

STATE OF THE ECONOMY AND GOVERNMENT FINANCES

BY THE HONOURABLE MINISTER OF FINANCE AND DEVELOPMENT PLANNING

Introduction

1. I wish to present a report on the state of the economy and the status of Government finances, the depth of the fiscal challenges and underlying issues which need to be addressed to attain economic stability and get back on a sustainable economic development path.
2. I will also present a set of critical measures that need to be taken to restore economic and fiscal stability as well as healthy employment levels. All these require commitment and sacrifice by all sections of society.
3. I think it is important to keep the nation and key stakeholders, including development partners and the international community at large, up to date about the issues concerning the economy, and the finances of the Kingdom, so as to appreciate what the Government, can deliver and the constraints it faces.
4. I wish to assure you that your Government is committed to reboot the economic system and rebuild the key foundations for an attractive investment climate, restore social order and reduce vulnerability of the population.

State of the Economy and Government Finances

5. **The economy has contracted, and the recovery is also slow. This is mirrored by slow pace of job creation and fiscal distress.**

Ladies and Gentlemen, let me give a brief background

6. Lesotho has last experienced the highest economic growth of above 8 per cent at the peak of implementation of Lesotho highlands Water Project, phase 1. Since then Lesotho has not experienced such high growth.
7. Manufacturing sector became the main growth driver from early 2000, where textiles and clothing grew by 40 percent in 2003. We also experienced another growth episode driven by mining. At its peak, it accounted for close to 2 percent of overall growth of the Economy.
8. Gross National income on the other hand is largely influenced by movements in SACU receipts which are highly volatile. In addition, government footprint is quite significant in the economy. Government expenditure is equal to 40 percent of National output or GDP.
9. Lesotho has been experiencing a slow-down in economic growth since the global economic crisis in 2008/09. Gross Domestic Product growth rate slowed from above 5 percent to an estimated 2.3 percent in 2022/23.
10. The situation has recently been worsened by the COVID-19 pandemic and other pressures such as the Russia and Ukraine war. Lesotho's economy was in recession in 2017/18 and GDP or economic output shrunk by more than 10 per cent between 2016/17 and 2020/21. Real GDP contracted again by around 5 per cent in 2020/21 due largely to COVID-19. The recovery is modest at 1.8 and 2.3 per cent for 2021/22 and 2022/23 respectively.
11. This year, Real GDP increased by 1.5 percent in the first quarter of 2022 before slowing to 0.1 percent in the second quarter. The slow-down in economic activity in the second quarter signaled the weakening of the manufacturing sector and tight expenditure control within the Government sector. Construction on the other hand strengthened in the second quarter, supported by LHWP II construction activities.
12. The geo-political tensions have impacted negatively on the global economies and Lesotho is no exception. The inflation continuously increased, especially food, which ran at double digit levels. The demand for our exports is also recovering slowly.

13. The slow growth translates into low employment creation in the private sector and limited fiscal space to implement growth enhancing programmes as well as responding to multiple shocks that the country has experienced. This is where a quick turn-around strategy is necessary to use the limited resources wisely to stimulate growth and widen economic space for job creation and reduce vulnerability.

Fiscal Developments

Given this background, and multiple shocks experienced, the Government has been running successive and relatively large deficits. The fiscal deficits ranged between 4 and 8 percent of GDP in the last 5 years. The budget deficit for 2021/22 was 13.1 per cent of GDP, even though the outturn was 4.3 % of GDP, compared to acceptable levels of 3 per cent. Moreover, expenditure has been growing much faster than revenue. The situation is further worsened by the depletion of government reserves or buffers overtime.

14. Then the old problem - The wage bill accounts for 48 – 50% of the Recurrent Expenditure. There is over establishment and there is a component of wage bill that is unnecessary cost or avoidable cost as it is for buy outs and for remunerating some government officials that are not rendering services to the Government, either due to unresolved suspensions or court orders. there are also illegally employed cadres that have not been recruited following Public Service Laws and processes. These will be dealt with decisively.

15. In the current budget estimates, revenue collection was expected to be M19.7 billion and Government expenditure to be M24.8 billion. Recurrent expenditure takes, M18.1 billion while capital budget accounts for M6.8 billion, of which M1.8 billion is financed from Government revenue. This had resulted in a fiscal deficit of 7.7 per cent of GDP and financing gap of M2.5 billion which had been planned to be financed through foreign and domestic borrowing.

Ladies and Gentlemen,

16. The fiscal situation is even more challenging this year as expected revenue collection by the end of the fiscal year falls short by M1.1 billion. This shortfall is largely attributed to the Tax Bills that did not pass through during the 10th parliament. These include:

- i. Abolishment of accelerated depreciation which would add additional M460 million
- ii. Alcohol and tobacco levy Bill with additional M293.2 million
- iii. Zero rating of M375 million, coupled with RSL's proposed VAT Fiscalisation program which was expected to bring additional M67.5 million in tax revenue

It is important to note that, in addition to the above-mentioned scenario, SACU receipts were lower than the previous year by close to M 3 billion.

17. The financial performance for 9 months, April to December 2022, indicate that the revenue collected in 9 months is: M11,581 billion, composed of SACU receipts, local taxes, and non-tax revenue. Whilst recurrent and capital expenditure were financed with M10,952 billion made up of compensation of employees, subventions and grants, debt service payments and operating costs.

18. In the 4th Quarter of 2022/2023, revenue is projected at M 4.2 billion and recurrent expenditure to register M5.3 billion and M767 million for development expenditure, with a total of M6, 067 Billion.

19. Currently there are commitments that need immediate funding and that are facing funding challenges. We have M 1.3 billion new requests at the Budget stage, M260 million at Treasury stage being overdue payments from last year.

Domestic Arrears

20. Whilst struggling with programmed budget implementation, the government is also faced with outstanding arrears. This is a perennial problem. By the end of fiscal years 2019/2020, 2020/21 and 2021/22, the Government had not been able to honour payments to the business community, amounting to M 1.2 billion, M 800 million and M 950 million respectively. This has been detrimental to cash flow of the business sector and non-performing loans in the financial sector.
21. This year, domestic arrears worth M643 million were uncovered, of which M200 million has been verified as ready for payment. The M 443 million worth of arrears do not have full documentation to proceed to payment stage.
22. There is further submission of arrears that do not have any supporting documents, which have been submitted by the Ministries. Some of the costs include interest charges due to delayed payments.

Additional requests

I wish to bring to your attention that,

23. There are further commitments that require additional budget and funding. These include; remaining commitments for local elections, payments for free primary education, Transfers to LMDA and preparatory work for local elections.
24. **It means that, the unpaid commitments from the previous years are paid with the cash balances of the current year, thus causing further strain on the fiscus.** It is important to note that the M10,952 billion of expenditure includes the carry over expenses for 2021/22, with the value of more than M800 Million at the beginning of the year and now the balance stands at M260 million Maloti. The clearing of these carry-overs means that some of the budgeted programmes had to be deferred to the coming years in order to avoid prolonging non-payment of suppliers.

Cash Balances/Deficits

25. The above scenario translates into an adjusted cash deficit of M3.2 billion, which accommodates, the remaining unrepresented payments for the fiscal year 2022/23, ready to be paid arrears and new critical commitments.

Key Challenges

As a result of the high fiscal and cash deficits the following challenges are encountered:

26. Suppliers are not paid on time: There is a vicious cycle of delayed payment and over-pricing of goods and services. It has become a norm for the business community to excessively over price the government procured goods services and major works claiming delays in payments. This has bred ground for corruption to and fro between the officials and the business community – it is major source of fiscal hemorrhage

27. Accumulation of Arrears:

There is accumulation of arrears, including legacy ones from the response to COVID 19. However, this is also attributable to among others the following:

- Procurement processes have been overlooked and violated. This is particularly rampant in capital projects where works that exceed the given limits are awarded without due authorization and responses to disasters
- Works or certificates awarded towards the end of the financial year, do not finish the payment processes before the end of the fiscal year. Funds are then swept back into the consolidated fund and in recent years, Ministries' budgets are not able to accommodate such carry overs through virements
- Unbudgeted for Cost overruns due to delayed completion, in some cases unforeseen circumstances and increases in the prices of goods

28. Low budget credibility – It has not been possible to implement the budget as appropriated due to cash deficits, as a result of delayed mobilization of financing from both domestic and local sources. Capital budget that is already low compared to other countries, suffers the most. This year only around half of the appropriated amount was spent. Donor funded projects, also move very slow, for various reasons including limited capacity to follow the tender and implementation procedures, unavailability of key technical

expertise to support infrastructure projects, since the COVID pandemic hit globally.

29. **Limited dividends from public investment spending:** Less than half of Government financed budget is not implemented due to cash shortages or re-allocation to accommodate unbudgeted expenditure as well as respond to multiple shocks as the contingency fund gets depleted before all emergencies and disasters can be responded to in a fiscal year.

30. **Recurrent expenditure overshadows development spending.** Currently, Capital expenditure accounts for 10% of the Government budget funded by Lesotho government and 20% when the development partners loans and grants are included. This a cause for concern and must be addressed.

Financing

31. In order to close the financing gap, and reduce the amount of outstanding payments, and commitments that resulted in an adjusted cash deficit of M3.2 billion, the Government will mobilise financing even though it will not be financed wholly in the last quarter so as not to cause disruptions in the market, which would also translate into inflationary pressures. The Government will engage with companies that are still owed and chart the way forward.

Implications on Fiscal and Debt Sustainability

32. Ladies and Gentlemen, you will note that the additional borrowing is quite large and adds significantly to the existing debt stock, which stands at M22.7 billion. Debt stocks are growing quite fast as compared to growth of the economy. Such that the total foreign and the domestic debt has grown by 64% in the past 5 years. This, therefore, means that we have to slow down.

33. You will note that debt repayments will further increase and continue to exert a lot of pressure on the budget. The plan going forward, is to contract debt in a systematic manner, and direct it to critical public investments that will also catalyze private investment. We also need to limit government dominance in domestic credit markets to allow the financial sector players

to direct resources to commercial and development projects in the private sector.

34.Path towards Economic Stability

In order to restore Economic stability, bring confidence to investors and create fiscal space to provide services the following strategies will need to be implemented:

Restore Macro-fiscal Stability by:

- Clearing the unrepresented payments and arrears and strengthen controls to prevent further accumulation by implementing laws, including available sanctions
- Budget for any anticipated legitimate unpaid commitments in any year and eliminate 'unrepresented payments' as they distort budget implementation and financial reporting
- Limit domestic borrowing to critical development financing and avoid crowding out of private sector
- Building Fiscal Buffers through adoption of counter cyclical fiscal policy.

35.Improve Cash Management and reduce Revenue leakages through:

- Strengthen capacity of the Ministry of finance, particularly treasury to improve cash management
- Digitising revenue collection systems, tax and non-tax collection thus curtailing corruption and evasion
- Delegate collection of Non-tax revenue to Lesotho Revenue Services which already has capacity and the systems in place to enhance collection

Restoring Budget Credibility

- Centralize procurement to a great extent
- We need to fast track e-procurement
- Continue with tight expenditure controls, until the end of the fiscal year and beyond

Structural Measures

36. Enhance Public Sector Delivery and productivity

The effectiveness of a government is dependent on effective and productive institutions. The government recognizes public servants as critical human resources to drive development agenda complimented by partnerships with the citizens and the private sector. Lesotho has one of the highest wage bills relative to its economic output, therefore this needs to be dealt with decisively and have impacts that will be of benefit to the nation. We therefore need to:

- Rationalize the Wage bill, including freezing of hiring and delink from illegal contracts
- Implement public sector performance management system
- Restructure departments and move resources to front line services
- Accelerate e-government

37. Change Composition of Expenditure

- Increase development expenditure and creating a pipeline of bankable projects that will drive economic activity in Lesotho for a sustainable growth.
- Rationalise the current Investment programme to align with priorities
- Reduce vehicle fleet substantially.

38. Competitive Investment Climate

- Implement doing business reforms to make business in Lesotho to be easy, quick and corrupt free.
- Enact laws that are enabling and growing local businesses.
- Improve access to finance, including enhancement of existing instruments
- Enhance programmes to improve economic participation of youth and other excluded groups

39. Rationalise social transfers whilst ensuring that the minimum basic needs are met by among others,

- Assessing the funding model for National Manpower Development Service by ensuring that only the needy get assistance and those who owe their bursaries do pay so as to ensure that the Fund is evolving (Means testing).

- Reassessing the Education System and Education programs that are currently on offer against what the market and the future demands, thus creating productive, technological savvy and entrepreneurial work force.

Thank you for your attention.

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