



KINGDOM OF LESOTHO

**2018/19 – 2020/21 BUDGET
STRATEGY PAPER**



MINISTRY OF FINANCE

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LIST OF ABBREVIATIONS AND ACRONYMS

1. AGOA	– African Growth and Opportunities Act
2. AJR	– Annual Joint Review
3. ANC	–Antenatal Care
4. ART	– Antiretroviral Treatment
5. BEDCO	– Basotho Enterprises Development Corporation
6. BFP	– Budget Framework Paper
7. BOS	– Bureau of Statistics
8. BSP	– Budget Strategy Paper
9. CGP	– Child Grant Programme
10. CPI	– Consumer Price Index
11. DCEO	– Directorate on Corruption and Economic Offences
12. ECCD	– Early Childhood Care and Development
13. FY	– Financial Year
14. GDP	– Gross Domestic Product
15. GIZ	– Deutsche Gesellschaft für Internationale Zusammenarbeit
16. GOL	– Government of Lesotho
17. Ha	– Hectare
18. HIV/AIDS	– Human Immunodeficiency Virus/ Acquired Immune Deficiency Syndrome
19. ICT	– Information Communications Technology
20. IMCI	– Integrated Management of Child Illness
21. IVRC	– Ithuseng Vocational and Rehabilitation Centre
22. KPA	– Key Performance Areas
23. LDC	– Least Developed Country
24. LDHS	– Lesotho Demographic Health Survey
25. LHDA	– Lesotho Highlands Development Authority
26. LMPS	– Lesotho Mounted Police Services
27. LNDC	– Lesotho National Development Corporation
28. LRA	– Lesotho Revenue Authority
29. M&E	– Monitoring and Evaluation
30. MDA	– Ministries, Departments and Agencies
31. MCC	– Millennium Challenge Corporation
32. MDP	– Ministry of Development Planning
33. MF	– Ministry of Finance
34. MoSBDCM	– Ministry of Small Business Development, Cooperatives and Marketing
35. MSMEs	– Micro, Small and Medium Enterprises
36. MTDS	– Medium Term Debt Strategy
37. MTEF	– Medium-Term Expenditure Framework
38. MTFF	– Medium-Term Fiscal Framework
39. NCD	– Non-Communicable Diseases
40. NER	– Net Enrolment Rate
41. NSDP	– National Strategic Development Plan
42. NUL	– National University of Lesotho
43. OBFC	– One-Stop Business Facilitation Centre
44. PBM	– Pediatric Bacterial Meningitis
45. PFM	– Public Financial Management
46. PFMA	– Public Financial Management and Accountability
47. PHC	– Population and Housing Census
48. PMTCT	– Prevent Mother-to-Child Transfer
49. PPP	– Public Private Partnership
50. PVC Vaccine	– Pneumococcal Vaccine
51. PQTR	– Pupils Qualified Teacher Ratio
52. PSIC	– Public Sector Investment Committee
53. PSIP	– Public Sector Investment Programme
54. RISDP	– Regional Indicative Strategic Development Plan
55. SACU	– Southern African Customs Union
56. SADC	– Southern African Development Community
57. SOE	– State Owned Enterprises
58. SDG	– Sustainable Development Goals
59. SQUAM	– Standards, Quality, Accreditation and Metrology
60. STEM	– Science, Technology, Engineering and Math
61. TVET	– Technical and Vocational Education and Training
62. UN	– United Nations
63. US	– United States of America
64. UNICEF	– United Nations Children’s Fund
65. VAT	– Value Added Tax
66. WB	– World Bank
67. WB SCD	– World Bank Systematic Country Diagnostic
68. WEO	– World Economic Outlook

FOREWORD

In compliance with Section 7 (1) of the Public Financial Management and Accountability (PFMA) Act, the Government of Lesotho (GOL) through the Ministry of Finance prepares the Budget Strategy Paper (BSP) every fiscal year to guide and underpin the formulation of the National budget. In particular, the BSP provides an assessment of recent macroeconomic and fiscal performances and a macroeconomic outlook for the coming years. The outlook presents in a clear tone economic assumption underlying the forecasts of the resource envelope, particularly tax and non-tax revenue, and provides the context for choices about expenditure in the budget; (ii) the Medium-Term Fiscal Framework (MTFF) which establishes the resource envelope available over the three-year period of the MTEF and; (iii) the Medium-Term Expenditure Framework (MTEF) (Government Expenditure Plans and Priorities). This Budget Strategy Paper also sets out country's policy goals and strategic priorities that will form the basis for formulation of Fiscal Year 2017/18 budget and the Medium Term.

The country priorities and goals outlined herein will focus on the following policy targets that will contribute to the realization of the Coalition Agreement, National Emergency Response Plan, NSDP II and Vision 2020 strategic goals: job creation and the drought related and resilience projects and programmes since the employment creation is the country's main strategy for poverty reduction and also building resilience is important as the country continues to experience the impacts of El Nino which also exacerbates food insecurity. These priorities shall remain the basis for formulation of FY 2018/19 budget and the Medium Term. The paper therefore links the country's planning and policies to Budget which is the main objective of the Medium-Term Expenditure Framework.

Therefore, the paper covers the following broad areas in review of the fiscal performance of financial year 2017/2018 and the proposed 2018/2019 resource allocation strategy; highlights of the recent economic developments and the economic outlook; broad strategic priorities and policies for the Medium Term and the Medium Term Fiscal Framework. The fiscal framework presented in the paper ensures a sustainable financing while allowing continued spending on Government priority programmes. Achievement of the set objectives calls for greater transparency, effectiveness and efficiency in PFM practices in order to ensure fiscal discipline, which will in turn embrace fiscal sustainability.

**MINISTER OF FINANCE
DR MOEKETSI MAJORO**

1. INTRODUCTION

1.1. OVERVIEW

In 2014/15 fiscal year, the Ministry of Finance and Ministry of Development Planning introduced the Budget Strategy Paper (BSP) into the national annual budgeting process as an effort to improve transparency in the preparation of the national budget. To this end, the BSP serves as a consultation document for the policy makers to facilitate discussions of the national budget. The BSP provides an opportunity for the key stakeholders to review suggested national priorities, strategies, projects, and budget allocations for the year. The BSP also adds to the national budget documentation such as the Budget Speech, which is produced as part of the public disclosure to improve fiscal transparency.

The preparation of the 2018/2019 BSP is formulated under very challenging global, regional and local environments. Countries are facing contracting economic conditions with stinging impacts on jobs, especially for the youth, increasing insecurity, political instability and the deterioration in the rule of law have dampened the prospects for our economy and unless these are reversed quickly, economic recovery is likely to be prolonged.

In particular, the BSP outlines Government interventions for Social and Economic Development for FY 2018/19 and over the medium term in line with Government's Macroeconomic and Fiscal strategy, National Vision 2020 and the NSDP. The BSP brings together into three key elements of importance to the budget process mainly:

- (i) *Overview of the Economy and Fiscal Trends* – this provides an assessment of recent macroeconomic and fiscal performances and a macroeconomic outlook for the coming three years. The outlook presents in a clear tone economic assumption underlying the forecasts of the resource envelope, particularly tax and non-tax revenues, and provides the context for choices about expenditure in the budget.
- (ii) *Medium-Term Fiscal Framework (MTFF)* – this establishes the resource envelope available over the three-year period of the MTEF. It is prepared to capture all sources of revenue (tax revenue and non-tax revenue), grants from donors, and any likely borrowings (both domestic and external). The MTFF also sets out any fiscal rules that the Government has agreed to abide by and an overview of fiscal risks, from both the expenditure and revenue perspectives.
- (iii) *Medium-Term Expenditure Framework (MTEF) (Government Expenditure Plans and Priorities)* – this presents the Government's policy priorities and how, given the resource envelope identified in the MTFF, these will be reflected in the budget. The MTEF process has three main objectives: ensuring fiscal discipline by spending what the public sector can afford; allocating resources in line with national priorities; and ensuring national resources are used efficiently. The MTEF is designed to draw consistent linkages between the medium and long-term policy objectives as set out in the National Strategic Development Plan and Vision 2020.

Therefore, to strengthen the link between national priorities set out in the NSDP and the budget, the MTEF sets out two separate phases of the budget preparation process: a strategic phase and an operational phase. The strategic phase is used to review high-level priorities and strategies before detailed resource allocation is undertaken. The operational phase of the budget preparation involves the allocation of resources to various spending entities/units, and concludes with the passing of the national budget by the national legislature. The BSP is in essence the final output of the strategic phase of the budget intended to facilitate consultation with key stakeholders on revenue and expenditure priorities for the fiscal year 2018/2019. It provides the public with an opportunity to measure the Government performance and commitment on pursuing and achieving its policies. The BSP, therefore, contains:

- ✓ Budgetary principles
- ✓ Highlights of recent economic performance and updated medium-term economic outlook.
- ✓ The initial macroeconomic fiscal framework for 2018/19 - 2020/21 and the fiscal strategy from which ministerial budgets allocations will be developed.
- ✓ Strategic policy priorities and public expenditure strategy that guides the preparation of Budget Framework Papers (BFPs) for all Ministries, Departments and Agencies (MDAs).
- ✓ A discussion on the risks to the budget parameters, the strategy and the national socio-economic outcomes.

1.2. NSDP PROGRESS AND ACHIEVEMENTS

Table 1: Summary Assessment of Progress and Achievements

Broad Strategic Goals	Strategic Outcomes	Performance Targets	Progress and Achievements	Key Challenges and Risks
Pursue high, shared and employment creating economic growth		GDP growth rate from 7.2 percent in 2012 to 10.6 percent per annum in 2015/16	3.03 percent as an estimate of real GDP growth in 2015	Agricultural sector was adversely affected by the climate change (El Nino) Manufacturing was also affected by unpredictable AGOA agreement
Develop key infrastructure (Minimum Infrastructure Platform)	-Increased access to safe and clean water -Increased access to basic sanitation	-Increase percent of population with access to safe and clean water from: 63.6 percent (2010) to 79.5 percent (2015/16) in rural areas and 56.8 percent (2010) to 70.7 percent (2015/16) in urban areas -Increase percent of population with access to basic sanitation from: 53.1 percent (2010) to 65.6 percent (2015/16) in rural areas and 77.8 percent (2010) to 88.9 percent (2015/16) in urban areas	Rural Access to clean and safe water has increased from 63.6 percent in 2010 to 75.0 percent in 2015/16 while Urban access has increased from 56.8 percent in 2010 to 96.3 percent in 2014/15. Rural access to basic sanitation has increased from 53.1 percent in 2010 to 54 percent in 2015/16 while Urban access has reduced from 77.8 percent in 2010 to 49 percent in 2014/15.	-Vandalism of water infrastructure -Persistent El Nino induced drought
	- Increased access to ICT	Increase percentage of mobile phone subscribers from 54 percent in 2010 to 57.1 percent in 2015/16	Percentage of mobile phone subscribers has increased from 54 percent in 2010 to 93 percent in 2014/15.	Development of communications and complimentary infrastructure is costly due to difficult terrain.
	Increased power generation	Increase power generation capacity from 72MW in 2012 to 180MW in 2015/16	Power generation capacity has increased from 72MW in 2012 to 74MW in 2015/16	Inadequate infrastructure to increase power generation
	Improved Roads Network	Reduce percent of paved roads classified as poor (Construct more & improve quality) by 5 percent per annum	Percentage of poor paved roads has reduced from 25 percent in 2012 to 22 percent in 2014/15 while percentage of poor unpaved roads has reduced from 96 percent in 2012 to 83 percent in 2014/15.	-The need to design climate proof infrastructure increases construction costs -Unregulated Construction Industry and Uncoordinated Infrastructure Development.

			Poor paved roads network has reduced to 22 percent while poor unpaved roads have reduced to 83 percent in 2014/15.	-Road Reserve Encroachment
	Planned human settlements	Increase area under well planned human settlement (percent of total area) from 3.8 percent in 2012/13 to 4.1 percent in 2015/16	Area under well planned human settlement has reduced from 3.8 percent in 2012/13 to 2.5 percent in 2013/14	-Lack of qualified land surveyors to complete the spatial planning process
Enhance the skills base, technology adoption and foundation for innovation	<ul style="list-style-type: none"> - Increased Enrolment at ECCD, Primary, Secondary and TVET - Improved Quality of Education - Improved Innovation Capacity 	Increase Net Enrolment Rate (NER) at Primary level from 81.1 percent in 2012 to 96.3 percent in 2015.	Primary NER has dropped from 81.1 percent in 2012 to 75.8 percent in 2015. - Reception classes (attached to primary schools) enrolment increased by 12 percent. - Enrolment of students with special educational needs increased by 3.4 percent	Child labour Children taking care of siblings and sick parents Child marriages
		Increase Secondary Education NER from 36.5 percent in 2012 to 42.5 percent in 2015	Secondary NER has been increasing steadily since 2012 from 36.5 percent to 38.7 percent in 2015. It is however below 42.5 percent target.	Secondary school fees are still unaffordable to scores of poor families
		Increase TVET total enrolment from 3,296 in 2012 to 3,436 by 2016.	TVET total enrolment increased by around 34 percent from 3,296 in 2012 to 4,410 in 2015.	-Key risk is the persistent youth unemployment -The skills and qualification of some TVET instructors remain questionable.
		Reduce Pupil – Qualified Teacher Ratio (PQTR) at Primary from 50 in 2012 to 40 in 2015	Primary PQTR has successfully declined from 50 in 2012 to 33.1 in 2015.	-Declining PQTR may also be a result of declining number of children attending school, especially at primary where NER is declining.
		Reduce PQTR at Secondary from 32 in 2012 to 25 in 2015	Secondary PQTR successfully declined from 32 in 2012 to 24 in 2015.	-Maths and Science pass rates have remained low over the years despite low PQTR.
		Register at least two Patents (IPRs) annually.	A total of 8 patents have been registered since NSDP inception year 2012. None were registered in 2012, three were registered each 2013/14 and 2014/15 FY. Two were registered during 2015/16. Therefore, the set target has been maintained.	- Low level of IP appreciation on issues of IPR for enforcement purposes where IPR infringements are observed
Improve health, combat HIV and AIDS and reduce vulnerability	Improved Maternal Health	Reduce Maternal Mortality (per 100 000 births) from 1155 (2009) to 1100 by (2015/16)	Maternal mortality reduced from 1155 in 2009 to 1024 in 2014 (per 100, 000 births)	-Inadequate Human Resources at different levels

	Reduced HIV Incidence	No target due to lack of baseline information	There is no Data on HIV incidence Prior 2014, HIV incidence (New infections per 100 person-years of exposure) is 1.9 (2014).	-Increasing prevalence of Non-Communicable and Communicable diseases (Disease Burden).
	Improved Child Health	Reduce Under 5 Mortality (per 1000) from 117 (2009) to 100 in (2015/16)	Under 5 Mortality (per 1000) has reduced from 117 in (2009) to 85 in (2014). Infant mortality decreased from 91 to 59 per 1000 live births	
	Reduced Malnutrition	Reduce Malnutrition prevalence, height for age (percent of children under 5) from 39 (2009)	Stunting decreased from 39 percent to 33 percent	
Reverse environmental degradation and adapt to climate change	Increased Rehabilitated Area	Rehabilitate areas affected by soil erosion	From 2012/13 to 2015/16, 16 dams, 1,224km of stone lines, 120 km diversion furrows and 333,620m ³ gully structures were constructed to rehabilitate areas affected by soil erosion.	-Environmental (Climate Change) -Vandalism of already existing structures
	Increased area covered by forest	Increase area covered by forest from 13,550 ha (2012/13) to 16,380 ha (2016/17)	From 2012/13 to 2015/16, forest cover increased from 13,550 ha to 53,105 ha.	
Promote peace, democratic governance and build effective institutions	Protected civil liberties improved	Improve civil liberties to not exceed 3	Civil Liberty Index has not changed since 2012. It is still 3 in 2015	Fragile political stability
	Protected political rights improved	Improve protected political rights to not go under 3	Political Rights Index has declined from 3 in 2012 to 2 in 2015/16	
	Reduced corruption	Reduce corruption from 3.5 in 2012 to 4.5 in 2015	Lesotho score on the corruption perception index declined from 49 points in 2012/13 to 44 points out of 100 in 2015/16.	-Ministries are not cooperative -Having no local tool of measurement of corruption
	Women empowered increased	Increase women in Parliament from 23 to 30	Women in Parliament has increased from 23 in 2012 to 25 in 2015	Women adherence to cultural norms towards political leadership
		Increase women in Cabinet from 30 to 40	Women in Cabinet decreased for 30 in 2012 to 22 in 2015	
		Increase women in local councils from 49 to 53	Women in Local Councils increased from 49 to 63	
Improved Public Finance Management	Reduced time to complete financial statements from 6 to 3 months	Completion of Financial statements reduced from 6 months to 3 months		

Source: MDP - Department of Monitoring and Evaluation

1.3. THE FY 2018/19 BUDGET STRATEGY

The 2018/2019 Budget will be guided by the policy targets that will contribute to the realisation of the Coalition Agreement, National Emergency Response Plan, NSDP II and Vision 2020 strategic goals and the Public Financial Management Accountability Act 2011(PFMA). The Government will live within its means by producing a budget that is affordable and sustainable yet responsive to the needs of the country. For the past three years, economic growth has been driven by significant activity in the Mineral & Water sector and supported by the associated high levels of construction.

The Government has continued the fiscal expansion to support the NSDP enablers. However, in response to consistent drop in SACU revenues (29 percent of GDP in FY 2014/15; 24 percent of GDP in FY 2015/16), the impact of South Africa Rand consistent depreciation against the US Dollar on external debt stock and the impact of drought, and taking into consideration strong recurrent expenditure growth in recent Budgets which have allowed for significant surplus/deficit Budgets (3.5 percent of GDP in FY 2014/15; -1.3 percent of GDP in FY 2015/16; and project to -9.6 percent of GDP in FY 2017/18).

1.3.1. Budgetary principles

To achieve this outcome, the following principles will underpin and guide the 2018/19 Budget:

- a) Achieve consistency of the MTEF to the national priorities; and efficiency, effectiveness and value for money in public expenditure;
- b) Adopt a Budget that is affordable, sustainable and yet responsive to the needs of the country over the medium term;
- c) Achieve sufficiency in domestic revenue mobilisation to finance Government programmes while gradually limiting the dependence on external financing;
- d) Consistently constraining the Government's recurrent expenditure not to grow more than the development expenditure;
- e) The Government's expenditure on compensation of employees should not be seen growing as a percentage of GDP;
- f) Over the medium term, the government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure;
- g) Management of fiscal risks in a prudent manner;
- h) A realistic degree of predictability with respect to the level of tax rates and tax bases shall be maintained, taking into account any future tax reforms;
- i) Ensure fiscal consolidation through expenditure prioritisation that will result in quality spending;
- j) Improve monitoring, transparency and accountability mechanisms to ensure expenditure efficiency; and
- k) 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.

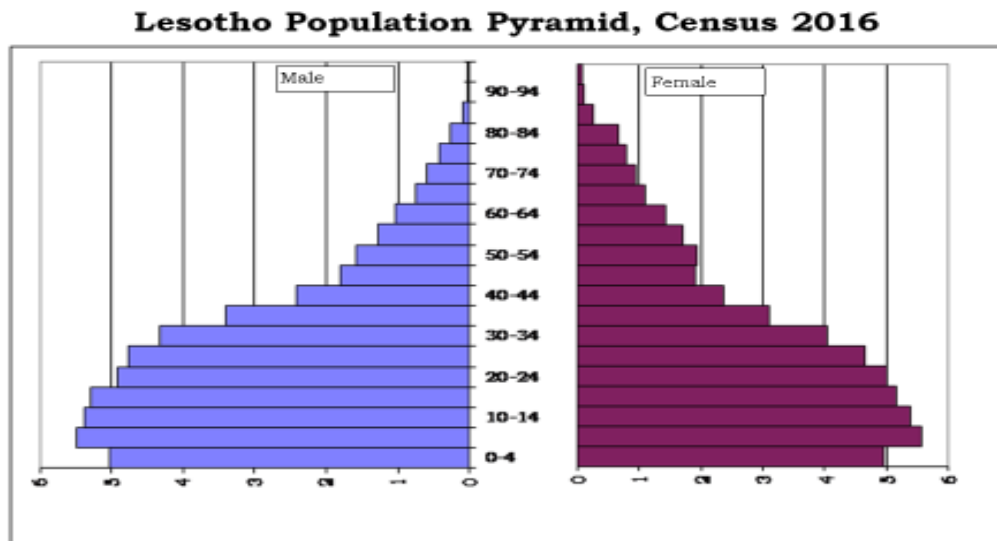
2. DEVELOPMENT CONTEXT

2.1. POPULATION, POVERTY, INEQUALITY, UNEMPLOYMENT

Lesotho has a population of 2,008,801¹, a 0.68 percent increase from the 2006 census. Females and males comprise 51 percent and 49 percent of the total population, respectively. The population pyramid below has a broad base and tapers at the top. This is an indication that Lesotho has a young population, with youth comprising 39.6 percent of the total population, while the elderly (aged 65 years and above) comprise 6.1 percent of the population.

The 2016 census estimates that 45,607 people have disabilities. The most prevalent types of disability include visual impairment and dementia with prevalence rates of 36.2 and 36.8 percent, respectively. These figures imply that 8.6 percent of the population is either old or disabled, which means there is an increasing need for social services and safety nets to take care of these people. The age dependency ratio, which is defined as the ratio of dependents (people younger than 15 or older than 64) to the working population, has increased from 40 percent in 2006 to 60.9 percent in 2016. This shows the significant impact HIV/AIDS related deaths are having on the country's working population, the working population is shrinking while the number of dependents is rising.

Figure 1: Lesotho Population Pyramid



Source: 2016 Population and Housing Census

Majority of the population, 58 percent lives in rural areas, while 34 percent lives in urban areas and 8 percent lives in peri-urban areas. The average national population density is low at 66 persons per square kilometre, however, while expressed in terms of arable land, the population density rises to 349.8 people per square kilometre. Mokhotlong is the least dense district with a population density of 24.1, while Berea is the most densely populated district at 132.9 persons per square kilometre.

¹ 2016 Population and Housing Census

Poverty and Inequality

After 50 years of independence, Lesotho has made much progress towards development but poverty and inequality remain significant challenges for the country. Lesotho is still a Least Developed Country (LDC) with per capita income of US\$ 9982, and 57.1 percent³ of population living below the poverty line. Poverty rates have remained high in rural areas, household headed by females and those with low levels of education. The urban-rural income gap remains large, with 76 percent⁴ of the people in rural areas earning significantly less than those in urban areas. Poverty among women-headed households was around 64 percent compared to 57 percent among households headed by men, which shows that poverty is closely linked with gender roles and power. Poverty and location are both correlated with worse health, nutritional, and educational outcomes. Access to health facilities is still a challenge for the poor. Educational outcomes have not changed that much in rural areas, and access to post-primary education remains a challenge for the poor.

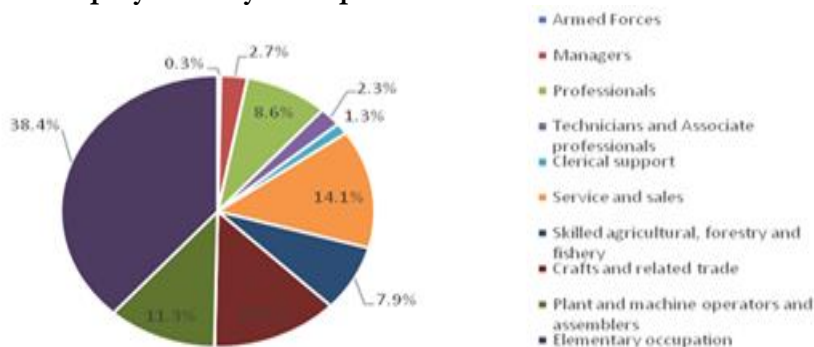
Most notably, poverty rates have virtually unchanged over time, from 56.6 percent in 2002/03 to 57.1 percent in 2010/11, despite huge investments in the social sectors by the government and its development partners. In addition to poverty rates being high and unchanged, poverty depth has also increased over time, with a poverty gap of about 30 percent, implying that significant growth would be needed to bring majority of the people out of poverty. Inequality, as measured by the Gini coefficient, increased slightly from 0.51 in 2002/03 to 0.53 in 2010/11 Household Budget Survey. The bottom 40 percent of the population's per capita consumption contracted by 0.4 percent annually over the past five years, while per capita consumption of the top 20 percent of the population grew by 1.1 percent⁵.

In order for the country to make progress on poverty reduction, both economic growth and policies to lower inequality will be required. This calls for a rethinking of the country's growth and development model to increase its inclusiveness by adopting integrated measures that deepens the inclusiveness of growth and improves the targeting and efficiency of the social safety net. According to the NSDP Review 2016, the role of social protection has increased and Lesotho has become a model of targeted reductions in vulnerability, with its own donor-supported programme, which is making a difference in rural areas. However, due to its heavy dependence on donor support, the programme's sustainability is unclear. Inclusiveness will require broad-based job creation, greater productivity, and a structural shift in Lesotho's growth model.

Unemployment

Although the overarching objective of Lesotho's long-term policies has been poverty reduction through job-creation, growth thus far has not resulted in sustainable jobs. The 2016 Population and Housing Census estimates total labour force at 656,809, where males make up 66 percent of the labour force and females make up the remaining 34 percent. The Continuous Multipurpose Survey Report, 2014/15 estimates unemployment rate at 32.8 percent⁶, which is high and has resulted in an economic dependency ratio of 1.41. Figure 2 below shows that majority of the working population (38.4 percent) is engaged in elementary occupations which, consist of simple and routine tasks that mainly require the use of hand-held tools and often some physical effort. Which is an indication that our economy has not been able to create jobs in more productive and higher paying activities. Further, the limited job opportunities in the private sector has put the public sector under enormous pressure to provide employment, which has bloated the size of the public sector and public expenditure. This has led to a vicious cycle that simultaneously crowds out private investment in the country.

Figure 2: Employment by Occupation



Source: 2014/15 Continuous Multipurpose Survey, BOS

2.2. HUMAN DEVELOPMENT

Lesotho ranks 160 out of 187 countries on the 2015 UN Human Development Index, falling into the category of low human development with a score of 0.497. Notably, Lesotho ranks lower than all the other SACU countries on human development. The recently published 2016 Population and Housing Census (PHC) found Lesotho’s life expectancy to have improved to 56 years in 2016. As shown in the following table, there have been gradual improvements since 2005, especially for females live 13 years longer on average than in 2005. Since 2005, HIV/AIDS and tuberculosis have remained the top major causes of deaths in the country, with lower respiratory infections being the third highest cause.

Table 2: Lesotho Life Expectancy

	1990	2005	2016
Males	56.5	42.3	51.7*
Females	64.5	45.8	59.5*

Source: <http://www.healthdata.org/lesotho> and *2016 estimates from the Population and Housing Census

The HIV prevalence has increased to 25 percent and still maintains Lesotho’s second position as most impacted by HIV/AIDS in the world. However, efforts are being made to prevent or minimize this high prevalence, especially towards prevention from the mothers to child such as the “mother-baby pack”; and new PMTCT guidelines which are aimed at scaling-up PMTCT services to a greater proportion of pregnant women and new-borns who would otherwise not receive antiretroviral drugs to prevent mother-to-child transmission. Pregnant and lactating mothers, HIV Positive & TB clients, and also malnourished under-5 are being provided with food supplements. The government has also launched the “test and treat” campaign in which every infected person will get treatment regardless of their CD4 count. However, significant challenges still remain due to limited access to health services, which is constrained largely by high out of pocket expenses for specialised medical health needs, especially in the rural areas and critical human resources for health are still limited.

²World Bank Development Indicators 2016

³ 2010/11 Household Budget Survey

⁴World Development Report 2012: Gender Equality and Development.

⁵ World Bank, Lesotho: Systematic Country Diagnostic

⁶ Bureau of Statistics, First Quarter 2014/15 Continuous Multipurpose Survey

According to the Lesotho Demographic Health Survey (LDHS) 2014, maternal mortality rate has improved slightly from 1155 to 1,024 per 100 000 live births due to improvements in the indicators relating to maternal health care. The proportion of women who received antenatal care (ANC) services from skilled providers increased from 90 percent in 2004 to 95 percent in 2014. The LDHS also reported a significant increase of births attended by skilled health providers from 55 percent (2004) to 62 percent (2009) then to 78 percent (2014). The proportion of births that occurred in the health facilities also increased significantly over the years, recording 52 percent in 2004, 59 percent in 2009 and 77 percent in 2014 (AJR, 2015). There has been a significant progress in reducing under-five mortality rate from 117 recorded in 2009 to 80 deaths per 1,000 live births in 2016.

According to NSDP Review 2016, the reduction in under-five mortality rate was attributable to a slight decrease in malnutrition, but advancements in immunization, especially in the case of measles. Likewise, infant and child mortality rates have also decreased from 59 to 53 and 28 per 1000 live births, respectively. Progress in these measures is a result of, among others, health workers gaining more and better skills in delivery care, obstetrics and family planning through the training of nurses and doctors on Integrated Management of Child Illnesses (IMCI) in all districts; conducting surveillance on Paediatric Bacterial Meningitis (PBM) and Rota Virus; and introducing Pneumococcal Conjugate Vaccine (PCV 13). Infant mortality rates are higher in rural areas at 55.1 percent compared to 50.9 percent in urban areas and 51.5 percent in peri-urban areas.

Malnutrition and food insecurity remain chronic problems in Lesotho, and are a key obstacle to the country's development agenda. An estimated 39 percent of households are vulnerable to food insecurity, despite implementation of agricultural support programmes, including input subsidy schemes and crop sharing schemes by the government. Around 70 percent of the population resides in rural areas and most of which are subsistence farmers. Household food security is low due to low productivity in agriculture and absence of other economic opportunities. The low agricultural productivity is a result of, among others, low adaptation of high yielding technologies and poor adaptation to climate change. The LDHS 2014 indicates that one-third of children under age 5 are stunted, or too short for their age. Stunting is an indication of chronic undernutrition. Children living in the poorest households are more than three times as likely to be stunted than children living in the wealthiest households (46 percent versus 13 percent). The report notes that the prevalence of stunting, wasting, and underweight have all declined over the past 10 years, with stunting declining from 44 percent in 2004 to 33 percent in 2014. These improvements suggest that food security at the household level has been improving, mainly due to efforts being made to address the problem like implementation of "Blanket Feeding Strategy" and the intensive training of pregnant and lactating mothers on options of proper nutrition for child feeding.

Despite the progress that has been made, the incidence of stunting is still high at 33 percent and remains a concern for the country, since the cognitive abilities of undernourished children are impaired; hence, their chances performing well at school and acquiring employable skills as an adult are lower. The 2016 Population and Housing Census estimates that the number of orphans has declined by 4.8 percent from 221,403 in 2006 to 210,712 in 2016. However, this number is still high, and it is mainly because of the high HIV/AIDS deaths. One of critical interventions has been the Child Grant Programme (CGP), which has reached at least 25,000 households and provided benefits for more than 70 000 children across the 10 districts.

The country has made significant progress in the overall literacy since 97 percent women and 85 percent of men aged 15-49 are literate. Over half of women and 40 percent of men attended at least some secondary school and 9 percent of women and 8 percent of men have more than secondary education. However, significant challenges remain on the efficiency and effectiveness of public spending in education. Expenditure on education is one of the highest relative to GDP, but the country's education outcomes have been unsatisfactory. Enrolment in primary schools had been steadily decreasing since 2004 and the primary school net enrolment rate in 2013 was 77.3 percent, down from 81.8 percent in 2010. Over the same period, secondary net enrolment increased from 34.2 percent to 37.3 percent, while enrolment of learners in TVET remained stagnant, with 3296 in 2012 and 3303 in 2013. In terms of quality, pupil learning scores compare poorly with the Sub-Saharan African region, despite the considerably higher spending on education in comparison to Sub-Saharan African countries (WB SCD, 2015). In Tertiary education, relevance of curriculum, employability of graduates and skills mismatch are widely cited as major causes of high graduate unemployment with simultaneous shortages of skilled labour in the private sector.

The country has made significant progress in water and sanitation access, although access to electricity is lagging behind. The 2016 Population and Housing Census indicates that more than 8.8 in 10 households have access to an improved source of drinking water, with 97 percent access in urban areas and 80.2 percent access in rural areas. Regarding sanitation, 56.4 percent of households use an improved sanitation facility, but 19.6 percent of households still use open defecation (bush or field). Overall, 28 percent of households in Lesotho have electricity that is connected to the grid.

Gender equality is one of the country's main priorities and 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. However, the country's progress in promoting gender equality has stalled, as the country has moved down 41 places from a rank of 16 in 2013 to 57 out of 144 countries in the Global Gender Gap Report 2016. 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. In order to keep momentum on gender equality and achieve inclusive economic development, the country will need to tackle the remaining underlying social norms and legal barriers that hinder equal participation of men and women in the economic opportunities.

2.3. COMPETITIVENESS

Lesotho's economy, like many small economies, is less diversified, predominately based on agriculture and textile manufacturing and it is highly dependent on trade, as the main path for the country's growth. This makes the country particularly vulnerable to international or regional shocks. To reduce this vulnerability, Lesotho needs to diversify into new economic activities. This requires strong industrial policy and strategic governance to encourage the discovery of new sectors and the establishment of infant industries. Against this backdrop, Lesotho's international competitiveness is of critical importance for growth. Lesotho's competitiveness ranking is low relative to those of its competitors for investment in the SACU region, meaning that it is among the least-attractive areas for investment in the region (Table 3 below). The country's competitiveness is affected by the high costs of doing business in Lesotho.

Table 3: International competitiveness of SACU countries

SACU country	Global Competitiveness Ranking 2016-2017 (World Economic Forum)	Ease of Doing Business Ranking 2017 (World Bank) - out of 190 economies
South Africa	47	74
Botswana	64	71
Namibia	84	108
Lesotho	120	100
Swaziland	-	111

Generally, the costs of doing business are higher in small, landlocked or mountainous countries – all three of which apply to Lesotho. The need to import intermediate goods and export final goods raises production costs, as do the small markets for labour and other domestic inputs. Consumer markets are small, transport costs are naturally high, and firms face much competition despite the high costs of production. Such high production costs have a greater impact on firms in low value-added goods and services. To enable firms to become internationally competitive, the costs of doing business must be reduced in other areas, notably the business environment, to compensate for these costs. The Government has the unenviable task of creating a business environment that is superior to those of its larger peers.

2.4. POLITICAL GOVERNANCE AND MANAGEMENT

Effective government institutions and a well-defined regulatory framework contribute to a stable investment climate, while the judiciary's ability to settle disputes, for example, facilitates smooth business operations. As a small, enclave country, Lesotho's special development challenges require effective strategic governance. This means that to achieve similar rates of job creation and growth as its peer countries, Lesotho has to be a better place for doing business than its neighbours, because it has to offset other constraints. Figure 3 below shows Lesotho's ranking (out of 215 countries) on the World Bank governance indicators which assess six dimensions of governance.

While the country has made progress on the dimensions of control of corruption, regulatory quality and accountability by improving its rankings between 2004 and 2014, there has been a deterioration in government effectiveness and political stability, while the rule of law dimension has remained relatively unchanged. Lesotho's government effectiveness rank declined from 43 in 2004 to 32 in 2014, while on political stability the rank declined from 60 in 2004 to 36 in 2014. Notably, threats to political stability remain, especially conflicts that arise between political parties and intra-party clashes. At community level conflicts still arise, especially over communal grazing and stock theft. Human trafficking is becoming an area for concern. A new forward looking national conflict management strategy is needed to consolidate the democratic and peace architecture. In addition, a significant reform and modernisation of the public sector will be required to improve government effectiveness, efficiency and accountability. Reforms will require improvements in planning, procurement, performance management processes and monitoring and evaluation. Support for a more effective public service and more informed policymaking will require substantial upgrading of statistical capacity to ensure access to regular, consistent, and comprehensive data.

In relation to decentralisation and service delivery, a new decentralization policy has been adopted and new district economic strategies are in progress, with district consultations completed, 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 foster a cadre of entrepreneurs in each district to convert potential commercial opportunities into jobs and propel economic growth.

Major improvements have been realised in improving business in Lesotho terms of licensing, getting passports, identification cards, water and electricity connections, reducing back log of cases and others, with the roll-out of the one-stop-shop pilot project expected to improve availability of services in the districts. There is still much more room for improvement in quality, availability and efficiency. 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. It is also important to improve the capacity to generate timely statistics, analyse policies and establish the approved national monitoring and evaluation system.

Figure 3: Lesotho’s Ranking on Worldwide Governance Indicators



3. MACROECONOMIC TRENDS AND OUTLOOK

3.1. GLOBAL ECONOMIC REVIEW AND OUTLOOK

According to the IMF World Economic Outlook (WEO) issue of July 2017, the awaited recovery in global output remains on track. Global output is projected to grow by 3.5 percent in 2017 and 3.6 percent in 2018. This pickup in growth is shaped by U.S. growth projections which are lower than in April. Growth has been revised up for the euro area and China. Oil prices have regressed, indicating strong inventory levels in the United States and a pickup in supply. Headline inflation remains relaxed at levels well below central bank targets in most advanced economies as the influence of the commodity price rebound of the second half of 2016 washed-out. Core inflation has remained broadly stable.

According to the WEO update 2017, the U.S. dollar has depreciated by about 3.5 percent in real effective terms since March, while the euro has strengthened by a similar amount on increased confidence in the euro area recovery and a decline in political risk. Over the same period, exchange rate changes across emerging market currencies have been relatively modest. At the same time, capital flows to emerging market economies have been buoyant in the first few months of 2017, with a remarkable pickup in non-resident portfolio inflows.

Outlook remains challenging In Sub-Saharan Africa, with growth likely to rise to 2.7 percent in 2017 and 3.5 percent in 2018. The slender upward revision to 2017 growth relative to forecast reflects a modest upgrading of growth prospects for South Africa, which is undergoing a bumper crop production due to better rainfall and an increase in mining output driven by a moderate rebound in commodity prices.

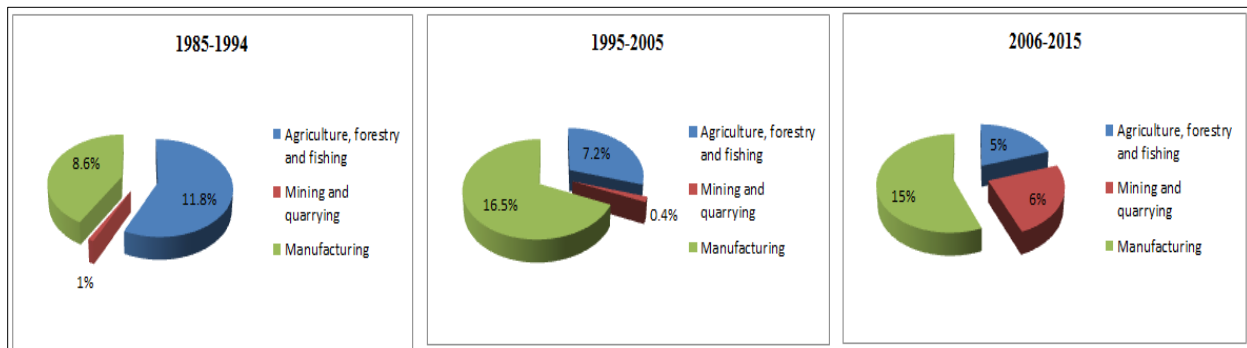
However, the outlook for South Africa remains difficult, with high political uncertainty and weak consumer and business confidence, and the country's credit ratings was consequently marked down.

3.2. DOMESTIC ECONOMIC REVIEW AND OUTLOOK

Over the past three decades, the structure of Lesotho's economy has changed significantly. Agriculture, which is the pillar of the rural economy and the sector that employs most of the poor, has been deteriorating since the early 1990s due to unpredictable climatic weather conditions, including inconsistent rains and persistent droughts.

As a result, the contribution of agriculture to gross domestic product (GDP) has been declining. It shrunk from 11.8 percent between 1985 and 1994 to approximately 7.2 percent between 1995 and 2005, and ultimately to around 5.0 percent in 2006 - 2015 (Figure 4). The poor performance of the agriculture sector has compounded the country's already weak food security situation.

Figure 4: Sectoral Contribution to growth 1985 - 2015



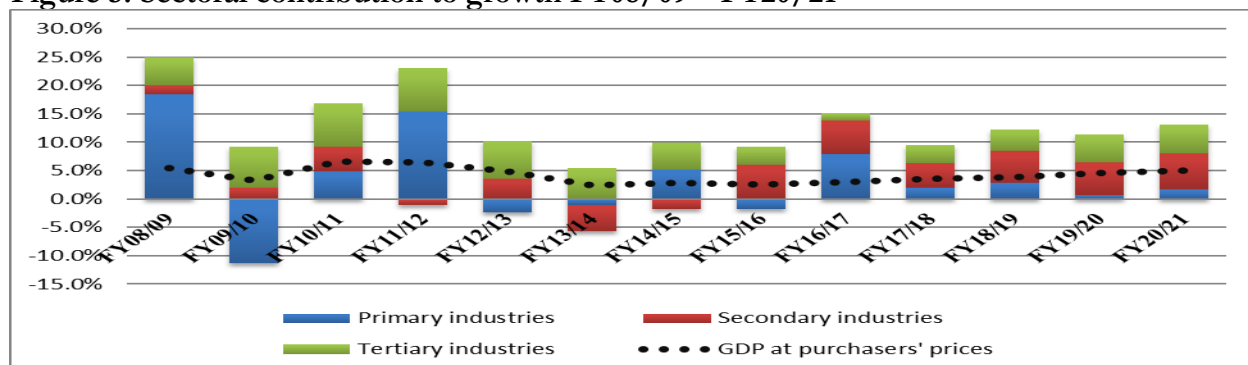
Manufacturing on the other hand, has become the main vehicle for growth and job creation over the past decade and is driven mainly by the textile and apparel industry. Its contribution to GDP has risen from 8.6 percent between 1985 and 1994 to nearly 16 percent in 2015 (Figure 1). This fast growth in textile and apparel was boosted by Lesotho's participation in the United States of America (USA) African Growth and Opportunity Act (AGOA) which started in 2000. However, the industry has experienced some challenges in recent years due to increased competition from Asian producers in the USA market subsequent to the termination of quotas under the Multi-Fiber Arrangement.

Mining activities have increased from contributing only 1.0 percent of GDP between 1985 and 1994 to about 6.0 percent in 2006 – 2015 as illustrated in Figure 1. The rapid growth reflects the opening of new diamond mines. However, mining's capital-intensive nature and weak linkages with the other economic sectors has limited its impact on job creation. For this reason, it is prudent for Lesotho to put in place stronger policies and strategies for managing its available mineral resources and promoting value addition of mining products in order to make growth more inclusive and increase the resilience of the country's medium-term growth prospects.

3.2.1. Recent economic development

Domestic output growth for 2016/17, forecasted at 2.5 percent at the time of the 2016/17 Budget, has been revised upwards to 2.9 percent. This growth is expected to increase to 3.6 percent by 2017/18, supported by improved production base in the mining sector, strong growth construction sector, financial intermediation, wholesale and retail trade and repairs, a recovery in agricultural production and low inflation, stabilising commodity prices and stronger global growth.

Figure 5. Sectoral contribution to growth FY08/09 – FY20/21



3.2.2. Developments in the Primary Industries

Real value added in the agriculture, forestry and fishing sector recovered in the last quarter of 2016 from a poor performance recorded in 2015/16 as a result of the experienced serious drought conditions in many parts of the country during the 2015/16 planting season. Mining production was down in 2016/17 but is projected to recover by 2017/18 compared with 2015/16. However, mining production between 2015/16 and 2016/17 recorded an averaged negative growth of 0.8 percent. High operating costs, low commodity prices and weak global demand made a difficult operating environment. Primary industries output is projected to recover to 2.8 percent in 2017/18 and average 1.8 percent over the projection period. Improved weather conditions coupled with moderate rise in commodity prices that began in 2016 is expected to boost production.

3.2.3. Development in the Secondary Industries

Secondary industries output has grown by 6.0 percent between 2015/16 and 2016/17. Growth in this sector was designed by good performance in the textile sector despite uncertainty that surrounded the renewal of AGOA in 2015, while construction performed poorly during the same period. Output in the secondary sector is estimated to register growth of 4.3 percent in 2017/18 at the back of the expected recovery in construction as well as buoyant growth in the manufacturing sector. Over the medium term, secondary industries are expected to get a boost from LHWP II which is anticipated to commence during the projection period.

3.2.4. Developments in the Tertiary Industries

For the past decade, tertiary sector industries have been the main vehicle for growth in the country. The sector has been growing steadily, driven mainly by robust growth in wholesale and retail trade, repairs, transport and communication, financial intermediation as well as public administration. Between 2015/16 and 2016/17, the industry recorded steady growth of 2.2 percent on average and this growth was driven primarily by information and communication (13.4%), and activities in administrative and support services (11.7%).

In 2017/18, the tertiary industries are expected to recover to 3.1 percent relative to 1.3 percent recorded in 2016/17. This recovery will be shaped by strong growth in sectors of wholesale and retail, accommodation and food services, financial and insurance, information and communication as well as professional, scientific and technical activities will boost growth in this sector.

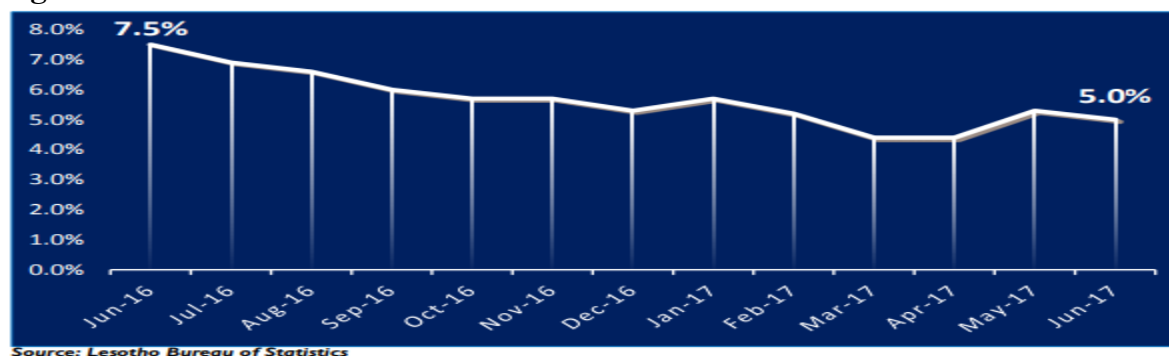
Table 4. Overview of domestic economic outlook

Percentage change	FY15/16	FY16/17	FY17/18	FY18/19	FY19/20
	Actual	Actual	Estimate	Projection	Projection
Industry Constant Prices					
Agriculture	-3.6%	15.6%	0.7%	1.6%	-2.1%
Growing of crops; market gardening; horticulture	3.9%	157.9%	3.0%	2.8%	-6.3%
Farming of animals (incl. fishing)	-1.1%	-15.8%	0.2%	0.2%	0.2%
Agricultural and animal husbandry service activities	-4.4%	0.0%	-0.1%	-2.2%	-1.4%
Forestry	-18.4%	-19.6%	-6.5%	3.9%	3.9%
Fishing and aquaculture	-13.0%	0.0%	7.3%	8.1%	8.6%
Mining and quarrying	0.8%	-2.4%	4.1%	4.7%	4.9%
Primary industries	-1.7%	8.0%	2.0%	2.8%	0.7%
Manufacturing	14.9%	21.8%	4.9%	5.0%	5.3%
Food products and beverages	-0.6%	10.1%	9.0%	2.0%	3.8%
Textiles, clothing, footwear and leather	17.3%	25.5%	5.1%	5.7%	5.9%
Other manufacturing	13.3%	8.7%	1.3%	2.5%	2.6%
Water and sewerage; waste collection	-2.6%	-3.9%	2.3%	3.8%	4.5%
Construction	0.0%	-13.5%	3.7%	8.5%	7.9%
Secondary industries	6.1%	5.9%	4.3%	5.7%	5.8%
Wholesale and retail trade; repair of motorvehicles	-3.4%	0.5%	3.4%	5.0%	7.3%
Transportation and storage	-2.3%	1.0%	1.0%	3.3%	5.5%
Accommodation and food service activities	-9.5%	1.3%	0.8%	4.1%	0.8%
Information and communication	13.7%	13.0%	4.1%	4.0%	6.5%
Financial and insurance activities	6.3%	-7.7%	4.0%	5.3%	7.3%
Financial service activities, except insurance	8.3%	-9.6%	4.2%	5.8%	8.0%
Insurance and pension funding	-7.1%	2.5%	2.8%	2.9%	3.5%
Activities auxiliary to financial services	3.8%	6.8%	3.0%	3.4%	3.7%
Real estate activities	1.8%	1.8%	1.9%	2.0%	2.0%
Professional, scientific and technical activities	-1.8%	-2.4%	5.8%	5.9%	6.2%
Administrative and support service activities	24.8%	-1.5%	2.3%	2.5%	4.0%
Public administration and defense; compulsory social security	5.5%	1.7%	1.9%	2.1%	2.6%
Education	0.0%	1.5%	2.7%	2.7%	2.7%
Human health and social work activities	7.4%	4.4%	6.4%	6.4%	6.4%
Other service activities	-1.8%	7.4%	6.4%	6.4%	6.4%
Tertiary industries	3.2%	1.3%	3.1%	3.7%	4.8%
All industries at producers' prices	3.2%	3.1%	3.3%	4.1%	4.6%
of which: Government activities	1.8%	1.9%	-0.1%	-2.2%	-1.4%
GDP at purchasers' prices	2.6%	2.9%	3.6%	3.9%	4.6%

3.3. PRICE AND MONETARY DEVELOPMENTS

Inflation and price developments in Lesotho are expected to continue to move in line with those in South Africa over the short to medium term. The annual inflation rate increased by 5.0 per cent in June 2017 compared to 5.3 per cent in the preceding month as reflected in figure 4. A year earlier inflation rate was 7.5 per cent during the corresponding month. The deceleration in the annual inflation rate between June 2017 and June 2016 was mainly due to the decline in the cost of food & nonalcoholic beverages (6.5 per cent down from 13.8 per cent in June 2016) that accounts for 36.1 per cent of the overall inflation basket. The other main categories based on the basket weights, the clothing & footwear category reflected that prices increased by 2.6 per cent in June 2017, while the prices of the third main category, housing & utilities rose by 5.5 per cent. On average, prices increased by 0.3 per cent between June 2017 and May 2017.

Figure 6: Lesotho Annual Inflation Rate



The Loti, which is pegged to the South African Rand, depreciated by an average of 16% against the US dollar between 2013/14 and 2015/16. As the South African economy's performance has been modest, the Rand has seen depreciation against international currencies. Similarly, the Loti depreciated further in 2016/17 and is expected to continue to depreciate further through the medium-term due to weak fundamentals in the South African economy including deterioration in economic growth as well as weak capital inflows.

3.4. EXTERNAL SECTOR

The current account balance registered an annual average deficit of 12.9 per cent of GDP between 2015/16 and 2016/17. Stronger export growth was offset by a higher growth in imports due to increased demand for imports over the reference period. This deteriorated the trade balance, thereby putting more pressure on the current account balance. The current account deficit was further exacerbated by a decline in income account due to lower compensation of Basotho miners in South Africa.

The performance of the external sector is expected to recover in 2017/18 from a deficit of 17.2 percent of GDP recorded in 2016/17 largely as a result of the expected decline in current transfers due to an expected decline in SACU transfers coupled with a drop-in income account following a continued decrease in compensation of Basotho miners in South Africa. The 2017/18 current account balance is expected to register a deficit of 14.1 percent of GDP and continue to deteriorate over the medium term.

4. MEDIUM-TERM FISCAL FRAMEWORK AND FISCAL STRATEGY

Table 3 presents the fiscal performance from 2014/15 to 2017/18 and the preliminary medium-term outlook for 2018/19 to 2020/21.

Table 5: Medium Term Fiscal Framework 2017/18 to 2020/21

ANNEX 3 FISCAL FRAMEWORK							
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Revenue	14 582,5	15 299,9	13 845,0	16 035,0	16 682,7	17 759,0	18 733,3
1. Tax revenue	5 785,4	6 578,1	7 044,2	7 604,3	8 600,5	9 215,0	9 788,0
3. Grants	495,7	966,1	866,5	793,4	833,9	878,1	916,6
4. Other revenue	1 267,3	1 357,1	1 415,2	1 483,1	1 625,4	1 739,9	1 782,3
5. SACU	7 034,1	6 398,6	4 519,0	6 154,2	5 623,0	5 926,0	6 246,3
Expense	-10 744,7	-12 030,6	-12 737,6	-14 162,0	-14 710,5	-15 559,8	-16 326,5
1. Compensation of Employees	-4 984,5	-5 538,4	-6 069,4	-6 572,1	-6 952,1	-7 477,3	-8 027,3
2. Use of goods and services	-2 829,6	-3 085,9	-3 208,9	-3 649,5	-3 813,6	-4 005,5	-4 142,6
4. Interest Payments	-177,2	-274,1	-282,5	-377,2	-443,4	-472,9	-432,6
5. Subsidies	-201,4	-250,7	-415,9	-307,9	-364,8	-336,4	-350,6
6. Grants	-1 037,0	-1 105,9	-1 258,0	-1 328,5	-1 156,2	-1 218,0	-1 266,1
7. Social Benefits	-779,1	-897,9	-852,4	-1 060,8	-1 108,6	-1 165,7	-1 220,1
8. Other expense	-735,9	-877,8	-650,4	-865,9	-871,9	-884,1	-887,2
Net Worth and its Changes	-3 673,1	-2 782,9	-477,8	-1 873,0	-1 972,2	-2 199,2	-2 406,7
1 Nonfinancial assets	-2 986,9	-3 685,2	-3 392,7	-3 467,7	-3 753,0	-3 915,0	-4 029,6
2. Financial assets	-1 499,3	598,7	2 471,5	845,5	774,3	922,5	760,3
3. Liabilities	813,0	303,6	443,4	749,2	1 006,5	793,4	862,6
Statistical Discrepancy	164,7	486,4	629,6	0,0	0,0	0,0	0,0
% revenue	1,1%	3,2%	4,5%	0,0%	0,0%	0,0%	0,0%
Analytical Measures	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Gross operating balance	3 837,8	3 269,3	1 107,4	1 873,0	1 972,2	2 199,2	2 406,7
Net lending/borrowing	850,9	-416,0	-2 285,3	-1 594,7	-1 780,8	-1 715,9	-1 622,9
Overall fiscal balance	850,9	-416,0	-2 285,3	-1 594,7	-1 780,8	-1 715,9	-1 621,9
IMF Oct 2012 Fiscal Balance Proj							
Fiscal Deficit/Surplus (GoL)	848,2	-416,9	-2 285,3	-1 597,7	-1 782,6	-1 717,6	-1 623,4
Core Fiscal Balance	-2 690,9	-3 115,2	-2 691,9	-3 133,9	-2 371,5	-2 255,6	-2 103,1
Overall fiscal balance (financing side)	686,2	-902,3	-2 914,9	-1 594,7	-1 780,8	-1 715,9	-1 621,9
MTFF fiscal balance (financing side)	683,5	-903,3	-2 914,9	-1 597,7	-1 782,6	-1 717,6	-1 623,4
Overall primary balance	4 015,1	3 543,4	1 389,9	2 250,2	2 415,5	2 672,0	2 839,3
Primary operating balance	4 015,1	3 543,4	1 389,9	2 250,2	2 415,5	2 672,0	2 839,3
Gross saving	3 791,1	2 986,0	915,1	1 758,2	1 879,9	2 107,2	2 313,0
Total expenditure	-13 731,6	-15 715,8	-16 130,3	-17 629,7	-18 463,5	-19 474,9	-20 356,1
Government final expenditure	-8 726,0	-9 540,1	-10 284,8	-11 320,1	-11 965,4	-12 766,5	-13 487,4
Gross investment	-2 986,9	-3 685,2	-3 392,7	-3 467,7	-3 753,0	-3 915,0	-4 029,6
Debt	11 941,1	14 905,9	14 013,0	14 477,3	14 577,5	12 252,0	12 165,6
Central Govt Deposits	6 581,2	5 806,4	3 270,2	2 424,7	1 650,4	728,0	-32,3
Foreign Assets (cbl)	-12 274,4	-13 983,7	-10 268,7	-10 530,1	-10 128,2	-9 407,4	-8 647,2
Foreign Liabilities	1 402,0	1 716,6	1 585,3	1 585,3	1 585,3	1 585,3	1 585,3
Imports (goods & services)	-23 765,3	-27 396,3	-27 343,9	-31 539,6	-33 214,5	-35 137,2	-35 136,2
Current Budget	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Total Current Budget Outlays	-9 936,0	-11 180,7	-11 637,2	-12 901,9	-13 290,9	-14 072,0	-14 785,4
Expense	-9 873,4	-11 088,6	-11 566,9	-12 823,5	-13 246,8	-14 026,5	-14 741,1
1. Compensation of Employees	-4 743,6	-5 400,4	-5 759,8	-6 208,5	-6 554,4	-7 062,4	-7 600,1
2. Use of goods and services	-2 477,7	-2 829,1	-2 801,6	-3 186,5	-3 307,1	-3 477,1	-3 598,6
4. Interest Payments	-177,2	-274,1	-282,5	-377,2	-443,4	-472,9	-432,6
5. Subsidies	-201,4	-250,7	-415,9	-307,9	-364,8	-336,4	-350,6
6. Grants	-812,5	-764,4	-920,9	-989,2	-785,4	-824,9	-854,6
7. Social benefits	-768,2	-883,3	-843,4	-1 048,7	-1 095,3	-1 151,9	-1 205,9
8. Other expense	-692,7	-686,6	-542,8	-705,5	-696,4	-701,0	-698,7
Net Worth and its Changes	-62,6	-92,1	-70,3	-78,4	-44,1	-45,5	-44,3
1 Nonfinancial assets	-59,9	-91,1	-70,3	-75,4	-42,3	-43,8	-43,8
2. Financial assets	-2,7	-1,0	0,0	-3,0	-1,8	-1,7	-0,5
3. Liabilities	0,0	0,0	0,0	0,0	1,0	2,0	3,0
Capital Budget	2014/15	2015/16	2016/17	2017/18	2014/19	2014/20	2014/21
Total Capital Budget By Source	4 002,7	4 697,6	4 655,1	4 913,9	5 374,4	5 618,7	5 797,9
1. Government of Lesotho	2 400,2	2 989,7	2 742,8	3 263,9	3 437,9	3 623,8	3 758,9
o/w Road Fund Subvention	145,3	161,6	161,9	183,1	200,0	214,3	226,7
2. Donor Loan	965,7	594,7	888,8	673,4	902,6	902,6	902,6
2.1. Non-Metolong	415,7	594,7	888,8	673,4	902,6	902,6	902,6
2.2. Metolong	550,0	0,0	0,0	0,0	0,0	0,0	0,0
3. Donor Grants	491,5	951,6	861,5	793,4	833,9	878,1	909,6
3.1. MCC	0,0	0,0	0,0	0,0	0,0	0,0	0,0
3.2. Non-MCC	491,5	951,6	861,5	793,4	833,9	878,1	909,6

Source: Ministry of Finance - Macroeconomic Policy & Management Dept. Estimates

The 2017/18 Budget is from the onset, under sustainability grounds, faced with tight fiscal restructuring and consolidation conditions as the fiscal balance worsened from surplus in 2014/15 to a massive deficit in 2016/17. The outturn for the year is a sharp deficit of 7.8 percent (M2, 285.3 million), far exceeding the sustainability dictates of at most 3 percent of GDP. Moreover, it is projected to remain above policy settings at 4.8 percent deficit in 2017/18 and average of 4.7 percent in the following two years.

Major fiscal imbalances leading to substantial deficits occur as a result of three outstanding issues, or four per say;

- a) Lower than anticipated revenue collections,
- b) SACU fluctuations (downward movements),
- c) Non-discretionary items (public service wage bill, Tsépong PPP, and most recent short-term hire of government fleet), and
- d) Fictitious expectations on budgetary allocations to capital expenditures that tend to undermine the fiscal balance projections.

4.1. REVENUE

Growth in total revenue excluding grants is volatile since its performance is largely influenced by highly unstable SACU receipts. The total revenue share averaged approximately 60 per cent of GDP between 2013/14 and 2015/16 due to relatively large SACU receipts at the time. Due to a subsequent decline in SACU revenue in 2016/17, total revenue declined nominally by M1, 454.9 million to 47.1 percent share of GDP. Throughout this period tax revenue remained strong averaging 23 percent of GDP and that performance is expected to be sustained in the projection period. SACU revenue is expected to remain subdued below 20 percent of GDP away from the traditional levels of around 30 percent of GDP.

4.1.1 Tax Revenue

Revenue collections failed to meet the targeted value by a variation of M430 million (inclusive of alcohol and tobacco levy at M38 million) attributable mainly to unfavourable performance in the mining sector corporate taxes. There was also, an unanticipated miss in the Value added tax component, which declined from 8.4 to 7.7 percent of GDP. This failure to collect the targeted revenues is second in magnitude only to M600 million miss recorded in the 2014/15 fiscal year.

The revenue authority is realising a declining trend of the collections in GDP ratios (and tax expenditures still contribute significantly to this trend) though still among the highest performers in the region at an average of 21 percent in the past three years. It is forecast that VAT will decline in GDP terms given the past years growth rates. There is therefore a haunting call for concern three years forward-looking, to mobilise domestic revenues that are currently forecast at a minimal growth of 0.1 percent of GDP given a persistent volatile trend in SACU revenues.

4.1.2 Grants

Grants received from development partners form part of revenue and have decreased from 2013/14 to 2015/16 due to facing out of Millennium Challenge Corporation (MCC) grants and budget support. The Government received a sum of M2, 328.0 million over a three-year period (2014/15– 2016/17) from foreign governments and international organisations in the form of budget support and capital grants. In 2017/18, grants are projected to increase to M1, 212 million from M866.5 million received in 2016/17 budget year. Between 2018/19, 2019/20 and 2020/21, grants are projected to average M835.1 million as reflected by the budget estimates.

4.1.3 Non-Tax Revenue

Under non-tax revenue, the most important components are water royalties received from South Africa, Dividends from the mines and the Central bank. During the period under the review, non-tax revenue fluctuated around 5 percent of GDP (M1, 266.00 million). In 2017/18 through 2020/21, non-tax revenue is expected average M1, 616.2 million. Government has an opportunity to tap on under-explored domestic revenue avenues. While non-tax revenue will not significantly increase resource envelope, imposing cost-based fees and charges and enhanced collection methods would alleviate reliance on volatile SACU revenues.

4.2. EXPENDITURE

Table 6: Recurrent Expenditure – Main Categories 2014/15– 2020/21

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Expense (current budget)	-9 873.4	-11 088.6	-11 566.9	-12 823.5	-13 246.8	-14 026.5	-14 741.1
Compensation of Employees	-4 743.6	-5 400.4	-5 759.8	-6 208.5	-6 554.4	-7 062.4	-7 600.1
Wages and salaries	-4 001.2	-4 591.9	-4 835.2	-5 223.1	-5 576.0	-6 005.2	-6 467.4
Employer contributions	-742.5	-808.5	-924.6	-985.4	-978.4	-1 057.2	-1 132.7
Use of goods and services	-2 477.7	-2 829.1	-2 801.6	-3 186.5	-3 307.1	-3 477.1	-3 598.6
Interest Payments	-177.2	-274.1	-282.5	-377.2	-443.4	-472.9	-432.6
Nonresidents	-132.7	-198.4	-208.0	-249.4	-271.4	-264.1	-187.0
Residents other than general government	-44.5	-75.7	-74.5	-127.8	-172.0	-208.8	-245.6
Subsidies	-201.4	-250.7	-415.9	-307.9	-364.8	-336.4	-350.6
Grants	-812.5	-764.4	-920.9	-989.2	-785.4	-824.9	-854.6
Foreign Governments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
International organizations	-22.5	-8.1	-4.9	-39.6	-39.6	-39.6	-41.1
Extra Budgetary Units	-754.6	-725.4	-890.5	-926.1	-721.1	-759.3	-786.6
Local Government	-35.4	-31.0	-25.5	-23.5	-24.7	-26.0	-26.9
Social benefits	-768.2	-883.3	-843.4	-1 048.7	-1 095.3	-1 151.9	-1 205.9
Other expense	-692.7	-686.6	-542.8	-705.5	-696.4	-701.0	-698.7
Student Grants	-661.6	-661.6	-496.6	-641.1	-641.1	-641.1	-641.1
Household - other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other expense	-31.1	-25.1	-46.2	-64.4	-55.3	-59.8	-57.6

Source: Ministry of Finance - Macroeconomic Policy & Management Dept. Estimates

4.2.1 Recurrent Expenditure

Recurrent expenditure grew more than inflation rate in the past three years despite government's commitment to curb recurrent expenditure growth to remain constant in real terms. The outstanding high spenders were the usual compensation of employees at a share of 47.7, 48.3, and 49.5 percent of total current expenses in 2014/15 to 2016/17 respectively. Two major assumptions underpin the evolution of this item, that is, market prices indexation and wage drift (2.5 percent estimate). The public-sector modernisation project is already underway to diagnose the issues in this payment; however, a strong political consensus is key in this respect. In 2019/20, it is projected that the compensation of employees will constitute more than half of recurrent expenses.

Expenditure on health care services has since evolved as one of the highest paid items classified as use of goods and services. This was since the PPP contract signed in 2009 between the government and Netcare to operate a holistic healthcare infrastructure deemed one of the best in Africa.

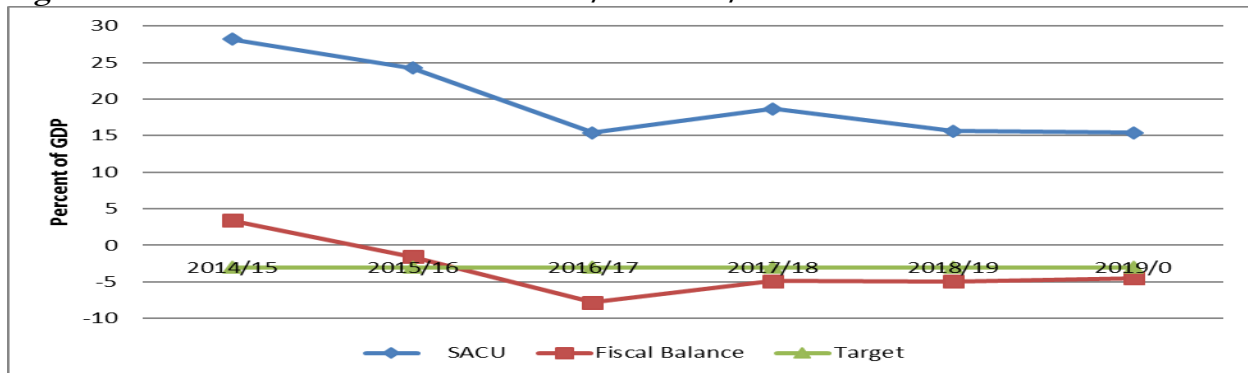
The spending on purchase of health services, currently recording more than a third of use of goods and services budget, is forecast to reach 40 percent by 2019/20 though the country is not performing well in health indicators both regionally and internationally. On the other hand, an emergent category surfaced in 2015 after the mutual consent to terminate a long-term government fleet agreement resulting in a short-term fleet service engagement. M408 million was recorded in 2016/17 from M12 million in 2014/15 as a result, but the outlook is expected to be lower as the government is processing a new long-term agreement.

4.2.2 Capital Expenditure

The government in partnership with international partners continue to pledge funds for development of Lesotho through development budget allocations, foreign loans and foreign grants while not neglecting public service delivery. However, the development budget continues to suffer discreet allocations given relatively low efficiencies and tight fiscal purse. To this end, absorption rates of capital budget rested at 75 percent with grants still constituting the lowest rates at 55 percent in 2014/15. The rates are projected to improve in the medium term from an estimated 85 percent in 2016/17 to 90 percent through 2020/21. It is vital to mention also that the growth of public recurrent expenses is visibly overcrowding public investment; however, austere measures underway through PFM integrated PSMP project are expected to deliver an optimal mix that will prioritise resources for public investment.

4.3. OVERALL FISCAL BALANCE

Figure 7: GOL Overall Fiscal Balance 2014/15 – 2020/21



Source: Ministry of Finance – Macroeconomic Policy and Management

The overall fiscal balance is mainly influenced by SACU transfers. Given the volatile movement of the said transfers, a major policy intervention is required. In 2014/15, the government registered a surplus of 3.4 per cent of GDP (Figure 5) as a result of favourable movements in SACU receipts during the period, registering a massive growth of 16.2 per cent (M7, 034.1million) relative to 2013/14 (M6, 054.6 million). In 2015/16, a decline of M635.5 million was realised which in turn led to slight fiscal deficit of 1.6 percent of GDP. In 2016/17 SACU revenue declined further by a staggering M1, 879.7 million while expenses increased by M706.9 million, the confluence of falling revenues and increase expenditures led to 7.8 percent deficit, the worst in 5 years. The medium-term forecasts are expected to remain subdued as SACU receipt continue to fall as a share of GDP.

The unsustainable fiscal balances compromise the government’s ability to implement the NSDP. This means that ministries will have to identify the scope for freeing up fiscal space from their recurrent budgets through cutting back possibly important priority activities (e.g. health and education) and generating savings that will enable them to restrict the delivery of important public services. It is worth noting that capital projects reach development objectives, recurrent budgets also advance vital areas such as boosting human capital and improving health care.

4.3.1. 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 against both external and fiscal shocks.
- **Reducing high and unsustainable level of recurrent spending.** This will require tighter control over recurrent expenditure budgets 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. In addition, we would consider measures including exploring a new mining taxation regime, and improving revenue administration.
- **Mobilising additional resources,** especially grants to finance public investments and crowding-in private investment.
- **Investigate measures to improve tax efficiency.**

4.3.2. Debt Strategy

New Borrowing 2017/18 ⁷		Amount (in Millions of Maloti)
Domestic		LSL500.00
External	1. Moshoeshoe I International Airport	LSL799.02
	2. Mpiti Sehlabathebe Road Project	LSL1,414.00
	3. Greater Maseru Sanitation Project	LSL399.51
	4. Smallholder Agricultural Development Project Phase II	USD133.17
	5. Integrated Transport Connectivity & Infra	LSL399.51
Total		LSL3,645.21

⁷ USD/ZAR = 13.317 (14 August 2017); CNY/ZAR = 2.02 (14 August 2017)

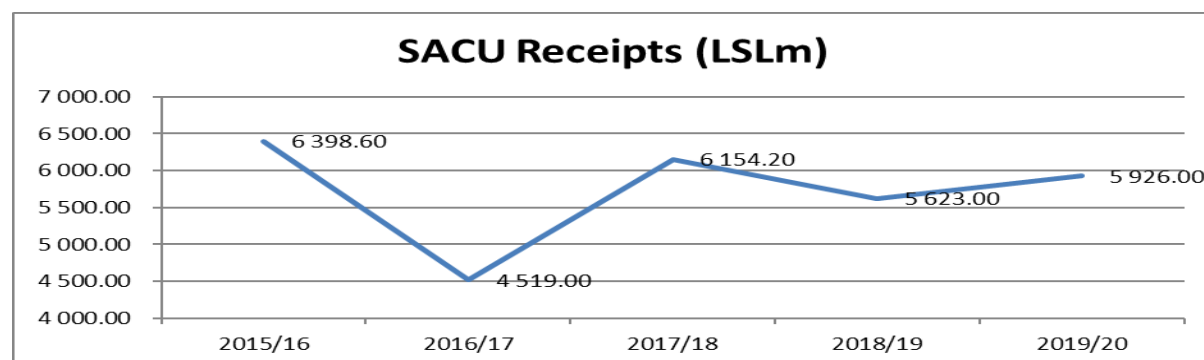
Summary of Public Debt Data

	2012/13	2013/14	2014/15	2015/16	2016/17
New Commitments	630.6	376.4	352.3	272.4	1,546.9
Committed Undisbursed Balance	3,556.9	3,605.2	2,804.8	3,021.3	3,344.2
Disbursed Outstanding Debt	7,266.0	8,817.2	10,032.5	12,834.2	11,021.5
Disbursements	643.4	725.4	1,270.2	651.1	590.2
Principal Repayments	247.5	312.4	312.9	448.6	435.4
Net Flows on Debt	395.9	413.0	957.3	202.6	154.8
Interest Payments	84.8	109.6	130.1	192.2	209.9
Net Transfers on Debt	310.4	302.2	819.4	9.1	-56.7
Total Debt Service	332.3	422.0	443.0	640.7	645.3

The table above shows that debt has been steadily rising, with the exception of 2016/17 due to global economic recovery and the appreciation of the Loti against world major currencies. Disbursements have also steadily fallen due to the completion of the Metolong Water Supply Project. Over the years, net transfers have been positive, but in 2016/17, negative LSL56 million was registered as a result of a sharp decline in disbursements.

i. Vulnerabilities vis-à-vis Debt Servicing

- a) **SACU Receipts:** The following figure shows SACU receipts trend over a period of five years from 20015/16 to 2019/20.



Source: MF - Department of Public Debt Management

SACU revenues have been an integral part of Lesotho revenue collection because on average, Lesotho collects around 50 percent of its total revenue from this source. Unfortunately, SACU receipts are highly volatile as is clear from the graph. The recovery in 2017/18 is due to global economic recovery. Another problem could be that the revenue sharing formula is currently being reviewed with the possibility that the share to Lesotho could dwindle.

- b) **Exchange Rate Fluctuations:** The table below illustrates the effect of the exchange rate movement in the currency market. The LSL3.1billion is a result of a depreciation of the Loti against the US dollar.

Amounts in Millions	2012/13	2016/17
Disbursed Outstanding Debt (DOD) in LSL	7,266.00	11,021.50
Disbursed Outstanding Debt (DOD) in USD	785.90	851.70
Exchange rate (2012/13)	9.25	
Apply 2012/13 rate on 2016/17 USD DOD	7,878.23	
Difference due to Exchange Rates (LSL)	3,143.28	

Source: MF - Department of Public Debt Management

ii. Debt Sustainability

A debt sustainability analysis was conducted in December 2016. The main objective of the analysis was to assess the sustainability of Lesotho's current debt stock and the government's capacity to sustain the envisaged increased borrowing to finance infrastructural development. The results of this exercise suggest that the external risk rating for Lesotho is moderate while public debt is projected to remain sustainable. However, the risk of debt distress is significant as stress tests result breaches indicative thresholds. The debt burden ratios are projected to significantly breach the indicative threshold in the event of adverse shocks to exports or significant exchange rate depreciation. The results depicted the same pattern although with a slight improvement when remittances were taken into consideration.

iii. Medium Term Debt Strategy (MTDS)

Lesotho debt portfolio is structured in such a manner that 90% of total debt stock is comprised of debt from external sources (thereby exposing Lesotho to high exchange rate risk), and 10% from domestic sources. The first strategy in the development of the MTDS was to maintain this composition. It proved to be a low cost and relatively low risk strategy. Nevertheless, the high exposure to exchange rate fluctuations means that even though this strategy might seemingly be the best in terms of cost and risk, events such as the downgrading of the South African economy by a number of risk agencies, could cause a shock that would see total debt stock sky rocketing. In light of this, another strategy was preferred. This would see the government gradually borrowing more from the domestic debt market (40%) and less from the external creditors (60%). This also has a cost implication to it in that interest rates in the domestic market are usually high, but this problem will be curbed by issuing more of the securities with longer terms than short ones. The implementation of this strategy will begin in 2017/18.

5. STRATEGIC PRIORITIES FOR 2018/2019 BUDGET

5.1. KEY POLICY TARGETS

It is proposed that in developing the government's budgetary plans for 2018/19 to 2020/21 the focus should be on economic growth and job creation. The budget priorities for 2018/19 to 2020/21 will be derived from the Vision 2020, Coalition Agreement and NSDP II focal areas as:

- Increasing economic growth towards a sustainable level of between 5 and 7 percent per annum.
- Create at least 5 000 jobs per year on average focusing on women and youth employment.
- Reduce malnutrition, especially for under 5 and food insecurity by 50%
- Reducing incidence of HIV and increase coverage for anti-retroviral treatment (ART) to 80 per cent
- Enhance democratic governance and political stability

5.2. PUBLIC SECTOR EXPENDITURE STRATEGY

The Public-Sector Expenditure Strategy specifies interventions that will be implemented to achieve the above-mentioned policy targets. The major medium to long term priority for the government is developing and empowering the private sector as a necessary instrument for job creation. This will involve expansion and diversification of the economic base and increase productivity in key growth sectors and job creation sectors.

The NSDP II identifies agriculture, manufacturing, tourism and creative arts, and technology as the strategic sectors for job creation for the period 2018/19 to 2023/24. These sectors have potential to create jobs, but currently they have critical constraints that limit their potential. Therefore, the Public-Sector Expenditure Strategy will attempt to unleash the growth and development potential of these strategic sectors, by undertaking strategic interventions to resolve those constraints that have been identified as most binding for businesses growth and expansion.

5.3. BUDGET PRIORITIES FOR 2018/19 – 2020/21

The Budget Priorities are:

- Promoting inclusive, job-rich and private sector led economic growth
- Improving the country's productivity and innovation capacity by strengthening human capital through investments in health and skills development,
- Promotion of peace, democratic governance and accountability systems.

Strategic Goal: Promoting inclusive, job-rich and private sector led economic growth

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 and job creation. This will involve expansion and diversification of the economic base and increased productivity in key growth sectors and in the green economy.

To achieve this objective, the government will have to address both the supply-side and demand challenges that constrain private sector growth. NSDP II process has identified commercial agriculture, manufacturing, tourism and creative industries and technology as the strategic sectors that can be prioritised for growth and job creation for the period 2018/19 to 2023/24.

However, these sectors are currently not growing as expected and to unlock potential of these identified sectors, the Government undertakes to implement a two-pronged strategy of: attracting private investment (both domestic and foreign investment) into these sectors; and resolving the constraints that hinder the growth and development of these sectors.

Strategic Objective 1: Create an Enabling Investment Climate and supportive Regulatory Framework:

- Accelerate Investment climate reforms and related legislation (residence and work permits, access to land, electricity, customs clearance)
- Maintain macro-economic stability
- Improve access to finance through the development of capital markets and other innovative products for SMMEs
- Reform Land Tenure System focusing mostly in rural areas: review the current land policies and legislation to ease access to land, especially to support commercial agriculture, private investment in industrial infrastructure and tourism establishments.
- Implement key reforms for promoting democracy and political stability

Strategic Objective 2: Increase agricultural productivity by commercialization, diversification and climate proofing agriculture.

Key Strategic Actions:

- Scale up commercial **fruit and vegetable** production by 100 ha per year

- Promote private investment in developing integrated value-chains of existing agriculture sub-industries (vegetables, fruits, potato, poultry, piggery, mushrooms, wool and mohair and others).
- Facilitate the development of water harvesting, irrigation and climate smart (green houses and hydro-phonics) agricultural infrastructure
- Introduce and/or Modernise short and long-term agricultural programs offered by the local training institutions
- Strengthen the research capacity focusing on high value agricultural products through collaboration with regional and international research centres
- Develop infrastructure for national quality assurance and quality control (authority).
- Facilitate the development of agriculture marketing intelligence and infrastructure

Strategic Objective 3: Diversify the manufacturing base

Key Strategic Actions

- Develop a strategy and programme to increase private sector participation in the development of industrial infrastructure
- Promote investment and trade promotion in selected countries, including the United States, to take advantage of the remaining trade preferences and diversify markets
- Support at least two Basotho firms per year through incubation/productivity centres to create capacity to enter textiles manufacturing value chain and to develop agro-industries

Strategic Objective 4: Increase volumes and length of stay of tourists as well as ensuring community participation in the sector.

Key Strategic Actions:

- Attract private operators to manage the developed tourism facilities through partnerships.
- Conduct a feasibility study for an additional ski resort on the Highlands Ski route and attract private investment to manage the ski resort, with a deliberate strategy to promote a partnership or joint-venture with the domestic private sector.
- Develop and implement a Lesotho tourism brand and management strategy Facilitate the establishment of at least one community based project per year
- Promote inter-institutional coordination in the tourism sector.

Strategic Objective 5: Technology and Creative Industries.

Research suggests that the highest growth within the creative industry is in technology-centered industries such as software programming and video games, modest in music and film. While animation and game development are gaining traction in some African countries, there is ample scope and opportunity to develop this further.

Key Strategic Actions:

- Enhance curriculum for digital- entrepreneurship skills
- Develop and implement a programme to develop creative arts based on the comparative advantage.
- Explore the possibilities of establishing call centres and remote data back-up centres (cold climate)
- Establish a technology research centre in Lesotho to promote research and innovation. In establishing the research centre, the government will need to collaborate with the academic institutions and the private sector.

- Create a model digital businesses accelerator/technology hub for youth.

Strategic Objective 5: Develop supporting Physical and Institutional Infrastructure for growth and employment.

Key Strategic Actions:

- Facilitate the provision of basic infrastructure to improve connectivity through roads, ICT, and to selected industrial, commercial agricultural areas and tourism sites
- Protect sources of water and develop multi-purpose dams to provide water for irrigation, clean electricity generation, potential export opportunities and sports
- Develop innovative solutions to improve accessibility of ICT infrastructure for e-commerce, e-education, e-health and e-government and others
- Strengthen the institutional infrastructure and coordination for investment and trade promotion

Strategic Goal 2: Improving the country's productivity and innovation capacity by strengthening human capital through investments in health and education and training.

Key Strategic Actions:

- Improve quality of basic health services and referral system
- Improve adolescent health and programmes to reduce maternal mortality
- Reduce drug stock outs
- Review the primary and secondary school curriculum and delivery methods to integrate entrepreneurial, problem solving and critical thinking skills.
- Adopt strategies to improve enrolment rates in secondary education and address gender equality
- Strengthen TVET institutions;
- Strengthen the country's capacity to anticipate and match labour market and skills need through:

Strategic Goal 3: Promote Peace, Strengthen democratic governance and accountability systems.

Key Strategic Actions:

- Depoliticise the Public Service
- Fight corruption
- Undertake security reforms
- Improve Public Sector Efficiency and effectiveness
- Deepen decentralisation
- Promote independence of the Legislature, Oversight Bodies and Institutions
- Strengthen media to play an effective role in promoting democracy
- Enhance Policy, Planning, Statistical Capacity and Monitoring and Evaluation
- Strengthen public financial management
- Strengthen the revenue collection and mobilisation capacity

Cross – cutting issues:

- Climate Change and Resilience Building
- Increased gender equality
- Increased participation of people with disability
- Protection of the rights of children and vulnerable groups

6. MEDIUM-TERM BUDGET PROJECTIONS FOR 2018/2019 - 2020/2021

For the Government to achieve its overall priorities, in the medium term, it is estimated that budget for 2018/2019 financial year total revenues and grants is expected to be **M16, 682.7 million**; an increase of **4 percent** from the 2017/18 approved budget estimates of **M16, 035.0 million**. Of which domestic revenue is **M15, 848.8 million** and total grants is **M833.9 million**. Tax Revenue is estimated to amount to **M8, 600.5 million** which is an increase of **13 percent** from 2017/18 approved target of **M7, 604.3 million**.

Using SACU revenue forecasts of the total Customs and Excise Pool, Lesotho shares of SACU revenue is forecasted to be **M5, 623.0 million** in 2018/19 from **M6, 154.2 million** in the previous year; which is a decrease of **9 percent** from 2017/18 target. Other Non-Tax revenues are projected to be **M1, 625.4 million**, which is an increase of **10 percent** from the **M1, 483.1 million** in 2017/2018 driven mostly by receipts from water royalties, diamond royalties, diamond dividends, oil levy, and electricity Muela. This significant growth rate of the other non-tax revenue is supportive of efforts that Government is undertaking, however more emphasis is still required in order to realise even better benefits. Over the medium term, revenue is projected to be **M17, 759.0 million** and **M18, 733.3 million** in 2019/2020 and 2020/2021 respectively.

Total expenditure is projected to reach **M18, 465.3 million** in 2018/19, from **M16, 558.0 million** in 2016/17, an increase of **12 percent**. Of this, recurrent expenditure is projected to be **M13, 290.9 million**; development expenditure is projected to be **M5, 374.4 million**, while net-lending is estimated at **M1, 780.8 million**. The proposed budget for 2018/19 financial year envisages a deficit of **M1, 782.6 million** or **5 percent** of GDP. The proposed budget is also in line with the current government policy of reducing recurrent budget and increasing the development budget in order to realise economic growth and development.

Over the medium term, total expenditure is expected to be **M19, 620.7 million** and **M20, 583.3 million** in 2019/20 and 2020/21 respectively. The projected deficit over the medium term is expected to be **4.5 percent** and **3.9 percent** of GDP in 2019/20 and 2020/21 respectively. The net financing remained negative by **M1, 594.7 million** in 2017/18, and is expected to slightly increase to **M 1,780.8 million** in 2018/19; representing an increase of **12 percent**. Over the medium-term net financing is expected to marginally decrease to **M1, 715.9 million** and **M1, 622.9 million** in 2019/20 and 2020/21 respectively.

7. TRANSLATING POLICIES INTO RESOURCE ALLOCATION

Recurring Projects and programmes: From the time Project Appraisal Committee (PAC) became dormant (after 1998 political unrest) most projects were allocated funding without having been appraised. Traditional Planning Cadre was also not functional for a long time. The implications of these are/were that, most projects were allocated funding without being adequately planned; they bypassed the PAC technical level screening and appraisal, as there was no institutional set up that ensured that all key aspects of a good project are considered prior to funding and implementation. In September 2013 PAC was revived by cabinet decision and renamed Public Sector Investment Committee (PSIC). Cabinet confirmed the position of PSIC as the highest administrative authority for the appraisal of projects for inclusion in the Capital Estimates and the Public-Sector Investment Programme (PSIP).

There are projects that have been in the Budget 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. There is also a problem of weak monitoring which creates a gap between financial and physical progress.

It is therefore proposed that a firm decision be made regarding such projects whether it be through i) refocusing or restructuring where such projects are not in line with new policy initiatives, ii) termination of projects that no longer have impact, iii) transfer into recurrent budget for those projects that are recurrent in nature or iv) implementing projects in phases in order to enable monitoring and to measure their impact. Any of these proposals should be well informed and to achieve it is recommended that:

- All ongoing capital projects which were not appraised are appraised. This exercise should take into consideration training of planners to equip them with necessary skills that will enable them to re-develop viable project proposals
- The process of resuscitating Planning Cadre should be expedited.
- Sector working groups should be established to promote integrated planning and to avoid duplication of efforts.
- The table below contains some of the projects which have to be considered as recommended.

There is a need to look closely into the capital projects of all ministries as some projects need to either be redesigned or terminated. Any of these conclusions however need to be informed by an in-depth evaluation of these projects. Projects that will be redesigned or terminated should be subjected to in depth appraisal by PSIC. The following are the examples of projects which may be considered for redesign, termination, transfer to recurrent budget, implement in phases or complete.

Table 7: Proposed Recommendations for Creating Fiscal Space 2018/2019

Recurring Projects					
Project Title	Source of Funding	Approved Budget	Approved Budget	Projections	
		2016/17	2017/18	2018/19	2019/20
Refocussing/Re-Design					
Health Sector Reforms Project	GOL				
Construction of Secondary Schools	GOL	6 000 000	8 200 000	8 400 000	8 820 000
Consultancies & Studies	GOL	1 000 000	1 000 000	-	-
Knit Fabric and Dye Mill	GOL	3 000 000	-	10 000 000	16 000 000
Watershed Management	GOL	130 000 000	157 000 000	157 000 000	157 000 000
Completed in 2017/18					
Piggery Sub-Sector Value Chain	GOL	3 000 000	5 000 000	-	-
Intensive Broiler Production Project	GOL	3 000 000	3 000 000	-	-
Maternal, New-born and Child Health Care Programme	GOL	3 500 000	4 600 000	-	-
Free Primary Education (classrooms)	GOL	5 000 000	10 000 000		
Lesotho Millennium Development Agency (LMDA)	GOL	100 000 000	185 628 120	-	-
Upgrading of Payroll and Human Resource Info System	GOL	5 800 000	2 000 000	-	-
Skills Training Centre	GOL	1 325 000	1 194 124	-	-
Population Census	GOL	77 500 000	6 969 945	-	-
Renovation of Central Correctional Institution	GOL	25 000 000	22 000 000	-	-
Renovation of Leribe Correctional Institution	GOL	10 000 000	10 000 000	-	-
E-Government - ADB	GOL	16 000 000	10 000 000	-	-
Re-capitalization of Post Bank	GOL	35 000 000	35 000 000	-	-
Integrated Transport Project	GOL	23 000 000	1 500 000	-	-
New State House	GOL	20 000 000	92 000 000	-	-
Mokhotlong- Sani Pass Road	GOL	220 000 000	1 000 000	-	-
Oxbow-Mokhotlong Road	GOL	80 000 000	2 000 000	-	-
Maseru Container Terminal	GOL	3 200 000	2 000 000	-	-
Bethel Bridge	GOL	50 000 000	36 000 000	-	-
Tele-Aliwan'skop Road	GOL	25 000 000	17 000 000	-	-
Northern Districts Electrification	GOL	12 000 000	65 000 000	-	-
Climate Change Policy, Sustainable Energy Policy and Strategies	GOL	1 000 000	2 000 000	-	-
Mejametalana Runway Rehabilitation	GOL	5 000 000	6 000 000	-	-
Mphorosane Training Academy	GOL	500 000	816 251	-	-
High Altitude Sports Centre	GOL	10 000 000	12 000 000	-	-
Youth Resource Centre	GOL	1 292 000	1 000 000	-	-
LIPAM Mobile Classrooms	GOL	-	3 000 000	-	-
Tsifa-li-Mali Court Complex	GOL	10 000 000	26 000 000	-	-
Mining Policy and Legal Framework	GOL	2 200 000	1 500 000	-	-
Tsikoane Water Supply and Sanitation Scheme	GOL	15 000 000	8 000 000	-	-
Urban and Peri-Urban Water supply Project	GOL	5 000 000	5 000 000	-	-
Terminate					
Solid Waste Management for Urban Councils	GOL	19 000 000	22 000 000	23 100 000	24 255 000
Solid Waste Management (Land Fill)	GOL	3 000 000	150 000	157 500	165 375
Transfer to Recurrent Budget					
Support to TB Control Programme - GF	GOL	4 300 000	6 700 000	7 500 000	8 000 000
Support to Immunisation - GAVI	GOL	13 000 000	13 000 000	8 000 000	5 300 000
Performance Based Financing - WB	GOL	3 000 000	3 000 000	4 314 376	-
IFMIS	GOL	9 000 000	51 900 000	42 580 972	25 353 389
Records Management	GOL	3 000 000	3 000 000	6 615 000	6 945 750
Lesotho SIMM (Mobile Money)	GOL	1 500 000	2 050 000	2 150 000	-
Private Sector competitiveness and Econ. Diversification :Phase II	GOL	4 000 000	1 190 000	2 582 000	2 500 000
National ID and Civil Registry	GOL	130 000 000	100 000 000	80 000 000	80 000 000
Livestock Registration	GOL	15 000 000	50 000 000	140 530 161	110 000 000
Data Network	GOL	66 311 000	80 000 000	59 147 556	60 315 680
Energy Survey	GOL	-	1 500 000	2 500 000	1 500 000
Gender Advocacy	GOL	1 200 000	1 248 000	1 310 400	1 375 920
Implement in phases					
Urban Roads Upgrading	GOL	100 000 000	120 000 000	110 250 000	115 762 500
Design of Urban Roads	GOL	3 150 000	2 000 000	3 045 000	3 197 250

Source: Ministry of Finance – Budget Department

While the good work of resuscitating appraisal committee is applauded, its work is compromised by the prevailing professional capacity problems of the planning cadre.

- The resuscitation process needs to be well thought e.g strong focus should be on capacitating the Ministry of Development Planning which is expected to lead all government ministries in coming up with viable projects long term strategy to build planning think tank of government of Lesotho in order to enhance better performance of capital projects. The rate at which projects are coming from line ministries is also not so good due to lack of expertise in the entire Planning Cadre.

The recurrent budget ceilings are fixed by an incremental process, which means that they mostly reflect the previous year's budget adjusted for inflation. Under this approach it is not possible to switch the relative shares of the Ministries in the aggregate recurrent budget. This implies that GoL cannot flexibly and on an annual basis give preference to recurrent activities that address emerging challenges and address national objectives. Given the rigid recurrent budget ceilings, GoL then resorts to including expenditure items that reflect new activities under the more flexible capital budget ceilings, regardless of the misclassification.

8. CONCLUSION

This Budget Strategy Paper is prepared under continued difficult domestic economic conditions, with moderate growth expected due to weak recovery in the global economy. Expected growth in the real GDP of 4.0 percent in 2018/2019 is insufficient in addressing the development challenges of unemployment, poverty, and income inequality. Hence, there is a need to use the 2018/2019 budget to align the implementation of the Vision 2020 and the NSDP, with a view to promoting growth, economic diversification, and employment creation.

The preparation of the 2018/2019 BSP therefore drew from the national priorities identified in the NSDP, while taking into account the country's fiscal policy parameters. However, there was also need to ensure that the implementation of the ongoing Public Financial Management Reform Programme is continued during 2018/2019 financial year, despite the budgetary pressures.

In terms of the budget outlook, the 2018/2019 financial year is projected to result in a budget deficit of M1,780.7 million or -5.0 percent of GDP. This is attributable to the projected decrease of revenues, and continued high expenditure pressures. This calls for continued efforts to expand the domestic revenue base, as well as prudent management of expenditure in 2018/2019.

Amongst the major disadvantages to the 2018/2019 budget outlook includes the; continued slow recovery in the global economy, undiversified revenue base, and unforeseen emergency expenditures to address water and electricity supply challenges, and natural disasters like drought and outbreak of animal diseases. Despite this unfavourable 2018/2019 budget outlook, Government remains committed to pursuing fiscal sustainability within the context of political instability and insecurity. Thus, additional measures to raise domestic revenues or trim the planned expenditure during the implementation of the NSDP will be considered, if necessary, to restore fiscal sustainability

