facilitate the expansion of farms for products that qualify for bio-trade

Manufacturing: Transform the textiles sector and diversify products and markets

- Support at least 2 Basotho firms per year through incubation/productivity centres to create capacity to enter textiles manufacturing value chain
- Facilitate the production of black boxes required for migration from analogue to digital
- Establish national handicrafts incubation centre to develop products and markets and provide training
- Promote private investment and facilitate the establishment of at least one new firm or major turn-around of firms under agro-industry/breweries, electronics, Jewellery and others

Mining: Facilitate access to electricity, equitable distribution of benefits and market integration for small operators

- Connect electricity to mines
- Develop mining tax code and other legislation
- Mobilise resources for NUL granite project
- Establish sandstone marketing platform to enhance market coordination

Tourism: Aim to increase volumes and length of stay of tourists as well as ensuring community participation in the sector.

- Engage private operators in the remaining developed tourism facilities

- Develop/review a master-plan to integrate district initiatives
- Conduct a feasibility study for an additional ski resort on the Highlands Ski route and promote private investment
- Develop a Lesotho tourism brand and market Lesotho in major source markets
- Facilitate the establishment of at least one community based project per year

Technology and Creative Industries

- Identify talent and establish incubation centres for music, film and fine artto take advantage of the opportunities brought about by analogue to digital migration
- Establish one pilot call centre
- Promote mobile money and e-services

Development of a Minimum Infrastructure Platform for Trade Facilitation

Industrial infrastructure: Develop a well-phased industrial and marketing infrastructure programme and implement in line with district advantages and provide basic infrastructure such as water and sanitation, electricity, roads and ICT

Customs Clearance: Deployment of border, and customs clearance, control and management systems (software, scanners, single windows),

Standards and Quality: Establish Standards, Quality, Accreditation and Metrology (SQUAM) coordinating body and standards in identified priority sectors as well as related infrastructure to support trade.

Information and Communication Technology: Facilitate smooth migration from analogue to digital; Consolidate backbone infrastructure to reduce wholesale costs and promote cost-efficient rollout of distribution network; Investigate anticompetitive behaviour in the industry; and Facilitate on line application for services, information dissemination and other critical e-services in health and education.

Green economy through Water and Energy: Implement pipeline projects to increase water distribution capacity and production of clean energy (hydro-power, wind and solar) for local consumption and export. The construction of Polihali Dam with a transfer tunnel to the Katse Dam; and the Kobong pump storage of 1 200 megawatt hydro-electricity scheme and be operational in 2018.

- **Transport:** Initiate the development of dry port facility and/or Moshoeshoe I International Airport as an international hub as well as providing key access roads to new economic nodes at local level.

Institutions: Transform and enhance capacity of institutions that support Micro, Small and Medium enterprises (MSMEs), especially to support start-ups and assist community based commercial projects, through business plan development, training on business management, incubation and/or facilitating access to technology and finance. The capacity of Lesotho - foreign missions should be enhanced to effectively promote investment, tourism and trade in key international markets.

Technology Diffusion and Technical Skills

- Establish technology and incubation centres for selected industries
- Upgrade Lerotholi to a University of technology
- Review Curriculum of TVET centres
- Establish Trade testing centre
- Develop capacity to source technology, acquire licenses and produce new industrial products

5.2.2 Intervention Cluster 2: Reducing Social and Economic Vulnerability

Deteriorating trends in morbidity and mortality depreciate our human resource capital, thereby reducing productivity, savings and growth. High and increasing mortality rates cause a reduction in the labour force, increasing numbers of orphans, and deepening and spreading poverty. The significant drivers are high HIV and AIDS prevalence, limited accessibility of essential maternal and preventive health care services that shows in relatively high out-of-pocket expenses, poor quality of services and access to essential drugs.

There is also need to enhance the social protection system such that it promotes prevention, reduction of exposure to vulnerabilities and enhance the management of risks and increases own capacity to reach livelihood security. Increasing crime and poor management of conflicts exacerbate social and economic vulnerability.

With regard to environmental vulnerabilities, limited adaption to climate change, due to increasing desertification, poor natural resource management, especially the fragile mountain ecosystems, wetlands, and degradation of forest and vegetation cover significantly reduce the capacity of catchments to capture and store water and increase soil erosion.

The key interventions therefore will be:

Improve Maternal and Child Health and HIV/AIDS Programmes

- Implement accelerated programme for reducing maternal mortality, under-five mortality, stunting and malnutrition;
- Operationalise guidelines for nutrition support for people living with HIV and AIDS
- Enhance the management of human resource for health and improve drugs and medical supply management.
- Scale-up HIV and AIDS behaviour change programmes, condom distribution and promotion of their use, expand coverage of ART treatment and rationalize the institutional infrastructure
- Review ALAFA model for efficiency and sustainability and implement recommended option

Reducing Socio-Economic Vulnerability

- Promote household food security;
- Consolidate social protection programmes to better target the poor and marginalised groups with the focus on increasing their own capacity for livelihood security;
- Accelerate population access to basic services, including access to water and sanitation, health services, clean energy, communication services and improve public transport system;

- Strengthen special programmes between the Government and the private sector to increase youth and young professionals' employment;
- Adopt and implement climate change strategy and plan thereby increase the creation of green jobs, through protection of water sources and fragile ecosystems and enhance climate change resilience

Reducing Corruption and Crime: On the Corruption Perception Index, Lesotho ranks 112 out of 174 in 2013 (1 is most corrupt and 174 is the least corrupt).

- Review the national anti-corruption strategy and strengthen the DCEO
- Decentralize and capacitate the office of DCEO to southern and northern regions.
- Provide necessary equipment and infrastructure to fight Stock theft and other major crimes
- Develop Livestock Registration, Marking and Information System (LRMIS)

Establish Conflict management and resolution institute

All the programmes should take into account population, gender, rural-urban dynamics and to ensure participation of people with disability and other marginalized groups.

5.2.3 Intervention Cluster 3: Improving Public Sector Efficiency and effectiveness

Public Sector efficiency and effectiveness still remains a challenge, despite the fact that Government has embarked on a number of reforms that were intended to improve service delivery. The public sector is continuing to be burdened with excessive implementation and compliance problems related to maladministration (corruption) and accountability issues. Cabinet then took a decision to provide a road map of how the service delivery dilemma will be addressed. As a result; for the Financial Years 2014/15-2017/18 the government's commitment is to continue to improve critical areas of reforms. To achieve this, Government has to enhance and continue to implement the following expenditure reforms:

- Continue the shift in the composition of resource allocation from recurrent to capital expenditures by keeping the level of recurrent budget constant in real terms or allowing only increases associated with new productive investments.
- Fast track elimination of ghost employees and review of redundant positions by the Ministry of Public Service.
- Enhance efficiency and quality of spending through; i) a comprehensive review of the size and management of government's vehicle fleet with the view to reducing the fleet; ii) pursuing a year-round prioritization of international travel for all government ministries to minimize cost on international fares and subsistence; iii) restricting workshops and training to areas crucial for effective service delivery.
- Strengthen management and operationalisation of the revolving fund under the tertiary bursary scheme. Effective recovery of loan bursaries will provide additional resources for the scheme while releasing annual revenue collections for funding other development programmes;
- Government to establish a consolidated asset management function, to have in place a government asset register, to improve management and maintenance of public assets. National assets have often suffered waste due to lack of maintenance and eventually become very expensive to rehabilitate or reconstruct.
- Enhance procurement capacity to increase value for money, reduce fraud, and enhance transparency.
- Finalise the review of the procurement regulations in order amongst others to improve on the efficiency and effectiveness of the current process.
- Undertake business process reviews and re-engineering in key public sector service delivery institutions e.g. One-Stop Business Facilitation Centre (OBFC).
- Improve financial management systems and administration to eliminate corruption and resource leakages.
- Rationalisation of Lesotho's diplomatic missions abroad.

6 TRANSLATING POLICIES INTO BUDGET ALLOCATIONS

6.1 Historical Budget Allocations and Expenditure

The Government of Lesotho for a number of years has made a concerted effort in streamlining resource allocation from Recurrent Expenditures towards Capital Expenditures in order to improve investment. The Recurrent Budget has on average grown by an annual increase of 6 per cent while Capital Budget registered a growth rate averaging 12 per cent.The focus area has been allocation of resources to National priority sectors such as commercial agriculture, manufacturing, mining, Information Communication Technology (ICT) and tourism. The overall aggregate capital budget for the financial year 2013/14 reflects a decline, mainly due to a decrease in donor funding while GOL contribution continues to improve. Table 2 below reflects the stipulated GOL policy.

Table 3: Aggregate Performance as Against Approved Budget and forecasts

Expenditure By Type	FY2011/12		FY2012/13		FY2013/14		FY2014/15	FY2015/16	FY2016/17
	Budget	Actual Exp	Budget	Actual Exp	Budget	Actual Exp	Budget	Projections	
Total	**11,867**	**10,183**	**12,629**	**9,387**	**12,844**	**12,926**	**15,835**	**18,276**	**19,675**
Recurrent	6,761	7,619	7,197	7,351	8,016	10,041	10,834	13,008	13,856
Capital:	5,106	2,564	5,432	2,036	4,828	2,885	5,002	5,268	5,819
GOL	2,022	2,412	2,386	1,555	2,534	2,661	2,984	3,318	3,521
Donor: Grant+ Loan	3,084	151	3,046	481	2,294	224	2,017	1,950	2,298
Recurrent % of Total	57%	75%	57%	78%	62%	78%	68%	71%	70%
Capital % of Total	43%	25%	43%	22%	38%	22%	32%	29%	30%
GOL % of Capital	40%	94%	44%	76%	52%	92%	60%	63%	61%
Donor % of Capital	60%	6%	56%	24%	48%	8%	40%	37%	39%
% of exp to recurrent budget	-	113%	-	102%	-	125%	-	-	-
% of exp to GOL capital budget	-	119%	-	65%	-	105%	-	-	-
% of exp to total capital budget	-	50%	-	37%	-	60%	-	-	-

SOURCE: MoF Budget Department

Table 3 reflects two messages; i) between 2010/11 and 2013/14, recurrent expenditure has on average been above 76 per cent and capital expenditure around 23 per cent of the total budget. This reflects that more resources have been used on recurrent to support capital budget implementation while the actual capital formation is lower and ii) lower spending on capital budget as compared to approved allocation. For priority ministries such as Trade and Industry, Cooperatives and Marketing Communications, Science and Technology, Public Works and Transport, Energy, Meteorology and Water Affairs and Local Government and Chieftainship Affairs, Capital expenditure is significantly on average 60 per cent of their total budget.

Given the above shown capital budget performance there is therefore a need to address the capital budget challenges even though more resources are being channelled towards investment, the usage of such funds is not satisfactory:

Absorptive capacity:

- Projects are included in the budget while conditions precedents to implementation are not yet finalised. For example, construction of building but acquisition of site not finalised.
- Long and complicated donor disbursement procedures

Institutional capacity:

- Lack of coordination between the client ministries and implementing ministry regarding construction projects

Financial constraints:

- Unwillingness to make necessary budgetary trade-offs amongst programmes and projects.
- Overestimated project costs.

Non-compliance/adherence to financial regulations and procedural requirements:

- Financing unbudgeted recurrent activities under capital budget.
- Not complying with warrant (RIE) release requirements.

Weak monitoring:

- Irregular site visits
- Limited reconciliation between financial and physical progress.

The following measures are recommended to address the above challenges:

- All projects that are considered for funding should be appraised by the Public Sector Investment Committee (PSIC).
- Ministries to develop and submit Programme based proposals in order to facilitate financing and implementation of programmes for which a realisable impact could be seen at end of the implementation of such a programme.
- Refocus or restructure projects that are not in line with new policy initiatives,
- Transfer into recurrent budget projects that are recurrent in nature.
- Implement projects in phases in order to enable monitoring and to measure their impact.
- Terminate projects that no longer have impact.
- The process of resuscitating Planning Cadre be expedited.
- Sector working groups established to promote complementarily

It is highly recommended that all on-going projects that are already in the current budget which were not appraised, be appraised. This exercise should take into consideration training of relevant stakeholders to equip them with necessary skills that will enable them to re-develop viable project proposals

6.2 Transformation of Capital Expenditure

For the Financial years 2015/16 and 2016/17 the macro economic projections indicate a capital budget funding of M3,160 million and M3,347 million at no policy change, reflecting 5.9 per cent increase for the two years recording a marginal growth of M176 million and M187 million respectively.

The indicative ministerial projections for the two years for on-going projects shows a resource need of M3,545.6 million and M2,344.5 million which registers a shortage in financing of M123.4 million and a surplus of M1,311.4 million respectively. On the basis of the above statistical information it has to be noted that the projected capital funding for 2015/16 will not accommodate additional projects and that new projects will likely be accommodated in the financial year 2016/17. It also has to be noted that 2016/17 is the last year of NSDP implementation. It is therefore recommended that fiscal space for the NSDP focussed projects be created sooner (2015/16). This could be either through reviewing the current capital budget portfolio, source external additional funding or draw down on the reserves.

6.3 Recurring Projects and programmes

The current capital budget is characterised by projects/programmes that have been on-going for a number of years and are not showing signs of completion due to increase of scope during the implementation of a project; projects that have been included in the budget while they are not ready for implementation and had not gone through appraisal process.

It is therefore recommended that a firm policy decision be made regarding projects mentioned in the above paragraph.

The table 3 below contains projects which have to be considered as recommended.

- **Absorptive capacity:**
  - Projects are included in the budget while conditions precedents to implementation are not yet finalised. For example, construction of building but acquisition of site not finalised.
  - Long and complicated donor disbursement procedures

- **Institutional capacity:**
  - Lack of coordination between the client ministries and implementing ministry regarding construction projects

- **Financial constraints:**
  - Unwillingness to make necessary budgetary trade-offs amongst programmes and projects.
  - Overestimated project costs.

- **Non-compliance/adherence to financial regulations and procedural requirements**

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- Not complying with warrant (RIE) release requirements.

- **Weak monitoring:**
  - Irregular site visits
  - Limited reconciliation between financial and physical progress.

The following measures are recommended to address the above challenges:

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It is therefore recommended that a firm policy decision be made regarding projects mentioned in the above paragraph.

The table 4 attached contains projects which have to be considered as recommended.

The basis for the recommendations is justified thus;

Refocus/re-design and submit proposal;

- Some project were not appraised
- Some projects were implemented before important activities such as designs or undertaking feasibility studies
- Most projects deviated from their original to a bigger scope.

Prioritise and implement in phases

- This category contains programmes whose impact cannot be easily evaluated hence need to be implemented in phases.

Merge with other related projects

Table 4: Projects Recommended for Review

PROJECT TITLE	SOURCE OF FUNDING	APPROVED BUDGET	APPROVED BUDGET	PROJECTIONS
		2013/14	2014/15	2015/16
Mpiti-Sekake Road (Design)	GoL	0	110,000,000	160,680,000
Literapeng-Tsehlanyane	GoL	3,000,000	0	0
Computerization of Traffic Dept	GoL	10,000,000	0	0
Joel's Drift-Monontsa (Design)	GoL	0	110,000,000	160,680,000
Irrigated Crop Production	GoL	3,000,000	5,000,000	8,000,000
Renovation of Central Correctional Institution	GoL	8,000,000	10,500,000	0
Passport System & Border Management	GoL	10,000,000	0	0
Construction of Mokhotlong Post Office	GoL	0	5,000,000	20,000,000
Nation Museum & Art Gallery	GoL	25,000,000	50,000,000	7,000,000
Mphorosane Training Academy	GoL	2,000,000	0	0
Construction of Low Income Houses	GoL	1,000,000	1,100,000	1,210,000
Construction of Bus Terminal	GoL	2,000,000	2,200,000	2,420,000
Youth Resource Centre	GoL	500,000	600,000	600,000
Vocational Training Centre	GoL	5,000,000	10,000,000	5,000,000
Social Compact for Youth-led Responses to HIV/AIDS	GoL	2,000,000	3,300,000	3,630,000
Tsifa-li-Mali Court Complex	GoL	20,000,000	24,000,000	0
Procurement of Agricultural Machinery	GoL	7,000,000	8,000,000	4,500,000
Construction of Secondary Schools	GoL	6,000,000	10,000,000	10,000,000
Renovation of Leribe Central Correctional Institution	GoL	8,000,000	7,000,000	0
NUL Lecture Rooms	GoL	0	5,000,000	0
Livestock Registration	GoL	8,000,000	0	0
Recapitalisation of LAC	GoL	8,000,000	10,000,000	10,000,000
Free Primary Education (Classrooms)	GoL	15,000,000	3,000,000	1,000,000
Solid Waste Management for Urban coucils	GoL	5,000,000	5,500,000	6,050,000

High Altitude	GoL	0	20,000,000	0
Mejametalana Runway Rehabilitation	GoL	54,000,000	0	0
Construction of Leribe Sports Complex	GoL	20,000,000	0	0
Rehabilitation of Farmers training Centres	GoL	5,000,000	2,000,000	5,000,000
Private Sector Competitiveness and Economic Diversification	GoL	4,000,000	12,000,000	12,500,000
Agric. Productivity and Trade Devt. - EIF Tier II	GoL	1,000,000	1,328,580	1,461,438
TOTAL		**232,500,000**	**415,528,580**	**419,731,438**

SOURCE: MoF Budget Department and MoDP Planning Department