

Lesotho: 2003 Article IV Consultation, Fifth Review Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria and Extension of Arrangement—Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Lesotho.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2003 Article IV consultation with Lesotho, fifth review under the Poverty Reduction and Growth Facility, and requests for waiver of performance criteria and extension of arrangement, the following documents have been released and are included in this package:

- the staff report for the combined 2003 Article IV Consultation, fifth review under the Poverty Reduction and Growth Facility, and requests for waiver of performance criteria and extension of arrangement, prepared by a staff team of the IMF, following discussions that ended on **October 29, 2003**, with the officials of Lesotho on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on December 31, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) and Press Release, **summarizing the views of the Executive Board as expressed during its January 21, 2004, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director for Lesotho.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Lesotho*
Memorandum of Economic and Financial Policies by the authorities of Lesotho*
Selected Issues Paper and Statistical Appendix
Technical Memorandum of Understanding*
*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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LESOTHO

**Staff Report for the 2003 Article IV Consultation,
Fifth Review Under the Poverty Reduction and Growth Facility, and
Requests for Waiver of Performance Criteria and Extension of Arrangement**

Prepared by the African Department

Approved by Juan Carlos Di Tata and Juha Kähkönen

December 31, 2003

- The discussions for the 2003 Article IV consultation and the fifth review under the Poverty Reduction and Growth Facility (PRGF) arrangement with Lesotho took place in Maseru during August 27- September 8, 2003 and at headquarters during October 28-29, 2003. The staff team met with the Minister of Finance and Development Planning, the Governor of the Central Bank of Lesotho, other senior officials, and representatives of the private sector, the donor community, and civil society organizations.
- The staff team comprised Messrs. Green (Head), Kpodar (new mission chief for Lesotho), Hossain, Engstrom, and Surti (EP) (all AFR), Halikias (PDR), and Gershenson (FIN).
- At the conclusion of the last Article IV consultation on March 18, 2002, the Executive Board noted the improvement in the macroeconomic situation, characterized by a moderate increase in real GDP and falling inflation. Directors welcomed the authorities' commitment to a stable macroeconomic environment, privatization, market-friendly policies, and public sector reform. They commended the authorities for their overall fiscal, monetary, and structural policies. They also encouraged them to continue strengthening tax administration and improve financial management.
- Lesotho has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement and maintains an exchange system free of restrictions on payments and transfers for current international transactions.
- Lesotho's macroeconomic data are broadly satisfactory for surveillance and program monitoring. Lesotho began participating in the Fund's General Data Dissemination System (GDDS) in August 2003.
- The Executive Board approved a three-year arrangement under the PRGF (IMF Country Report No. 01/79) for Lesotho on March 9, 2001, in an amount equivalent to SDR 24.5 million. The fourth review under the arrangement was concluded on June 17, 2003, which allowed Lesotho to draw SDR 3.5 million. Upon completion of the fifth review, Lesotho would be eligible to draw an additional SDR 3.5 million.

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EXECUTIVE SUMMARY

Overview and recent developments

- Lesotho's economy performed well in 2002/03 (fiscal year starts April 1), despite adverse weather conditions and the regional food shortage. Economic growth rose to almost 4 percent, from less than 3½ percent in the previous year, reflecting strong textile exports to the United States under the African Growth and Opportunity Act (AGOA). Consumer price inflation declined in line with developments in South Africa. The fiscal situation deteriorated, however, in 2002/03, and there was a significant fiscal overrun in the first fiscal quarter (April-June) of 2003/04. As a result of domestic financing of the deficit, the spread between interest rates on treasury bills in Lesotho and South Africa has widened during 2003.

Medium-term outlook and key issues

- Lesotho faces daunting medium-term problems: (i) agricultural productivity is falling because of soil degradation; (ii) almost one-third of the adult population is HIV positive, and fiscal resources to address this and other health problems are scarce; (iii) the growth of the textile industry is driven by preferential treatment under AGOA and may not be sustainable as U.S. trade preferences are phased out; and (iv) fiscal revenue is expected to decline as a proportion of GDP owing to changes in the Southern African Customs Union (SACU) revenue-sharing formula.
- The government's medium-term strategy seeks to enhance growth and reduce poverty by removing impediments to Lesotho's labor-intensive industries and creating appropriate conditions for private sector development. Major impediments to economic growth are the lack of an adequate physical infrastructure, weak property rights, insufficient access to bank credit, and the high incidence of HIV/AIDS. The government intends to reprioritize the composition of spending to create room for investment in basic health care, education, and other social services in order to reduce poverty.

Program for 2003/04

- As noted above, performance under the program was weak during April-June 2003, and the ceiling on domestic financing of the government was exceeded by almost 2 percent of annual GDP at end-June. In addition, five out of seven structural performance criteria were missed or met with delays (most of the structural benchmarks were observed). Fiscal performance improved during the second quarter, and the end-September ceiling on domestic financing of the government was observed with a large margin.
- The authorities' short-term fiscal strategy is to limit domestic financing of the government to 3.2 percent of GDP in 2003/04 (below the original program's ceiling), in order to reduce pressures on domestic interest rates. To that end, a number of corrective measures are being adopted.

- Reforms of the public financial management system will be essential to bring spending in line with the government's priorities. In addition, the monitoring of the fiscal performance needs to be accurate, swift, and timely, in order to give the ministries sufficient information to correct deviations from the budget at an early stage. To this end, the staff reached understandings with the authorities on a set of measures to improve forecasting, budgeting, accounting, and auditing within the public sector.
- The government has taken steps to speed up the implementation of structural measures. Of the five structural performance criteria that were missed, two were completed in early December. The authorities expect to fulfill the remaining three performance criteria in the second quarter of 2004, and therefore, request an extension of the PRGF arrangement through June 2004.

I. INTRODUCTION

1. **The discussions for the 2003 Article IV consultation and the fifth review under the Poverty Reduction and Growth Facility (PRGF) arrangement** took place in Maseru during August 27–September 8, 2003 and at headquarters during October 28–29, 2003.
2. **Lesotho continues to enjoy a stable political situation.** General elections were held in May 2002, and local elections, which were originally scheduled to take place by end-2003, have been delayed until early 2004 owing to insufficient preparatory work. Following its victory in the May 2002 elections, the ruling Lesotho Congress for Democracy (LCD) party prevailed over the two main opposition parties—Basotho National Party (BNP) and Lesotho’s People Congress (LPC)—in two by-elections held in August 2003.
3. In the attached letter of intent and accompanying memorandum of economic and financial policies (MEFP) (Appendix I), the authorities review recent economic developments, outline their objectives and policies through March 2005, and request waivers for the nonobservance of one quantitative and five structural performance criteria, as well as for an extension of the current PRGF arrangement through June 30, 2004 to have more time to complete their structural reform agenda and the sixth review. Lesotho’s relations with the Fund and the World Bank are described in Appendices II and III, respectively. Statistical issues are described in Appendix IV, social and demographic indicators are provided in Appendix V, and the Public Information Notice is included in Appendix VI.

II. KEY ISSUES AND MEDIUM-TERM CHALLENGES

4. **Despite positive macroeconomic developments in recent years, Lesotho remains a poor country, with a GDP per capita of US\$340 in 2002 (about 15 percent of that of South Africa).** Most citizens are subsistence farmers who live in remote areas with only limited access to the formal economy. Available data indicates that 58 percent of the population are poor (1995 data), a reduction of only 0.6 percent from 1987. However, the conditions of the population below the poverty line has worsened. Available human development indicators also suggest deteriorating social conditions.¹
5. **Lesotho’s growth performance weakened during the last five years (1998-2002) as a result of various shocks.** Real GDP growth averaged less than 2 percent a year over this period, compared with more than 6 percent a year during 1990-97 and 4¼ percent in the 1980s. Inflation was contained at single-digit levels during most of the last five years. Economic development has been hampered by: (i) the sharp drop in mining jobs in South Africa, which reduced remittances from nearly 50 percent of GDP in the early 1990s to about 20 percent in 2002; (ii) a high HIV/AIDS prevalence rate—31 percent of the adult population (see Box 1); (iii) declining agricultural productivity owing to soil erosion and protracted

¹ Life expectancy, which reached 59 years in the 1990s, declined to 54 years by 2002 because of the impact of HIV/AIDS. For other social indicators, see Appendix V.

drought, which is jeopardizing the livelihood of approximately 80 percent of the population; and (iv) the long-term effects of civil unrest in 1998, which destroyed physical infrastructure and some public institutions. Economic growth is also constrained, among other things, by high cost of and inadequate access to finance.

Box 1. The Impact of HIV/AIDS

HIV/AIDS is emerging as a major health and development concern in Lesotho. While more than 30 percent of the adult population is living with HIV/AIDS, the infection rate may be close to 42 percent in urban areas. Approximately 6 percent of the households have members who have been ill for more than three months or have died after extended illness, and a similar proportion of households are raising orphans, largely without public support. Life expectancy would drop to 31 years by 2015, from 59 years in the 1990s and 54 years in 2002.

	HIV/AIDS Infection Rate (In percent)			Social Indicators	
	Adults (Ages 15-49)	Women in Antenatal Care Clinics		1990	2001
	2001	1992	2000		
Lesotho	31.0	...	42.2	Population growth (in percent)	1.9 1.2
Botswana	38.8	17.5	44.9	Total fertility rate	5.1 4.3
South Africa	20.1	2.5	24.3	Infant mortality (per 1,000 births)	148 132
Swaziland	33.4	4.0	32.3	Net primary school enrollment (in percent of total age group) 1/	73 78
Zimbabwe	33.7	...	31.1		

1/ Net primary school enrollment in 1990 and 2000.

Sources: *World Development Indicators*, 2003, World Bank; and Swaziland: 2002 Article IV Consultation - Staff Report, IMF Country Report No. 03/21.

The HIV/AIDS epidemic is a major risk to Lesotho's medium-term prosperity. Higher absenteeism and morbidity will reduce productivity and raise hiring and training costs, while pension payments will increase due to early retirement. Increasing morbidity combined with declining land quality is likely to lower productivity in agriculture. The authorities indicated that they are addressing the issues through donor-supported expansion of preventive and curative programs. A more detailed discussion of the impact of HIV/AIDS on the economic and social situation is included in the Selected Issues (www.imf.org).

6. **Lesotho's financial sector is well capitalized but small.** Structural constraints limit the total size of bank lending, in particular to small and medium-sized enterprises.² The ratio of bank assets to GDP, at one-third, is well below the average for similar countries. The capital adequacy ratio, at 19 percent, exceeds the Basel Capital Accord requirement. The authorities have taken steps to reduce nonperforming loans (a large write-off of bad loans was made in February 2003), but several structural weaknesses need to be addressed. In particular, wide bank spreads are regarded as a major factor behind the low level of financial intermediation. Over the past four years, lending rates have fluctuated around 17 percent and deposit rates have averaged 4 percent. This contrasts sharply with interest rate spreads in South Africa, which are on the order of 8 percent. The reasons for high spreads include: (i) the narrow and oligopolistic structure of the banking system; (ii) high lending risk related to a weak judicial and legal framework, a culture of nonrepayment of loans, and the absence of credit information on borrowers, and (iii) difficulties in using land and property as collateral. The authorities intend to address these problems by limiting public sector borrowing, fostering competition in the financial system, establishing a credit bureau, and creating the Rural Savings and Credit Guarantee Fund to encourage bank lending in rural areas. In addition, they have drafted a law for submission to the parliament that would provide direct leasing rights to foreigners and would facilitate buying and selling of land.

7. **In recent years, the Fund has been advising Lesotho to maintain macroeconomic stability and competitiveness through continued fiscal discipline, improvement in public expenditure management, and deepening of structural reforms. Despite the fiscal slippages, in general the authorities have been responsive to Fund advice.** They have strengthened tax administration, restarted audits of governments accounts, and improved monetary instruments, in line with staff's recommendations. Although revenue collection has not improved as much as needed, tangible progress has been made in introducing the value added tax and establishing the new Lesotho Revenue Authority (LRA). Some progress has also been made in improving financial services and in the areas of deregulations and privatization, and initial steps have been taken to strengthen treasury management.

8. **Looking to the medium and long term, the government intends to pursue policies aimed at achieving higher sustainable growth, reducing poverty, and improving social indicators.** Lesotho's poverty reduction strategy paper (PRSP) which would discuss in detail the government's growth strategy, is expected to be finalized in early 2004. The 2003/04 budget was based on the policy priorities defined during the PRSP consultations, which will also provide the basis for the 2004/05 budget. The authorities observed that implementation would require substantial support from donors.

² Two independent banks—NED Bank and Standard Bank—that are subsidiaries of South African banks dominate the financial sector. The third bank, Lesotho Bank, is owned jointly by the Standard Bank and the government.

III. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PRGF ARRANGEMENT DURING 2002/03 AND 2003/04

9. **Over the past three years, the authorities have been implementing a program of economic reform supported by a PRGF arrangement and assistance from development partners.** Lesotho's economy performed well in 2002/03 (April-March), despite some adverse conditions. Supported by strong activity in construction and manufacturing, economic growth increased slightly to 3¾ percent in 2002/03 (3¼ percent in 2001/02), allowing for a modest rise in per capita income (Table 1 and Figure 1). Access to international textile and clothing markets, particularly under the U.S. African and Growth Opportunity Act (AGOA), has allowed employment in manufacturing to exceed 45,000 in 2003, making this sector the largest employer in the economy. The textile sector is expanding rapidly; a denim mill is scheduled to open soon, and a knitting facility is under construction.

10. **Consumer price inflation has been declining in line with developments in South Africa.** Average inflation declined to 9.1 percent in 2002/03 and further to 6.5 percent in the 12 months ended October 2003, after peaking at over 13 percent in 2002 (see Figure 1). The decline in inflation reflected improvements in the regional food situation in 2002/03 and inflation conditions in neighboring South Africa.

11. **The fiscal situation deteriorated in 2002/03.** The overall deficit (before grants) worsened to 8.1 percent of GDP, from 2.2 percent in 2001/02 (Tables 2 and 3 and Figure 2). This reflected an upward shift in public expenditure, combined with slow growth in customs revenue (see para. 15 below). With increased domestic financing of the government, interest rates came under pressure. Treasury bill interest rates in Lesotho rose to about 200 basis points above those in South Africa at end-September 2003, compared with virtually no spread in January 2003 (Tables 4 and 5; Box 2 and Figures 1 and 3).

Box 2. Increasing Spread on Treasury Bills

The interest rate spread between treasury bills issued in Lesotho and South Africa has widened during 2003 (Figure 1). The spread started to emerge in early 2003 but widened rapidly in June, as short-term interest rates in South Africa were pulled down, reflecting reduced expectations of future inflation.

There are two likely reasons for the wider spread:

- Larger borrowing to finance Lesotho's fiscal deficit may have raised the perceived credit risk associated with treasury bills issued by the government.
- Lesotho's financial market is shallow, and the capacity to absorb more treasury bills is limited. Treasury bills are already as much as one-half of the liquid assets of Lesotho's commercial banks. South African investors are permitted to invest in Lesotho's treasury bills, but few have expressed an interest to do so.

12. **The external current account deficit (including official transfers) is estimated to have reached 16¾ percent of GDP in 2002/03, reflecting Lesotho's long-standing large trade deficit.** A strong export performance, helped by increasing textile exports under AGOA, was more than offset by a rise in imports stemming from increased activity in the

manufacturing sector and high demand for agricultural inputs. The external situation reflected a larger public sector deficit and a deteriorating savings-investment balance in the private sector. Gross official reserves decreased to the equivalent of 4½ months of imports at end-2002/03, from 5¼ months at end-2001/02 (Tables 1 and 6).

13. **The loti, which is pegged at par to the South African rand, mirrored the large swings in the rand against the U.S. dollar.** The loti appreciated by 31 percent versus the U.S. dollar during the 12 months ended November 2003, owing to the strengthening of the South African rand. In the real effective terms, the currency appreciated by 32 percent in the 12-month period through June 2003. The appreciation has reversed a previous depreciation and the real effective exchange rate is now at about the same level as in early 2000 (Figure 4).

14. **Performance during April-June 2003 under the PRGF-supported program was weak. In particular, the performance criterion on domestic financing of the central government at end-June 2003 was exceeded by close to 2 percent of annual GDP** (Table 7). About one-half of the slippage reflected higher scholarships and vehicle lease costs, unanticipated agricultural support, and a shortfall in the collection of the sales tax and other revenues. The other half reflected timing issues, such as a delayed transfer of revenue from the Lesotho Revenue Authority (LRA) to the government owing to technical reasons, delayed payments of dividends by the Central Bank of Lesotho (CBL), and the early completion of a road project.

15. **Fiscal performance improved in the second fiscal quarter (July-September), and the end-September benchmark on domestic financing of the central government was met with a large margin.** This improvement was attributable to lower-than envisaged outlays on wages and interest payments, and to significantly lower than programmed spending on goods and services because of the postponement of the legislative elections to the third quarter. Total government revenue, however, remained below expectations, notwithstanding a recovery in the collection of the income tax and revenue from dividends.

16. **In the area of structural reforms, two structural performance criteria were met, notably the introduction of the value added tax (VAT) on July 1, at a 14 percent rate, from the initially planned rate of 10 percent. However, five of the seven structural performance criteria were not observed (Table 8).** These are: (i) appoint a contract representative for Imperial Fleet contract; (ii) enter transactions in bank accounts, including diplomatic missions, into the treasury ledger system and initiate practice of reconciling all cash balances with bank balances monthly; (iii) integrate into the treasury accounting system loans to parastatals and ministry accounts that are not being captured by the system and report such integration to the IMF; (iv) complete government's 2002/03 accounts and present to the Auditor General; and (v) submit for audit a report on below-the-line accounts. The authorities explained that these structural performance criteria had been missed owing to capacity constraints and difficulties in recruiting qualified staff. Most of the 11 structural benchmarks were met.

17. **The authorities have intensified in the meantime their efforts and two actions subject to structural performance criteria have been completed in early December.**

These are: submission of the government's 2002/03 accounts and an audit of below-the-line accounts to the Auditor General. The authorities are taking steps to complete the remaining three performance criteria by end-April 2004.

IV. POLICY DISCUSSIONS

18. The discussions with the authorities centered on measures to bring the fiscal program back on track and achieve the March 2004 targets and on policies to achieve and maintain a sustainable fiscal position over the medium term. The authorities also indicated their intention to move ahead with structural measures to improve financial management, accountability, and transparency. Together with efforts to build human capital and physical infrastructure, these actions would provide a supportive economic environment for private sector development.

A. Medium-Term Macroeconomic Framework and Fiscal Sustainability

19. **The medium-term projections underpinning the PRGF-supported program envisaged real GDP growth** of 4 percent a year during 2004–2006 because of a continued rapid expansion of the textile sector and supporting construction activities, as well as a modest rebound in agricultural production. Beyond 2006, the projections assume that the adverse effects of HIV/AIDS will dampen growth. The outlook assumes that consumer price inflation would decline following a projected fall in inflation in South Africa.

20. **The authorities and the staff recognize that Lesotho's growth prospects will continue to depend on the external economic environment, most notably continuation or extension of the trade preferences under AGOA (Box 3).** Industry representatives and government officials expressed concern over the potential loss of the LDC status under AGOA beyond 2004, and the phasing out of the quota regime under the Agreement on Textiles and Clothing (ATC), which would expose the industry to intense competition from low-cost producers in Asia. On the positive side, Lesotho would benefit from the free trade agreement (FTA) under discussion between the United States and the Southern African Customs Union (SACU) region, which is expected to be ratified by end-2004. This agreement would enable unfettered access of several hundred product lines, including textiles, to the United States. On balance, the authorities believed they would be able to maintain Lesotho's competitiveness through new private investment and improvements in basic infrastructure, which is inadequate.

21. **The medium-term fiscal projections indicate that Lesotho is at risk of rising domestic debt and interest payments.** After declining from 45 percent of GDP in 2000/01 to about 42½ percent in 2003/04, total revenue (including grants) is projected to drop further to about 41 percent in 2008/09. Declining SACU receipts has been a major factor behind the recent drop in revenue, and the downward trend is likely to continue when the new SACU

arrangement takes effect.³ A temporary jump in SACU revenue arising from an upward revision of the import figures for 2001/02 is, however, expected to ease the fiscal constraint

Box 3. Lesotho's Textile Sector

Background and developments

From a modest beginning in the late 1980s, the export-oriented textile sector has become the primary source of economic growth and employment. Preferential access to the EU market attracted the first investors mostly from East Asia in the late 1980s and early 1990s. Domestic incentives – including provision of infrastructure (factory shells and utilities) – proximity to South African ports, fiscal incentives, and a relatively inexpensive and well-organized workforce also played a role. The preferential access to the EU expired in the early 1990s and exporters shifted their exports to the US market.

Lesotho received preferential access under AGOA in 2000, including an exception from the AGOA rules of origin until 2004; the rules of origin state that the input fabric used by the textile factory must originate from the USA or a qualifying African country. The sector has attracted high levels of foreign direct investment, contributing to phenomenal growth in production, exports, and employment since then. While textile exports grew from US\$77 million in 1992 to about US\$262 million in 2002 (an average growth of about 24 percent a year), the sector's share of GDP increased from about 4 percent in 1992 to about 8 percent in 2002. Employment grew from less than 12,000 in 1992 to about 39,000 in 2002.

Domestic business environment and constraints

Infrastructure: Lack of adequately serviced factory shells and water supply is now constraining the further expansion of production facilities. In addition, the limited capacity of the Maseru Container Terminal (MASCON) is a key constraint to the speedy movement of raw materials and finished products. To attract investment in infrastructure, the government is considering to provide long-term land leases to foreigners.

Labor costs, labor markets, and regulatory environment. Important, but not critical, constraints are the minimum wage regulation, constraints in hiring and firing of workers, and difficulties for expatriate employees to obtain work permits and resident permits that are valid longer than 3 months.

Future prospects: AGOA and phasing out of the quota under ATC

If the current exception from the AGOA rules of origin is not extended after 2004, a large part of Lesotho's textile exports would lose its duty free access to the US market because it is not made with U.S. or local fabrics. In addition, the current quotas under the Agreement on Textiles and Clothing (ATC) will be abolished in 2005 and this is likely to hurt small producers like Lesotho.

There are also positive developments that could support Lesotho's textile industry. Lesotho should benefit from the ongoing negotiations of a Free Trade Agreement between the USA and SACU, which is expected to be concluded in 2005. Lesotho should also gain from preferential access under the EU's Everything-But-Arms initiative, once the rules of origin have been agreed.

^{3/} For details, see the Selected Issues (www.imf.org).

³ For details on potential effects of new SACU arrangement on Lesotho's revenues, see Selected Issues (www.imf.org).

in 2004/05. The authorities and the staff agreed that in the face of declining revenue, there was a need to enhance the efficiency of public investment, curtail nonpriority spending, and reprioritize public expenditure. These issues are being discussed in the context of a medium-term public expenditure framework (MTEF) being prepared with technical assistance from the World Bank. The authorities stressed that the ongoing reforms, including the upgrade of treasury operations, will be crucial to strengthen public expenditure management.

22. Against this background, the authorities concurred with the staff on the need to ensure a sustainable medium-term fiscal outlook and to continue to give priority to structural measures aimed at reforming the public expenditure management system. Under the baseline scenario, total expenditure would be cut by about 4 percentage points of GDP to stabilize the stock of domestic debt at about 13 percent of GDP over the medium term, with a view to further reducing pressures on domestic interest rates. To that end, the domestic primary balance would need to shift from a deficit of 1½ percent of GDP in 2003/04 to a surplus of about ½ percent in 2008/09 (Table 9). Reflecting this fiscal effort, the total public debt would decline from 68 percent of GDP in 2003/04 to 51 percent in 2008/09.⁴ In an alternative scenario that envisages more expansionary policies, primary expenditure is assumed to remain at 44½ percent of GDP over the medium term. With increased domestic borrowing to cover the deficits, the stock of gross domestic debt would reach 26 percent of GDP by 2008/09, while the total public debt would remain at about 65 percent of GDP.

B. Policies for the Remainder of Fiscal Year 2003/04

23. The revised program aims at containing inflation at around 6 ½ percent from 9½ percent in line with the expected decline in inflation in South Africa. Real GDP is revised to 3.9 percent from originally envisaged growth of 4.2 percent owing mainly to the anticipated impact of the drought on agricultural output.

Fiscal policy

24. **During the discussion, the authorities identified a number of corrective measures in the fiscal area (see below).** Based on these measures, favorable exchange rate developments, and adjustments in the capital budget, the domestic financing of the government envisaged for fiscal year 2003/04 has been revised downward to 3.2 percent of GDP from 4.0 percent of GDP under the original program (Box 4). The tighter fiscal program is expected to allow for a decline in domestic interest rates and the spread with South African rates.

25. **Revenue projections for the year as a whole have been revised downward by about 1½ percentage point of GDP relative to the original program,** reflecting lower revenue collection from the sales/VAT taxes (1¼ percent of GDP) and a shortfall in nontax

⁴ The size of Lesotho's public debt is sensitive to exchange rate movements, as about 75 percent of the debt is denominated in foreign currency.

Box 4. Central Government Revenue and Expenditure in 2003/04

Revenue and Expenditure According to Budget, Original Program, and Revised Program

	Budget (Millions of Maloti)	Program ^{1/} (Millions of Maloti)	(Percent of GDP)	Revised program ^{1/} (Millions of maloti)	(Per- cent of GDP)
Revenue	3,203.6	3,491.9	40.9	3,368.9	39.4
Tax revenue	2,675.9	2,920.6	34.2	2,873.7	33.6
Sales tax/value-added-tax (VAT)	388.8	619.0	7.2	501.9	5.9
Income tax	760.3	782.3	9.1	850.9	10.0
Other tax revenue	1,526.8	1,519.3	17.8	1,520.9	17.8
Nontax revenue	527.7	571.3	6.7	495.2	5.6
Grants	292.0	295.8	3.5	276.8	3.2
Total expenditure and net lending	3,946.5	4,128.9	48.3	3,891.6	45.5
Wages and salaries	1,127.1	1,126.3	13.2	1,123.2	13.1
Interest payments	208.9	255.2	3.0	215.2	2.5
Other expenditure	1,781.3	1,897.0	22.2	1,826.0	21.4
Goods and services	1,151.5	1,273.6	14.9	1,193.0	14.0
<i>Of which: agricultural support</i>	0.0	0.0	0.0	41.0	0.5
<i>Of which: vehicle leases</i>	102.0	113.0	1.3	149.0	1.7
Transfers and subsidies	629.8	623.4	7.3	633.0	7.4
Capital expenditure	846.2	867.4	10.2	740.9	8.7
Domestically funded	320.1	341.0	4.0	320.8	3.8
Externally funded	526.1	526.4	6.2	420.1	4.9
Net lending	-17.0	-17.0	-0.2	-13.7	-0.2
Overall balance, including grants	-450.9	-341.2	-4.0	-245.9	-2.9
Total financing	450.9	341.2	4.0	245.9	2.9
External financing	-0.2	0.1	0.0	-25.9	-0.3
Domestic financing	450.6	341.1	4.0	271.8	3.2

^{1/} To facilitate the analysis, the revised GDP is used to calculate the shares for both the original and the revised programs. Thus, the shares in this box are not comparable to those in Tables 1, 2 and 3.

revenue (1¼ percent of GDP), owing to a lower than originally projected seigniorage⁵ compensation (see paras. 13 and 14 of the MEFP). These shortfalls would be partially offset by a more favorable performance of income tax revenue, which has been recovering since the second quarter. The authorities and the staff agreed to base the near-term revenue projections

⁵ Lesotho receives seigniorage compensation from South Africa in the context of its membership in the Common Monetary Area (CMA).

on conservative assumptions, taking into account that the LRA was established only recently and needs more time to attain its full collection capacity. The yield of the new VAT is projected to increase only gradually.

26. The expenditure projections for 2003/04 have been revised downward relative to the original program by about 3 percentage points of GDP, owing to the following:

- savings on current noninterest expenditure of about 1 percentage point of GDP, arising from correctives measures taken by the authorities, as spelled out below;
- lower interest payments of about ½ of 1 percent of GDP, mainly due to the appreciation of the loti; and
- adjustments in capital expenditure, while protecting social infrastructure. This mainly reflects savings made in foreign-financed capital spending in line with the exchange rate appreciation and, to a lesser extent, implementation capacity constraints.⁶

27. The government has taken a number of steps to achieve the revised targets. The cabinet approved in October the payment of VAT on government transactions, requiring ministries to accommodate this within their original budget allocations by reducing other expenditure in nonpriority areas. This would cut government expenditure relative to the original program by approximately M 120 million (1¼ percent of GDP) in 2003/04.⁷ In addition, the cabinet has instructed ministries to cut budget allocations by M 20 million (about ¼ of 1 percent of GDP), with the cut distributed proportionally across ministries. The government indicated that any proven problem in a particular ministry would be dealt with on a case-by-case basis. Moreover, to address the overrun on scholarships, the cabinet has deferred a planned doubling of first-year students at the national university, while a more targeted system is being put in place.

28. The authorities have been working to reduce vehicle costs, including through better monitoring and management. These costs, which have been a problem during the past three years, have now been consolidated and are more transparent. As noted above, the government intended to appoint a contract representative to work with the supplier, Imperial Fleet Service, by end-July. The terms of reference were, however, delayed, and the new contract representative is now expected to begin work by early April 2004. In the meantime, an audit of the vehicle lease contract is in progress, and the government is renegotiating cost-savings measures with the supplier. The Prime Minister has also asked ministries to reduce the number of vehicles used by up to 50 percent. The staff supported these measures and

⁶ Foreign-financed public investment is not affected in dollar terms.

⁷ The original program assumed that ministries would be compensated for the introduction of the VAT.

encouraged the authorities to make further savings by reducing the number of expensive off-road vehicles in the fleet. The total savings from these measures have not yet been determined; an assessment will be conducted in the coming months.

29. **Recent developments suggest that the end-December quantitative performance criterion on net domestic credit to the government would be met.** Expectations are that the end-March 2004 target would also be met, despite some risks pertaining to the uncertainty of the gains to accrue from income taxes and the continued adverse weather, which could trigger new government spending on famine relief and drought-related agricultural support.

Monetary policy and capital account liberalization

30. **In light of the peg of the loti to the South African rand and Lesotho's membership in the CMA, the scope for an independent monetary policy is limited, and the authorities' main objectives have been to preserve the fixed exchange rate system and maintain an adequate level of international reserves.** Assuming an increase in money demand in line with nominal GDP, the fiscal program described above would allow for an expansion in credit to the private sector of 13 percent in 2003/04. The central bank will continue to use indirect instruments—treasury bills and repurchase agreements—to sterilize excess liquidity. The international reserve cover would remain at about four months of imports. The CBL indicated its desire to raise the import cover to six months in the medium term, in light of Lesotho's vulnerability to external and weather shocks.

31. **The authorities and the staff concurred that the peg system has served Lesotho well because of the financial discipline it entails and the country's close integration with South Africa.** However, further strengthening of public finances, a prudent monetary policy to secure an adequate level of international reserves, and continued structural reforms would be crucial for ensuring the credibility of the peg and maintaining Lesotho's external competitiveness.

32. **In recent months, the authorities have introduced a series of measures to further open up the economy and enhance financial intermediation.** In June, Lesotho partially liberalized capital account transactions, allowing companies and private individuals to open foreign currency accounts outside the CMA, subject to limits and approval by the central bank. In addition, all restrictions on long-term capital inflows have been lifted. Banks and businesses have generally welcomed these measures, noting that they will stimulate higher levels of foreign investment in the country. The staff agrees with the authorities' gradual approach to proceed with capital account liberalization, particularly in view of Lesotho's fiscal and financial sector vulnerabilities and the prevalence of structural rigidities. The objective should be to achieve the same level of liberalization as other members of the CMA.

Structural measures and governance issues

33. Structural measures are designed to strengthen fiscal policy implementation through improved tax administration and public expenditure control, and to bolster the investment

climate through financial sector reforms. Previous technical assistance has recommended that the Government of Lesotho Financial Information System (GOLFIS) be upgraded. Treasury officials and the mission reached understandings on several measures, with a view to improving forecasting, budgeting, accounting, and auditing within the public sector. Structural reforms critical to the success of the program in the areas of Fund expertise are summarized in Box 5.

Box 5. Structural Measures

Status of structural measures

The agenda for structural reform has focused on three areas: (i) tax and revenue administration; (ii) public sector financial management; and (iii) the financial sector. The results have been successful in general, although actual implementation has been delayed in some cases and, sometimes, there have been minor deviations from the original plan.

Coverage of structural conditionality in the current program

Structural measures are listed in Tables 2 and 8 of the MEFP. The most important measures are the following:

- A value-added tax (VAT) with a 14 percent rate was introduced on July 1, 2003.
- The authorities engaged in a broad financial management reform agenda aimed at improving the whole process of forecasting, budgeting, accounting, and auditing. As part of the agenda, the government submitted its 2002/03 accounts, including an audit report of below-the-line accounts, to the Auditor General in early December. Moreover, the authorities will (i) complete an action plan to improve the GOLFIS system by January 31, 2004; (ii) advertise positions for Deputy Accountant General by February 28, 2004; (iii) integrate into the treasury accounting system all loans to parastatals and ministry accounts by March 31, 2004; and (iv) implement a reorganization of treasury top management, including by appointing two new Deputy Accountants General by April 30, 2004.
- In the area of financial sector reform, the authorities have developed a strategy to address impediments to a well-functioning financial market. As part of this strategy, the first stage of the capital account liberalization was completed by end-June. Steps are also being taken to address the property rights issues, including by streamlining administrative procedures for the transfer of land use rights.

Structural areas covered by World Bank lending and conditionality

The World Bank's present engagement focuses mainly on assisting the government in reforming the utility sector, strengthening public expenditure management, and carrying out poverty and social impact analysis.

Other relevant structural initiatives not included in the current program

The authorities have already addressed the problem of two insolvent banks, reduced its share in Tele-Com Lesotho to 30 percent, and the Lesotho Electricity Company will be open for tender in 2004 as part of a concession arrangement.

34. **Lesotho has made substantial progress in privatizing state-owned entities over the past several years.** The privatization of the Lesotho Bank, which was undercapitalized and beset with large nonperforming loans, removed a major source of risk to the banking system. After the successful privatization of the telecommunications company in 2001,

attention has now turned to the state-owned electricity company. In this regard, the cabinet is reviewing both a proposal to adjust electricity tariffs to ensure financial viability and a privatization scheme. To protect consumers and provide appropriate incentives to private operators, the government is expected to establish a regulatory agency for the power and telecommunications sectors in 2004.

35. **The government expressed its intention to continue to address governance issues,** mainly through (i) steps to enhance the transparency and accountability of public resources; (ii) decentralization and community empowerment; and (iii) deregulation and privatization of state entities to reduce incentives and opportunities for rent seeking. Several steps have also been taken to combat corruption. Over the past year, one official and one foreign corporation have been convicted of bribery. Moreover, an Anti-Corruption Unit (ACU) set up in November 2002 is recruiting staff to speed up investigation and prosecution procedures. Regarding decentralization and community empowerment, a new draft Local Government Act provides an institutional framework for local bodies (e.g., district boards and municipalities), including sharing of resources.

C. Statistical Issues and Safeguards Assessment

36. **Although Lesotho's statistical data are broadly satisfactory for program monitoring, there are still deficiencies in data quality and timeliness.** The authorities have adopted the General Data Dissemination System (GDDS) as a framework for production and dissemination of economic, financial, and socio-demographic information. Lesotho's metadata and comprehensive plans for improvement were posted on the Fund's website in August 2003. The staff urged that improvements in trade information needed for SACU revenue-sharing calculations be given the highest priority, as these data are used to determine about 40 percent of the government's revenue. The short-term technical assistance provided to Lesotho by FAD, MFD, FIN, and STA during 2002 and 2003 is detailed in Appendix II.

37. An updated safeguards assessment conducted in July 2003 concluded that the CBL had made commendable progress in strengthening its safeguards, following recommendations made in the context of a previous assessment in July 2001. There are, however, some pending issues that the authorities are committed to addressing, including the need to strengthen program data compilation procedures and enhance internal audit procedures.

D. Request for Waivers and Program Monitoring

38. **The government has requested waivers for the nonobservance of the quantitative performance criterion on net domestic financing for end-June 2003 and for the five structural performance criteria that were missed.** In this regard, corrective measures and steps have been taken by the authorities to address the fiscal slippage and the program has been tightened to help reduce pressures on domestic interest rates. Also, the pace of implementation of structural measures has been accelerated and two delayed structural performance criteria were met in early December. The remaining three are expected to be

completed by end-April 2004. The staff supports the authorities' request for waivers, taking into account that the main objectives of the missed structural performance criteria were achieved, namely, improved expenditure recording and transparency. In particular, comprehensive government accounts, including loans to parastatals and below-the-line information, have been submitted for the first time to the Auditor General.

39. **The authorities thought that that the structural reform agenda had been overly ambitious, particularly in view of capacity constraints and staffing issues.** The staff concurred with this view but urged them to intensify efforts so as to ensure a timely completion of the remaining structural measures before the program expires, as specified in Table 8.

40. **To monitor program implementation, quantitative and structural performance criteria and indicative targets through end-June 2004 are set out in Tables 1 and 2 of the MEFP.** To allow more time to implement the delayed reforms as well as the new structural measures agreed with the staff, the authorities are requesting an extension of the PRGF arrangement through end-June 2004. The sixth review under the arrangement is expected to be completed in May-June 2004. The review will focus on medium-term fiscal sustainability, public expenditure management, tax reforms, improvement in governance, and completion of the PRSP. An interdepartmental task force has also been put in place to conduct an ex post assessment, which is expected to be submitted to the Board at the time of the sixth review.

V. STAFF APPRAISAL

41. **Lesotho's economy has continued to perform well despite adverse weather conditions and the regional food shortage.** The economy has recorded moderate growth in 2002/03, and inflation has been declining. The authorities have been successful in consolidating macroeconomic stability in recent years, but public expenditure management remains weak and the financial sector is still fragile. Moreover, Lesotho remains a poor country in which the majority of the population are subsistence farmers.

42. **Looking ahead to the medium and long term, Lesotho needs to achieve higher and sustainable real GDP growth to increase per capita income levels, reduce poverty, and improve social indicators.** For this to materialize, it is essential to address daunting medium-term challenges, including falling agricultural productivity, the impact of HIV/AIDS and other health-related problems, the erosion in trade preferences, and lack of adequate infrastructure. This will also require higher levels of investment in health, education, and physical infrastructure, such as water, electricity, and rail facilities. To deal with these challenges, the authorities need to reassess their expenditure priorities in the context of a medium-term expenditure framework, improve the government's financial management system, and increase the efficiency of government expenditure.

43. **Following a weak performance during the first quarter of fiscal year 2003/04, the authorities are implementing measures to strengthen the fiscal position and speed up structural reforms.** In particular, steps are being taken to address overspending on

scholarships and vehicle leases, and to reduce other non-priority outlays. On the revenue side, however, a recovery in income tax collection has not been enough to compensate for the underperformance of the newly established VAT. Actions have also been adopted to comply with two structural performance criteria whose implementation was delayed, and the remaining three structural performance criteria are expected to be completed by end-April 2004.

44. **The staff welcomes the government's resolve to cut expenditure and contain the overall fiscal deficit in 2003/04.** Savings in current spending and adjustments in capital expenditure to reflect favorable exchange rate developments, as well as delays in project execution, are expected to contain the overall fiscal deficit and the resulting domestic financing requirement at lower levels than in the original program, which would help reduce pressures on domestic interest rates. In this regard, a close monitoring of government outlays will be crucial to make timely corrective adjustments so as to ensure that the program targets are met.

45. **A prompt implementation of the government's ambitious agenda for reforming the financial management system is critical to tackle Lesotho's medium-term challenges.** To address current weaknesses, there is a need to improve forecasting, budgeting, accounting, and auditing within the public sector. The computerized accounting system should be expanded to take account of all revenues, grants, and expenditures, and it should be reconciled with other data sources, in particular government bank accounts. Moreover, ongoing reforms to strengthen public expenditure management and the accounting system should be accelerated, and decisive measures should be taken to improve accountability.

46. **The staff supports the ongoing reform of Lesotho's financial institutions and regulations.** These reforms are crucial to increase access to financial services by the private sector, in particular for small and medium-sized enterprises, and to promote sustainable growth. Notably, there is a need to strengthen property rights, establish credit bureaus, and improve the functioning of the judicial system.

47. **The current peg to the South African rand has served Lesotho well because of the financial discipline it entails and the country's close integration with the South African economy.** Looking forward, the staff urges the government to avoid large fiscal deficits that could undermine external competitiveness and to press ahead with improvements in human capital and basic infrastructure to increase productivity.

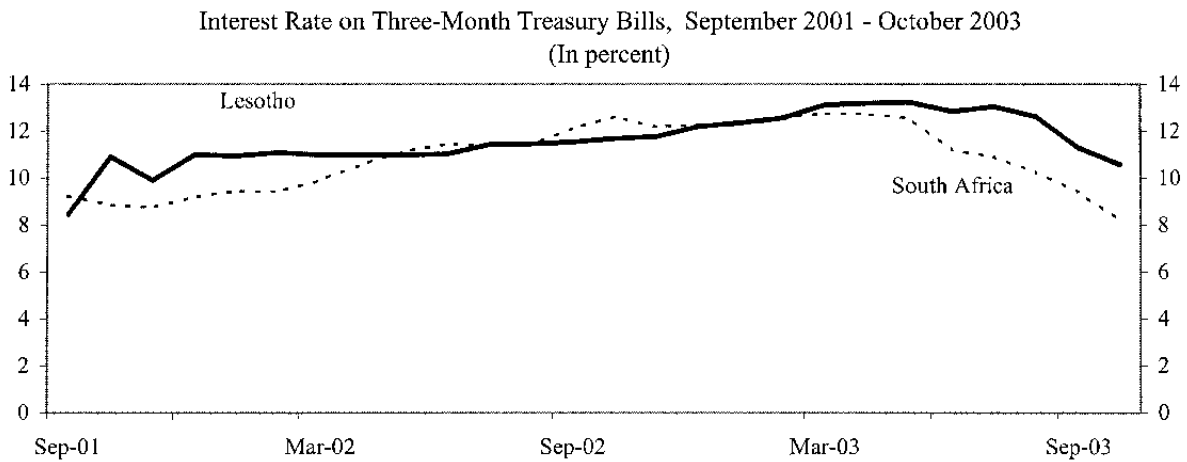
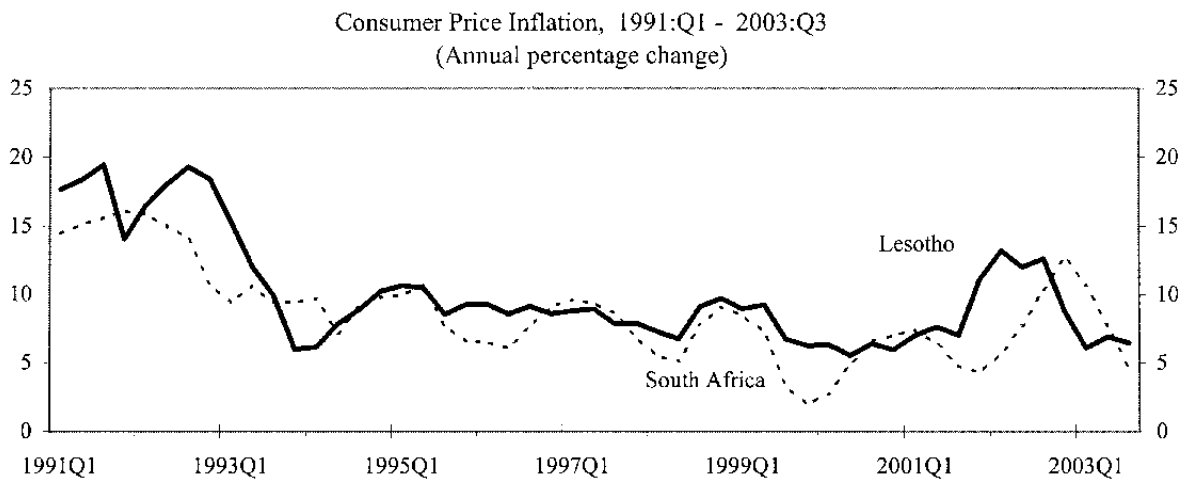
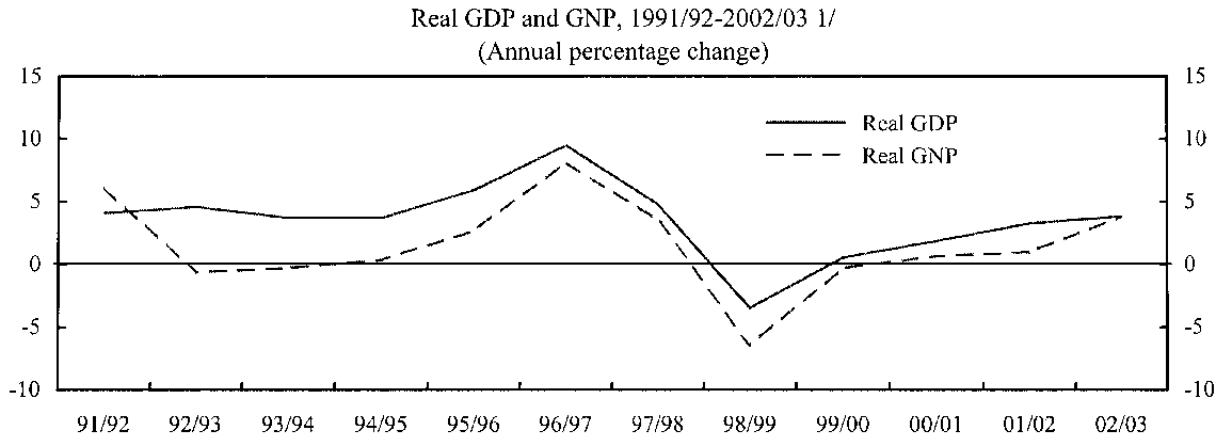
48. **Lesotho's statistical database is broadly satisfactory for program-monitoring purposes.** There are, however, serious deficiencies in the quality and timeliness of core surveillance data, which call for a strengthening of capacity in the statistical agencies.

49. In view of the corrective measures taken by the authorities to address the program slippages registered in the first quarter of the fiscal year, their renewed efforts to speed up structural reform, and the strength of the revised program, the staff supports the authorities' request for waivers for the nonobservance of the quantitative performance criterion on net

government domestic financing at end-June 2003 and for the nonobservance of five structural performance criteria, and their request for the completion of the fifth review under the PRGF arrangement. The staff also supports the authorities' request for an extension of the current PRGF arrangement to end-June 2004 to allow more time to complete the ongoing structural agenda, as well as the sixth review.

50. It is proposed that the next Article IV consultation with Lesotho be held on the 24-month cycle.

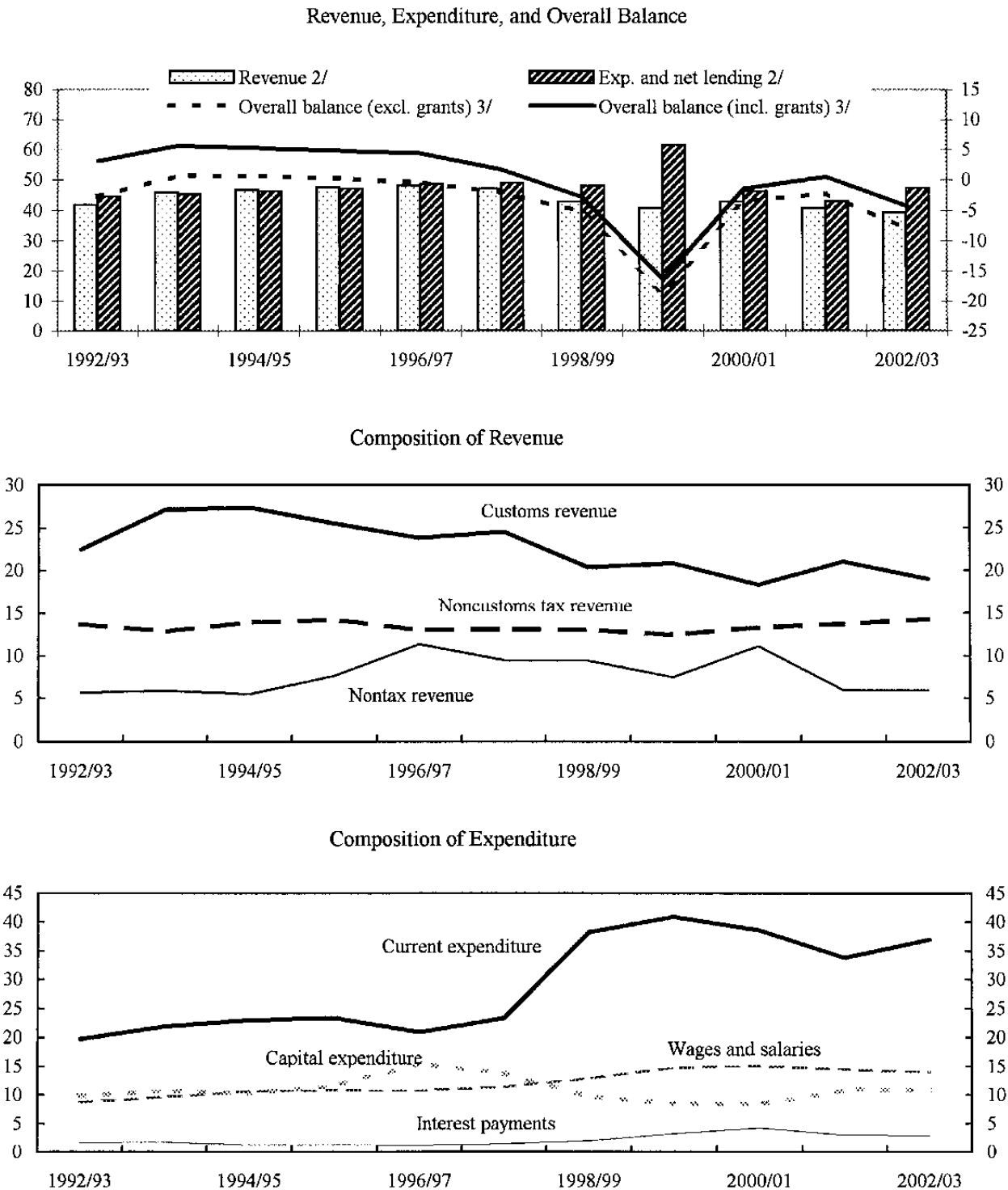
Figure 1. Lesotho: Output, Prices, and Interest Rates



Sources: Central Bank of Lesotho; Fund staff estimates; and IMF *International Financial Statistics*.

1/ Fiscal year starting on April 1.

Figure 2. Lesotho: Fiscal Developments, 1992/93-2002/03 1/
(In percent of GDP)



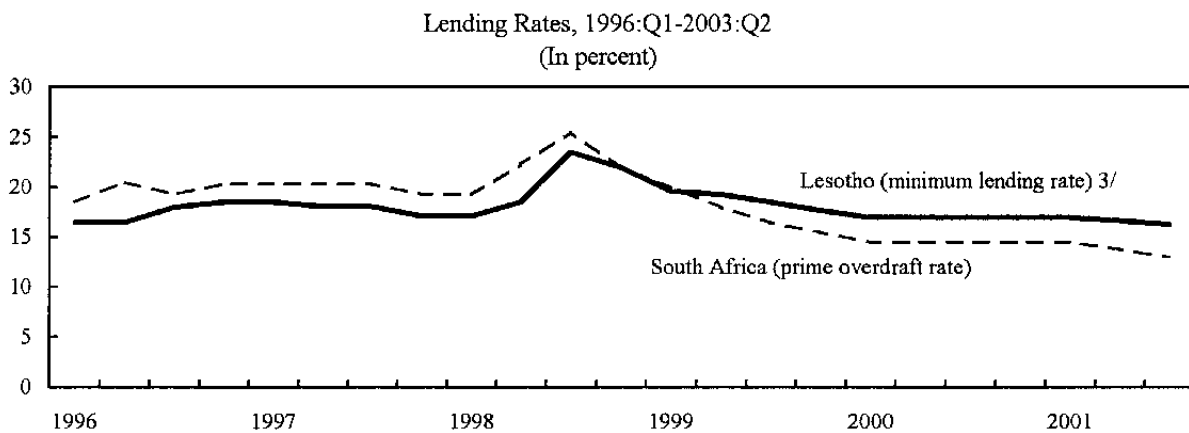
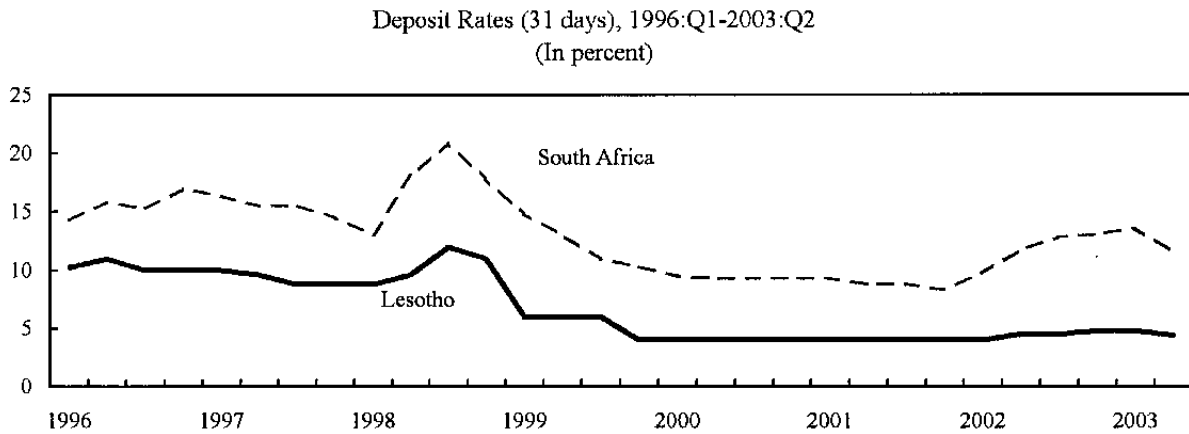
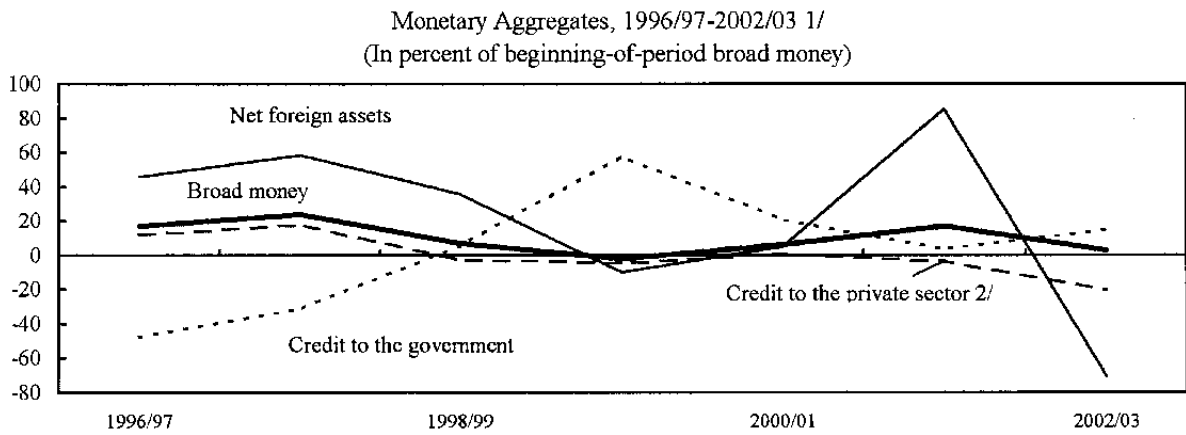
Source: Lesotho authorities.

1/ Fiscal year starting on April 1.

2/ Left scale.

3/ Right scale.

Figure 3. Lesotho: Monetary Developments



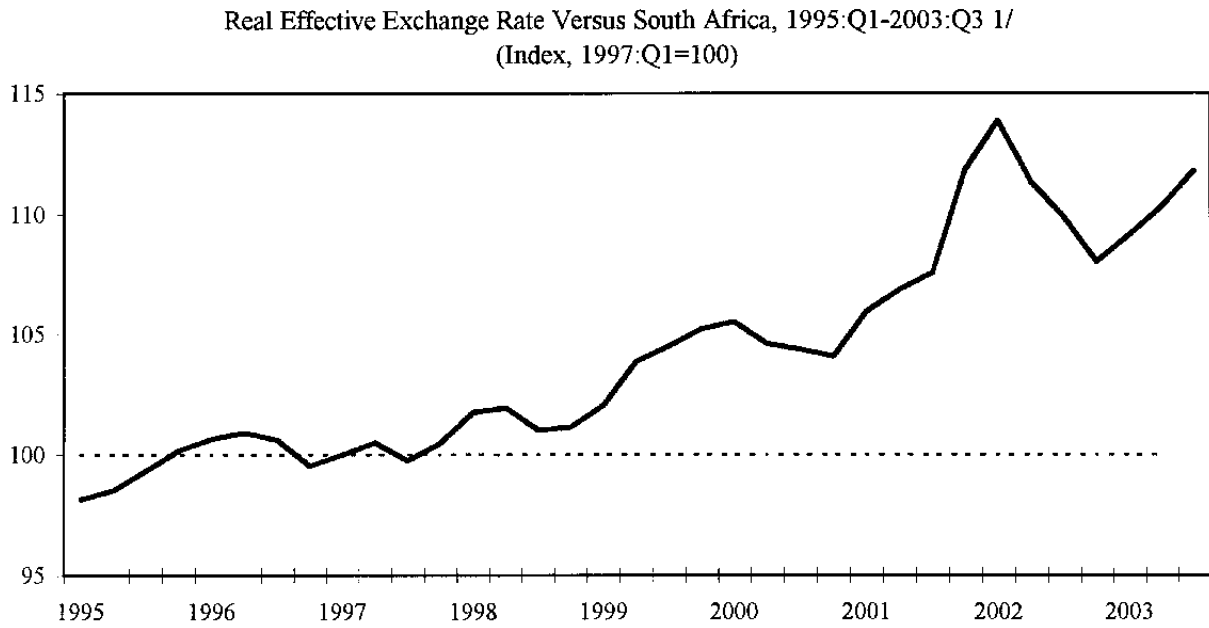
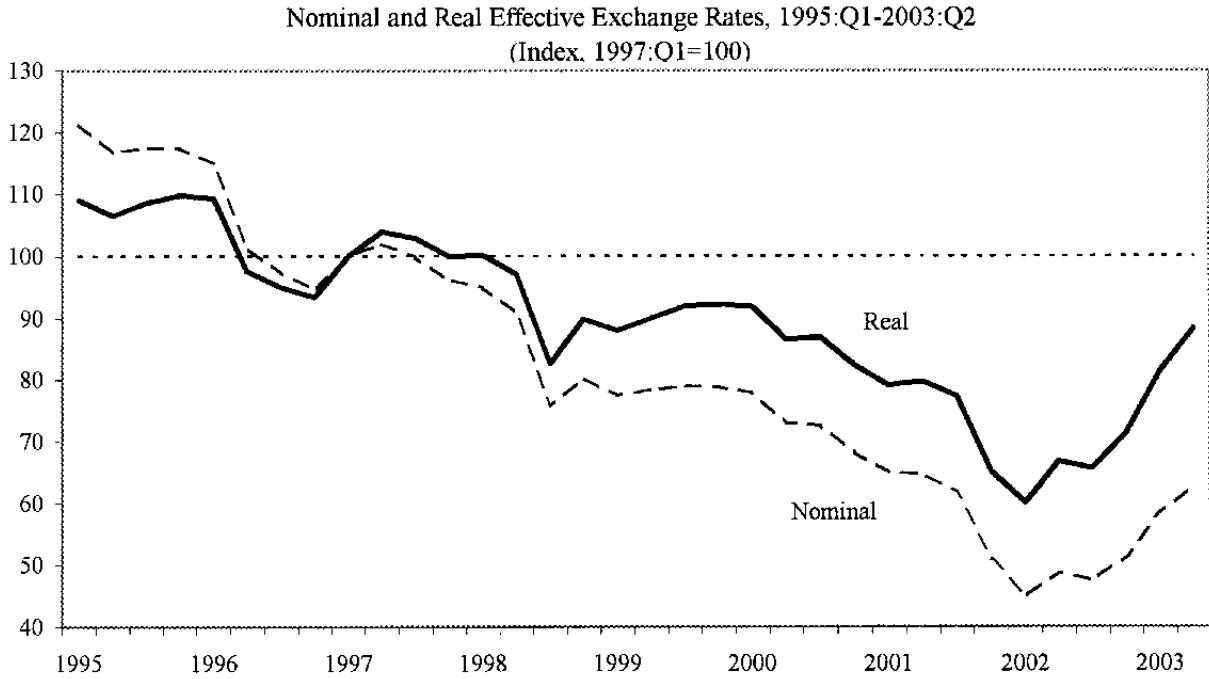
Source: Lesotho authorities.

1/ Fiscal year starting on April 1.

2/ Credit to the private sector affected by a write-off of bad loans in 2002/03.

3/ Minimum lending rates are not statutory rates. They simply indicate the minimum of the rates reported by banks.

Figure 4. Lesotho: Effective Exchange Rates



Source: Fund staff estimates.

1/ Calculated using South Africa as the single partner country.

Table 1. Lesotho: Selected Economic and Financial Indicators, 2001/02-2008/09 1/

	2001/02	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09
	Act.	Act.	Prog. 2/	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise specified)									
National income and prices									
Real GDP	3.3	3.8	4.2	3.9	4.2	4.2	3.8	3.8	3.8
Real GNP	1.0	3.8	3.5	3.3	3.5	4.0	3.2	3.2	3.0
Consumer price index (average change)	11.3	9.1	9.4	6.4	6.6	5.1	5.6	5.4	5.5
Nominal GDP (in millions of maloti)	6,839	7,731	8,909	8,548	9,425	10,361	11,344	12,425	13,603
Nominal GNP (in millions of maloti)	8,374	9,466	10,743	10,399	11,395	12,504	13,614	14,829	16,114
External sector 3/									
Exports, f.o.b.	31.7	35.9	13.2	29.0	8.0	9.5	7.7	8.2	7.8
Imports, f.o.b.	-7.7	27.1	19.8	22.6	14.7	3.9	5.3	5.4	5.1
Net labor income	-22.7	12.4	25.8	26.6	12.0	4.9	3.1	3.0	2.4
Nominal effective exchange rate 4/	-20.3	-7.3	...	...	...	...	...	...	...
Real effective exchange rate 4/	-15.7	1.0	...	...	...	...	...	...	...
Government budget									
Revenue (excluding grants)	6.1	8.9	14.7	11.0	17.7	1.7	7.9	8.3	8.0
Total expenditure and net lending	2.6	24.5	14.7	6.4	9.7	6.1	7.4	7.8	7.5
Current expenditure	-5.0	23.6	14.0	10.8	5.8	7.9	8.4	8.6	8.2
Capital expenditure and net lending	45.5	28.2	17.3	-9.3	26.6	-0.2	3.4	4.4	4.9
Money and credit									
Net foreign assets 5/	85.5	-70.6	-17.0	-6.0	13.1	10.1	9.8	9.2	5.5
Net domestic assets 5/	-68.5	73.4	23.0	16.6	-5.5	0.2	1.3	1.8	4.6
Credit to the government 5/	3.7	15.0	15.5	8.3	-2.0	1.6	1.6	1.5	1.6
Credit to the rest of the economy 6/	-6.0	-45.8	6.1	13.3	8.1	12.0	10.0	10.0	10.0
Broad money	17.0	2.7	6.0	10.6	7.6	10.2	11.2	11.0	10.1
Velocity (GDP/average broad money)	3.5	3.6	3.9	3.7	3.7	3.8	3.7	3.7	3.6
Interest rate 7/	10.2	12.1	...	...	...	...	...	...	...
(In percent of GDP, unless otherwise specified)									
Investment and saving									
Investment	45.4	38.6	37.2	34.4	33.2	32.3	32.4	32.5	32.7
Public	12.1	9.7	9.9	8.8	9.2	8.6	8.4	8.0	7.6
Private	20.6	21.2	21.2	21.8	22.4	22.9	23.5	24.1	24.7
Lesotho Highlands Water Project	12.8	7.7	6.1	3.8	1.6	0.8	0.4	0.4	0.4
Gross national savings (including remittances)	32.0	21.9	24.3	18.5	19.9	17.8	18.5	19.3	20.0
Public	9.7	6.1	5.7	5.6	10.5	7.4	7.3	7.2	7.1
Private	22.3	15.7	18.6	12.9	9.3	10.4	11.2	12.1	12.9
Government budget									
Revenue	40.8	39.3	39.2	39.4	42.1	38.9	38.4	37.9	37.4
Total grants	2.8	3.8	3.3	3.2	3.8	3.4	3.5	3.6	3.6
Total expenditure and net lending	43.0	47.3	46.3	45.5	45.3	43.7	42.9	42.2	41.5
Overall balance (before grants)	-2.2	-8.1	-7.1	-6.1	-3.2	-4.8	-4.5	-4.3	-4.0
Overall balance (after grants)	0.6	-4.2	-3.8	-2.9	0.6	-1.3	-1.0	-0.7	-0.5
Domestic balance	2.0	0.0	0.2	0.0	4.4	1.8	1.5	1.5	1.5
Domestic primary balance	1.7	-2.8	-2.3	-1.4	1.7	-0.5	0.0	0.4	0.6
Gross government domestic debt	16.4	16.6	14.8	14.8	10.5	11.5	12.6	13.6	13.0
External sector									
Current account balance (excluding official transfers)	-29.9	-33.0	-25.9	-27.0	-30.7	-27.4	-26.3	-25.4	-24.6
Current account balance (including official transfers)	-13.4	-16.7	-12.9	-11.8	-15.5	-14.5	-13.8	-13.2	-12.7
Stock of public external debt 8/	74.9	76.1	50.1	53.4	48.8	46.2	43.7	41.0	38.2
Debt-service ratio 9/	14.4	14.5	9.2	9.4	8.9	7.7	6.8	6.2	6.1
(In millions of U.S. dollars, unless otherwise specified)									
Gross official reserves (end of period)	399.7	408.4	398.9	419.8	424.5	448.9	475.3	501.5	501.5
Gross official reserves (in months of imports of goods and services)	5.3	4.4	4.0	3.9	3.8	3.8	3.8	3.8	3.8

Sources: Lesotho authorities; and Fund staff estimates and projections.

1/ Fiscal year beginning in April.

2/ Annual percent changes based on old numbers for 2002/03 which have since been revised.

3/ In U.S. dollars.

4/ Based on partner-country data excluding South Africa. A minus sign indicates a depreciation.

5/ Change in percent of broad money at the beginning of the period.

6/ Credit to the rest of the economy affected by a write-off of bad loans in 2002/03.

7/ The average effective rate on three-month treasury bills.

8/ The programmed appreciation of the loti versus the U.S. dollar has a significant effect on the debt-to-GDP ratio in 2003/04.

9/ In percent of exports of goods and services.

Table 2. Lesotho: Central Government Operations, Annual, 2001/02-2008/09 1/ (concluded)

	2001/02	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09
	Act.	Act.	Prog.	Rev. prog.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In percent of GDP, unless otherwise indicated)								
Revenue	40.8	39.3	39.2	39.4	42.1	38.9	38.4	37.9	37.4
Customs revenue	21.0	19.0	16.0	16.6	18.8	15.6	15.2	14.9	14.6
Noncustoms tax revenue	13.7	14.3	16.8	17.0	18.3	18.4	18.3	18.2	18.1
Nontax revenue	6.0	5.9	6.4	5.8	5.1	4.9	4.8	4.8	4.8
Grants	2.8	3.8	3.3	3.2	3.8	3.4	3.5	3.6	3.6
Total expenditure and net lending	43.0	47.3	46.3	45.5	45.3	43.7	42.9	42.2	41.5
Current expenditure	33.8	37.0	36.8	37.0	35.5	34.8	34.5	34.2	33.8
Wages and salaries	14.5	14.0	12.6	13.1	13.0	12.9	12.7	12.6	12.5
Interest payments	3.0	2.8	2.9	2.5	2.1	1.7	1.7	1.8	1.7
External	1.8	1.4	1.3	1.1	1.0	0.9	0.8	0.7	0.6
Domestic	1.1	1.4	1.6	1.5	1.1	0.8	0.9	1.1	1.1
Other expenditure	16.3	20.1	21.3	21.4	20.4	20.2	20.0	19.8	19.6
Goods and services	10.5	13.5	14.3	14.0	13.1	13.0	12.9	12.7	12.6
Transfers and subsidies	5.8	6.6	7.0	7.4	7.3	7.3	7.2	7.1	7.0
Capital expenditure	10.9	10.8	9.7	8.7	9.8	8.9	8.4	8.0	7.6
Net lending 2/	-1.8	-0.4	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants	-2.2	-8.1	-7.1	-6.1	-3.2	-4.8	-4.5	-4.3	-4.0
Overall balance, after grants	0.6	-4.2	-3.8	-2.9	0.6	-1.3	-1.0	-0.7	-0.5
Domestic balance 3/	2.0	0.0	0.2	0.0	4.4	1.8	1.5	1.3	1.1
Total financing	-0.6	4.2	3.8	2.9	-0.6	1.3	1.0	0.7	0.5
Financing abroad	-0.8	0.7	0.0	-0.3	1.4	1.0	0.6	0.3	0.1
Domestic financing	0.2	3.5	3.8	3.2	-2.0	0.4	0.4	0.4	0.4
Memorandum items:									
GNP at current prices (in millions of maloti)	8,374	9,466	10,743	10,399	11,395	12,504	13,614	14,829	16,114
GDP at current prices (in millions of maloti)	6,839	7,731	8,909	8,548	9,425	10,361	11,344	12,425	13,603

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Fiscal year from April to March.

2/ In 2001/02, redemption of Lesotho Bank treasury bills. In 2002/03, parastatals paid back loans of M 9 million and M 25 million was recovered from nonperforming loans in the old Lesotho Bank.

3/ Domestic balance excludes grants, foreign-financed capital spending, foreign interest payments, and exceptional factors. In 2002/03, current spending because of the famine was excluded as an exceptional factor.

Table 3. Lesotho: Central Government Operations, Quarterly, 2003/04 1/

	Cumulative							
	Q1		Q2		Q3		Q4	
	Prog.	Act.	Prog.	Act.	Prog.	Proj.	Prog.	Rev. prog.
	(In millions of maloti)							
Revenue	796.2	725.9	1,684.9	1,647.2	2,541.0	2,483.8	3,491.9	3,368.9
Tax revenue	637.9	591.0	1,415.5	1,358.9	2,121.1	2,092.5	2,920.6	2,873.7
Customs revenue	355.4	355.4	710.9	710.8	1,066.3	1,066.2	1,421.7	1,421.6
Noncustoms tax revenue	282.5	235.6	704.7	648.1	1,054.8	1,026.3	1,498.9	1,452.1
Income taxes	162.7	134.0	391.5	391.5	551.3	595.7	782.3	850.9
Sales tax / value-added tax (VAT)	95.6	78.0	265.1	209.9	431.0	357.5	619.0	501.9
Petrol levy	21.2	21.8	43.4	43.2	65.1	64.8	86.3	86.3
Other tax revenues	3.0	1.8	4.7	3.5	7.4	8.3	11.3	13.0
Nontax revenue	158.3	134.9	269.4	288.3	419.9	391.3	571.3	495.2
Grants	39.9	46.1	147.7	85.6	204.7	187.4	295.8	276.8
Total expenditure and net lending	839.7	918.6	2,004.8	1,792.1	3,014.1	2,901.3	4,128.9	3,891.6
Current expenditure	671.9	714.3	1,628.5	1,462.8	2,376.6	2,373.1	3,278.5	3,164.4
Wages and salaries	273.4	278.5	561.2	557.7	844.7	840.5	1,126.3	1,123.2
Interest payments	46.5	39.4	104.5	92.3	187.0	155.1	255.2	215.2
External	16.3	14.1	37.3	31.7	82.8	62.2	113.3	90.3
Domestic	30.2	25.3	67.2	60.6	104.2	92.9	141.9	124.9
Other expenditure	352.0	396.4	962.8	812.8	1,344.9	1,377.5	1,897.0	1,826.0
Goods and services	221.4	247.8	666.4	514.4	869.9	894.6	1,273.6	1,193.0
<i>Of which: agricultural support</i>	0.0	16.3	0.0	26.6	0.0	...	0.0	41.0
<i>vehicle leases</i>	25.0	33.0	51.0	72.8	76.0	...	102.0	149.0
Transfers and subsidies	130.6	148.6	296.4	298.4	475.0	482.9	623.4	633.0
<i>Of which: scholarships</i>	48.8	70.0	...	...	...	...	195.0	215.0
Capital expenditure	167.8	208.0	376.3	333.0	637.5	535.3	867.4	740.9
Domestically funded	80.7	132.6	167.6	196.0	255.4	254.0	341.0	320.8
Externally funded	87.1	75.4	208.7	137.0	382.1	281.3	526.4	420.1
Grant funded	39.9	46.1	118.0	71.6	175.0	150.6	266.1	240.0
Loan funded	47.2	29.3	90.7	65.4	207.1	130.7	260.3	180.1
Net lending	0.0	-3.7	0.0	-3.7	0.0	-7.1	-17.0	-13.7
Overall balance, before grants	-43.5	-192.7	-319.9	-144.9	-473.1	-417.5	-637.0	-522.7
Overall balance, after grants	-3.6	-146.6	-172.2	-59.3	-268.4	-230.1	-341.2	-245.9
Domestic balance 2/	35.6	-86.9	-98.2	23.8	-32.5	-105.4	16.7	1.7
Total financing	3.6	146.6	172.2	59.3	268.4	230.1	341.2	245.9
External financing	-3.6	-16.4	-20.3	-24.9	-0.7	-39.0	0.1	-25.9
Loan drawings	47.2	29.3	90.7	65.4	207.1	130.7	260.3	180.1
Amortization	-50.8	-45.7	-111.0	-90.3	-207.8	-169.7	-260.2	-206.0
Domestic financing	7.2	163.1	192.5	82.7	269.1	269.1	341.1	271.8
Bank	...	104.5	...	-6.8	...	179.6	...	182.3
Nonbank	...	58.6	...	89.5	...	89.5	...	89.5
Residual	0.0	-0.1	0.0	1.5	0.0	0.0	0.0	0.0

Table 3. Lesotho: Central Government Operations, Quarterly, 2003/04 1/ (concluded)

	Cumulative							
	Q1		Q2		Q3		Q4	
	Prog.	Act.	Prog.	Act.	Prog.	Proj.	Prog.	Rev. prog.
(In percent of GDP, unless otherwise indicated)								
Revenue	8.9	8.5	18.9	19.3	28.5	29.1	39.2	39.4
Customs revenue	4.0	4.2	8.0	8.3	12.0	12.5	16.0	16.6
Noncustoms tax revenue	3.2	2.8	7.9	7.6	11.8	12.0	16.8	17.0
Nontax revenue	1.8	1.6	3.0	3.4	4.7	4.6	6.4	5.8
Grants	0.4	0.5	1.7	1.0	2.3	2.2	3.3	3.2
Total expenditure and net lending	9.4	10.7	22.5	21.0	33.8	33.9	46.3	45.5
Current expenditure	7.5	8.4	18.3	17.1	26.7	27.8	36.8	37.0
Wages and salaries	3.1	3.3	6.3	6.5	9.5	9.8	12.6	13.1
Interest payments	0.5	0.5	1.2	1.1	2.1	1.8	2.9	2.5
Other expenditure	4.0	4.6	10.8	9.5	15.1	16.1	21.3	21.4
Goods and services	2.5	2.9	7.5	6.0	9.8	10.5	14.3	14.0
Transfers and subsidies	1.5	1.7	3.3	3.5	5.3	5.6	7.0	7.4
Capital expenditure	1.9	2.4	4.2	3.9	7.2	6.3	9.7	8.7
Net lending	0.0	0.0	0.0	0.0	0.0	-0.1	-0.2	-0.2
Overall balance, before grants	-0.5	-2.3	-3.6	-1.7	-5.3	-4.9	-7.1	-6.1
Overall balance, after grants	0.0	-1.7	-1.9	-0.7	-3.0	-2.7	-3.8	-2.9
Domestic balance 2/	0.4	-1.0	-1.1	0.3	-0.4	-1.2	0.2	0.0
External financing	0.0	-0.2	-0.2	-0.3	0.0	-0.5	0.0	-0.3
Domestic financing	0.1	1.9	2.2	1.0	3.0	3.1	3.8	3.2
Memorandum items:								
GNP at current prices (in millions of maloti)	10,743	10,399	10,743	10,399	10,743	10,399	10,743	10,399
GDP at current prices (in millions of maloti)	8,909	8,548	8,909	8,548	8,909	8,548	8,909	8,548

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Fiscal year from April to March.

2/ Domestic balance excludes grants, foreign-financed capital spending, foreign interest payments, and exceptional factors.

Table 4. Lesotho: Central Bank Balance Sheet, March 2002-March 2005

	2002		2003							2004			2005
	Mar. Act.	Dec. Act.	Mar. Act.	June Prog.	June Act.	Sep. Prog.	Sep. Act.	Dec. Prog.	Dec. Proj.	Mar. Prog.	Mar. Rev. prog.	June Proj.	Mar. Proj.
(In millions of maloti)													
Net foreign assets	4,474.6	3,201.1	2,949.7	2,900.3	3,060.2	2,741.9	2,680.1	2,741.9	2,672.4	2,741.9	2,672.4	2,672.4	2,685.3
Foreign assets	5,006.8	3,847.8	3,569.1	3,568.0	3,570.2	3,439.2	3,177.3	3,438.5	3,371.0	3,472.2	3,403.6	3,439.8	3,451.8
Foreign liabilities	532.2	646.7	619.5	667.7	510.0	697.4	497.2	696.6	698.6	730.4	731.2	767.4	766.5
Net domestic assets	-4,199.9	-2,872.6	-2,635.0	-2,579.3	-2,673.9	-2,416.1	-2,422.5	-2,411.4	-2,411.2	-2,406.3	-2,407.5	-2,403.7	-2,398.8
Net claims on government	-1,297.0	-1,066.0	-792.2	-1,007.0	-966.1	-840.7	-971.1	-832.6	-803.0	-824.1	-770.6	-833.2	-690.7
Claims on government	231.8	191.3	184.0	197.7	196.1	200.6	183.2	203.5	182.6	206.6	215.2	251.4	250.5
Government deposits	-1,528.8	-1,257.3	-976.2	-1,204.7	-1,162.1	-1,041.2	-1,154.3	-1,036.1	-985.7	-1,030.7	-985.8	-1,084.6	-941.3
Official entities' deposits	-205.9	-151.3	-151.1	-155.8	-150.0	-158.1	-160.8	-160.4	-163.0	-162.9	-165.3	-167.7	-178.8
Claims on commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net claims on private sector	2.6	2.8	2.4	2.5	3.5	2.5	3.4	2.5	3.5	2.6	3.5	3.6	3.8
Other items (net)	-2,699.6	-1,658.0	-1,694.1	-1,418.9	-1,561.4	-1,419.9	-1,293.9	-1,420.9	-1,448.6	-1,422.0	-1,475.0	-1,406.4	-1,533.1
Other assets	127.4	141.5	150.2	145.7	147.4	147.8	148.5	150.0	150.6	152.3	152.7	154.9	165.2
Other liabilities	-260.7	-27.7	-263.3	-27.7	-25.9	-27.7	-33.9	-27.7	-33.9	-27.7	-33.9	-33.9	-50.0
Capital account	-2,566.3	-1,771.8	-1,580.9	-1,536.9	-1,682.8	-1,540.0	-1,408.6	-1,543.2	-1,565.3	-1,546.5	-1,593.9	-1,527.4	-1,648.2
Reserve money	274.6	328.5	314.7	321.0	386.3	325.7	257.7	330.5	261.2	335.5	264.9	268.7	286.5
Maloti outside banks	164.1	179.7	178.6	170.4	175.8	172.9	188.2	175.4	190.8	178.1	193.5	196.2	209.2
Currency in commercial banks	32.1	43.4	31.7	44.7	37.5	45.3	34.7	46.0	35.2	46.7	35.7	36.2	38.6
Commercial banks deposits	78.4	105.4	104.4	105.9	173.0	107.5	34.7	109.1	35.2	110.7	35.7	36.2	38.6
(In units indicated)													
Memorandum items:													
Net foreign assets (in millions of U.S. dollars)	392.5	373.6	377.1	377.1	404.6	357.1	389.4	357.1	364.6	357.1	364.6	364.6	360.9
Gross international reserves (in percent of currency in circulation)	2,777.0	1,937.7	1,807.0	1,759.5	1,842.9	1,665.4	1,524.6	1,640.9	1,555.4	1,633.8	1,590.6	1,586.6	1,509.5
(in percent of M1)	322.5	241.6	223.6	219.5	232.2	207.7	201.6	204.7	190.6	203.8	190.8	190.6	182.4
(in percent of M2)	213.6	160.6	147.3	145.8	143.7	138.0	129.7	136.0	127.0	135.4	127.0	126.8	121.1
(in months of imports)	5.3	4.4	4.4	4.4	4.0	4.2	3.9	4.2	3.9	4.0	3.9	3.8	3.8

Sources: Central Bank of Lesotho; and Fund staff estimates and projections.

Table 5. Lesotho: Monetary Survey, March 2002-March 2005

	2002		2003							2004			2005
	Mar. Act.	Dec. Act.	Mar. Act.	June Prog.	June Act.	Sep. Prog.	Sep. Act.	Dec. Prog.	Dec. Proj.	Mar. Prog.	Mar. Rev. prog.	June Proj.	Mar. Proj.
(In millions of maloti)													
Net foreign assets	5,229.0	3,884.1	3,722.3	3,356.4	3,635.6	3,339.5	3,430.5	3,273.5	3,555.9	3,212.4	3,591.3	3,582.9	3,910.0
Central bank	4,474.6	3,201.1	2,949.7	2,900.3	3,060.2	2,741.9	2,680.1	2,741.9	2,672.4	2,741.9	2,672.4	2,672.4	2,685.3
Commercial banks	754.4	683.0	772.6	456.1	575.3	597.6	750.4	531.7	883.4	470.5	918.9	910.5	1,224.7
Net domestic assets	-3,095.9	-1,715.9	-1,530.9	-1,124.3	-1,381.2	-1,074.8	-1,218.9	-975.7	-1,158.6	-879.8	-1,167.3	-1,126.6	-1,301.7
Domestic credit 1/	432.3	691.9	321.4	870.3	454.5	1,070.6	366.5	1,162.5	560.7	1,250.5	571.5	531.7	570.6
Claims on central government (net)	-511.0	-321.5	-190.3	-154.7	-85.8	30.5	-197.1	107.1	-10.7	179.1	-8.0	-56.1	-56.1
Central bank	-1,297.0	-1,066.0	-792.2	-1,007.0	-966.1	-840.7	-971.1	-832.6	-803.0	-824.1	-770.6	-833.2	-690.7
Commercial banks	786.0	744.5	602.0	852.3	880.3	871.2	774.1	939.7	792.4	1,003.2	762.7	777.1	634.7
Claims on the rest of the economy 1/	943.3	1,013.4	511.6	1,025.1	540.3	1,040.1	563.6	1,055.4	571.4	1,071.5	579.5	587.8	626.7
Other items (net) 1/	-3,528.2	-2,407.8	-1,852.3	-1,994.7	-1,835.7	-2,145.4	-1,585.4	-2,138.3	-1,719.3	-2,130.4	-1,738.8	-1,658.3	-1,872.3
Money and quasi money (M2)	2,133.1	2,168.2	2,191.3	2,232.0	2,254.4	2,264.7	2,211.6	2,297.8	2,397.2	2,332.5	2,424.0	2,456.3	2,608.3
Money	1,413.2	1,440.9	1,443.9	1,483.3	1,395.8	1,504.9	1,422.9	1,526.9	1,597.7	1,549.9	1,613.1	1,633.8	1,731.3
Of which: currency outside dep. mon. banks	164.1	179.7	178.6	185.0	175.8	187.7	188.2	190.5	195.8	193.4	193.5	196.2	209.2
demand deposits	1,032.4	1,099.2	1,103.4	1,131.7	1,059.6	1,148.3	1,063.6	1,165.2	1,078.1	1,182.9	1,093.5	1,109.1	1,182.5
Quasi money (time and savings deposits)	719.9	727.2	747.5	748.8	858.6	759.8	788.7	770.9	799.5	782.6	810.9	822.5	876.9
(Annual change in percent of beginning-of-year M2, unless otherwise specified)													
Net foreign assets	85.5	-71.8	-70.6	-63.0	-50.4	-57.9	-53.7	-28.2	-15.1	-17.0	-6.0	-36.5	13.1
Central bank	76.8	-71.0	-71.5	-46.8	-39.6	-51.0	-53.8	-21.2	-24.4	-7.2	-12.7	-39.8	0.5
Commercial banks	8.7	-0.7	0.9	-16.1	-10.8	-6.9	0.1	-7.0	9.2	-9.8	6.7	3.3	12.6
Net domestic assets	-68.5	80.6	73.4	63.4	51.9	61.4	54.8	34.1	25.7	23.0	16.6	40.4	-5.5
Claims on central government (net)	3.7	15.4	15.0	14.7	17.8	17.0	6.6	19.8	14.3	15.5	8.3	13.3	-2.0
Claims on the rest of the economy 1/	-3.3	1.3	-20.2	3.1	-18.7	1.5	-20.3	1.9	-20.4	2.8	3.1	-35.9	1.9
Claims on the rest of the econ. (yearly percent change) 1/	-6.0	2.6	-45.8	7.2	-43.5	3.3	-44.0	4.1	-43.6	6.1	13.3	-59.1	8.1
Other items (net) 1/	-68.9	63.9	78.6	45.6	52.7	42.9	68.5	12.4	31.8	4.7	5.2	63.0	-5.5
Money and quasi money (M2)	17.0	8.8	2.7	0.5	1.5	3.5	1.1	6.0	10.6	6.0	10.6	3.9	7.6
Quasi money (yearly percent change)	6.2	3.8	3.8	-0.3	14.3	3.1	7.0	6.0	9.9	6.1	8.5	3.0	8.1
Memorandum item:													
Money multiplier (M2/reserve money)	7.8	6.6	7.0	7.0	5.8	7.0	8.6	7.0	9.2	7.0	9.2	9.1	9.1

Sources: Central Bank of Lesotho; and Fund staff estimates and projections.

1/ Claims on the rest of the economy and other items (net) affected by a write-off of bad loans in February 2003.

Table 6. Lesotho: Balance of Payments, 2001/02 - 2008/09 1/
(In millions of U.S. dollars)

	2001/02	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09
	Act.	Act.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Trade balance	-367.7	-441.3	-485.2	-515.9	-626.3	-620.1	-638.3	-654.6	-668.1
Exports, f.o.b.	293.7	399.1	562.6	514.7	556.1	609.0	655.9	709.9	765.3
Imports, f.o.b.	-661.4	-840.4	-1,047.8	-1,030.6	-1,182.4	-1,229.1	-1,294.3	-1,364.4	-1,433.5
Services (net)	-11.5	-22.4	-31.3	-36.4	-38.2	-46.2	-51.0	-60.4	-70.4
Receipts	36.5	40.8	49.0	48.5	62.6	65.2	72.4	76.1	79.9
<i>Of which</i> : water royalties (and power sales)	10.6	12.1	23.3	14.6	28.0	30.2	36.9	39.6	42.5
Payments	-48.0	-63.2	-80.3	-84.9	-100.8	-111.5	-123.4	-136.5	-150.3
Income (net)	161.0	185.6	227.2	243.4	266.8	284.5	295.4	306.8	314.1
Labor income (net)	165.3	185.9	235.0	235.3	263.7	276.7	285.2	293.8	300.7
Receipts	189.0	210.4	259.7	267.0	290.4	299.6	307.4	315.4	322.5
<i>Of which</i> : miners' wages	148.6	169.5	199.7	218.4	235.8	241.4	245.9	250.2	253.8
Payments	-23.6	-24.5	-24.7	-31.7	-26.7	-22.9	-22.2	-21.5	-21.8
Investment income (net)	-4.3	-0.2	-7.8	8.0	3.1	7.8	10.2	13.0	13.4
Receipts	23.5	25.4	21.9	37.0	31.4	35.3	36.9	39.0	39.0
Payments	-27.8	-25.6	-29.7	-28.9	-28.3	-27.5	-26.7	-26.0	-25.6
<i>Of which</i> : interest on debt	-13.5	-12.9	-13.2	-14.1	-12.5	-11.3	-10.2	-9.2	-8.5
Unrequited transfers	122.2	139.8	147.2	176.8	200.1	182.4	190.3	199.2	207.7
Official	118.8	134.9	143.5	171.3	194.6	176.8	184.6	193.5	201.9
Southern African Customs Union nonduty receipts	113.7	118.5	125.2	146.2	170.2	152.2	159.8	168.3	176.3
Rand compensation	0.0	6.2	11.3	8.7	6.6	6.5	6.2	6.4	6.5
Other	5.0	10.2	7.0	16.4	17.8	18.2	18.5	18.8	19.1
Private	3.4	4.9	3.7	5.4	5.5	5.6	5.7	5.8	5.8
Current account (including official transfers)	-96.0	-138.2	-142.1	-132.2	-197.7	-199.4	-203.6	-209.0	-216.7
<i>Of which</i> : LHWP 2/	-46.1	-34.1	-21.1	-37.1	-8.8	-3.8	-2.8	-2.7	-2.7
Capital and financial account	201.1	129.4	142.1	132.2	197.7	199.4	203.7	208.9	216.7
Capital account (transfers received)	29.3	37.4	40.2	27.8	59.2	54.1	52.0	56.4	60.9
Financial account	171.7	92.0	101.9	104.4	138.5	145.2	151.6	152.5	155.9
Direct investment	107.1	92.6	60.5	115.5	95.8	97.5	99.3	100.9	102.3
Other investment	71.0	8.1	34.0	0.3	47.4	72.1	78.7	77.8	53.6
Assets	7.0	-33.4	27.2	-37.0	-39.0	2.7	4.6	6.2	-6.1
Liabilities	64.0	41.4	6.8	37.3	86.4	69.5	74.1	71.6	59.7
Loans	62.4	74.9	19.5	68.0	89.4	66.9	70.1	65.7	53.4
Public and publicly guaranteed	7.6	-2.9	8.6	-1.0	25.5	21.0	17.6	15.5	12.8
Disbursements	29.4	27.5	40.0	30.4	55.6	50.8	47.0	43.9	41.2
Repayments	-21.8	-30.4	-31.5	-31.5	-30.1	-29.8	-29.4	-28.4	-28.4
LHDA (water transfer) loans, net 3/	54.9	78.2	59.1	62.7	58.4	46.4	28.1	29.1	27.5
Private (net)	-0.2	-0.5	-48.2	6.3	5.5	-0.5	24.4	21.0	13.0
Other liabilities	1.6 ^d	-33.5	-12.6	-30.7	-3.0	2.6	4.0	5.9	6.3
CBL liabilities	2.7	-31.7	-12.6	-21.4	-3.3	2.2	3.7	5.6	6.0
Commercial banks' liabilities	-1.1	-1.8	0.0	-9.3	0.3	0.4	0.3	0.3	0.3
Change in reserve assets 4/	-6.4	-8.7	7.4	-11.4	-4.7	-24.4	-26.4	-26.2	0.0
Errors and omissions	-105.1	8.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Central Bank of Lesotho (CBL); and Fund staff estimates and projections.

1/ Financial year is April-March.

2/ Lesotho Highlands Water Project.

3/ Lesotho Highlands Development Authority.

4/ Transactions-based data; a minus sign indicates an increase in reserves.

Table 7. Lesotho: Quantitative Benchmarks and Performance Criteria,
June 2003 - September 2003

	June Perf. Criteria				September Benchmarks			
	Prog. 1/ Prog. 2/	Actual	Met (M) or not met (NM)	Prog. 1/ Prog. 2/	Actual	Met (M) or not met (NM)		
(In millions of maloti)								
Ceiling on the domestic financing requirement of the central government 3/	7	2	163	NM	193	203	83	M
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-2,579	-2,579	-2,717	M	-2,416	-2,416	-2,649	M
(In millions of U.S. dollars)								
Floor on the stock of net international reserves of the Central Bank of Lesotho 4/	377	377	392	M	357	357	367	M
Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector (cumulative from end-November 2000 onward) 5/ 6/ 7/								
Maturity of less than one year 8/	0	0	0	M	0	0	0	M
Maturity of one year or more	0	0	0	M	0	0	0	M
Ceiling on the stock of external payments arrears 7/	0	0	0	M	0	0	0	M

Sources: Ministry of Finance; Central Bank of Lesotho; and Fund staff estimates.

1/ Before application of adjusters.

2/ After application of adjusters, as indicated in the technical memorandum of understanding (TMU) in EBS/03/66 (5/23/03).

3/ Cumulative from end-March 2003 onward.

4/ The exchange rates are indicated in the TMU in EBS/03/66 (5/23/03).

5/ This performance criterion applies not only to debt as defined in point no. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. A loan is concessional if its grant element is at least 35 percent, calculated using a discount rate based on the ten-year average of OECD commercial interest reference rates (CIRRs) for loans of maturity of greater than 15 years; for loans of maturity of 15 years or less, the discount rate is based on the six-month average of OECD CIRRs. To both the ten-year and six-month averages, the same margin for differing repayment periods would be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

6/ Excludes borrowing for water transfer operations of the Lesotho Highlands Development Authority.

7/ Continuous performance criterion.

8/ Except for normal short-term import credits and nonresident holdings of treasury bills.

Table 8. Lesotho: Structural Performance Criteria and Benchmarks, June 2003-December 2003

Structural Performance Criteria	Status
<ul style="list-style-type: none"> Put into effect VAT (July 2003). 	Met.
<ul style="list-style-type: none"> Put into effect measures to raise revenue by the equivalent of 1 percent of GDP (June 30, 2003). 	Met. Measures put into effect, but revised yield projections indicate lower net revenue gains.
<ul style="list-style-type: none"> Appoint a Contract Representative for Imperial Fleet contract (July 31, 2003). 	Not met. The terms of reference was delayed, while the authorities initiated a review of the contract. A new structural performance criterion for February 28, 2004 is proposed to appoint the Contract Representative.
<ul style="list-style-type: none"> Transactions in bank accounts, including diplomatic missions, will be entered into the Treasury ledger system. Initiate practice of reconciling all cash balances with bank balances monthly (August 31, 2003). 	Not Met. A few bank accounts are still missing from the Treasury ledger system. The measure is proposed to be retimed as a structural benchmark for April 30, 2004.
<ul style="list-style-type: none"> Integrate into the Treasury accounting system loans to parastatals and ministry accounts that are not being captured by the system and report such integration to the Fund (August 31, 2003). 	Not Met. Loans to parastatals have been identified, but they have not yet been integrated into the Treasury system due to staff constraints. This measure is proposed to be retimed as a structural performance criteria for March 31, 2004.
<ul style="list-style-type: none"> Complete Government's 2002/03 accounts and present to Auditor General (September 30, 2003). 	Not Met. The measure was implemented with a delay. The Auditor General received the submission in early December.
<ul style="list-style-type: none"> Submit for audit a report on below-the-line accounts (September 30, 2003). 	Not Met. The measure was implemented with a delay. The Auditor General received the submission in early December.
Structural benchmarks	
<ul style="list-style-type: none"> Begin a study on the costing of all income tax, VAT, and customs exemptions (June 30, 2003). 	Met.

Table 8. Lesotho Structural Performance Criteria and Benchmarks, June 2003-December 2003 (concluded)

Structural Performance Criteria	Status
<ul style="list-style-type: none"> • Prepare a timed action plan for Treasury reform including a restructured top management, a strengthened internal audit function, and a review of Treasury computer arrangements (June 30, 2003). 	Met.
<ul style="list-style-type: none"> • Prepare a schedule for improving balance of payment data (June 30, 2003). 	Met.
<ul style="list-style-type: none"> • Complete the first stage of capital account liberalization (June 30, 2003). 	Mct.
<ul style="list-style-type: none"> • Complete a study on the needs for future famine relief and agricultural support programs (July 31, 2003). 	Not met.
<ul style="list-style-type: none"> • Hold commercial court workshops (July 31, 2003). 	Not met. Implemented with a delay as the workshop was held on October 6 to 11, due to busy High Court schedule.
<ul style="list-style-type: none"> • Complete vision planning paper for national payments system (August 31, 2003). 	Met.
<ul style="list-style-type: none"> • Enhance status of Fund reports to include revenue collections and projections of spending and revenue through the end of the financial year (September 30, 2003). 	Framework has been established and ministries are now reporting revenue and expenditure monthly. Projections are still incomplete and limited to the recording of committed expenditure.
<ul style="list-style-type: none"> • Strengthen financial control at the ministry level by enforcing existing regulations and reemphasizing the financial oversight role and responsibilities of the Principal Secretaries, Chief Accounting Officers, and Financial Controllers. Strengthen Inspectorate and increase number of inspections (September 30, 2003). 	Mct.
<ul style="list-style-type: none"> • Strengthen the accounting cadre in Government by reviewing minimum qualifications for accounting positions and the salary structure (September 30, 2003). 	Met.
<ul style="list-style-type: none"> • Complete the revision of the insurance legislation (December 31, 2003). 	Ongoing.

Table 9. Lesotho: Medium-Term Fiscal Scenarios, 2002/03-2008/09

	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09
	Act.	Prog.	Rev. prog.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change)							
Real GDP	3.8	4.2	3.9	4.2	4.2	3.8	3.8	3.8
Consumer price index (average change)	9.1	9.4	6.4	6.6	5.1	5.6	5.4	5.5
I. Baseline scenario	(In percent of GDP, unless otherwise specified)							
Government budget								
Total revenue and grants	43.1	42.5	42.6	45.9	42.4	41.9	41.5	41.0
Southern African Customs Union	19.0	16.0	16.6	18.8	15.6	15.2	14.9	14.6
Other revenue and grants	24.1	26.5	26.0	27.2	26.8	26.7	26.6	26.4
Total expenditure and net lending	47.3	46.3	45.5	45.3	43.7	42.9	42.2	41.5
<i>Of which: primary expenditure 1/</i>	45.9	44.7	44.1	44.2	42.9	41.9	41.1	40.4
Overall balance, after grants	-4.2	-3.8	-2.9	0.6	-1.3	-1.0	-0.7	-0.5
Domestic primary balance 1/	-2.8	-2.3	-1.4	1.7	-0.5	0.0	0.4	0.6
Gross government domestic debt	16.6	14.8	14.8	10.5	11.5	12.6	13.6	13.0
Memorandum item:								
Real interest rate (domestic) 2/	1.5	5.0	5.0	4.5	5.0	4.0	4.2	3.6
II. Scenario with more expansionary policy								
Government budget								
Total revenue and grants				45.9	42.4	41.9	41.5	41.0
Total expenditure and net lending				45.5	45.4	45.8	46.3	46.8
<i>Of which: primary expenditure 1/</i>				44.5	44.5	44.5	44.5	44.5
Overall balance, after grants				0.4	-3.0	-3.9	-4.8	-5.8
Domestic primary balance 1/				1.4	-2.1	-2.6	-3.0	-3.5
Gross government domestic debt				10.8	13.5	17.4	21.7	26.3
Memorandum item:								
Real interest rate (domestic) 2/				4.5	5.0	5.0	5.0	5.0

Sources: Lesotho authorities; and Fund staff estimates and projections.

1/ Excludes domestic interest payments.

2/ Real interest rate on public gross domestic debt; in percent.

Table 10. Lesotho: External Financing Requirements and Sources, 2001/02-2008/09
(In millions of U.S. dollars)

	2001/02	2002/03	2003/04		2004/05	2005/06	2006/07	2007/08	2008/09
	Act.	Act.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Gross financing requirements	-244.2	-314.6	-358.1	-355.8	-427.6	-431.0	-444.3	-457.3	-447.4
External current account deficit (excl. off. transfers)	-214.8	-273.2	-285.6	-303.5	-392.2	-376.3	-388.2	-402.4	-418.6
Debt amortization	-18.6	-29.4	-78.1	-39.1	-30.5	-30.1	-28.1	-25.6	-25.7
Medium- and long-term debt 1/	-18.6	-29.4	-78.1	-39.1	-30.5	-30.1	-28.1	-25.6	-25.7
Public sector	-17.3	-27.0	-29.7	-29.7	-29.9	-29.7	-27.8	-25.3	-25.3
Commercial banks	-1.1	-1.8	0.0	-9.3	0.3	0.4	0.3	0.3	0.3
Corporate private sector	-0.2	-0.6	-48.4	0.0	-0.8	-0.8	-0.7	-0.6	-0.8
Short-term debt 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross reserves accumulation (-)	-6.4	-8.7	7.4	-11.4	-4.7	-24.4	-26.4	-26.2	0.0
IMF repurchases and repayments	-4.5	-3.3	-1.7	-1.7	-0.2	-0.2	-1.6	-3.0	-3.0
Available financing	244.2	314.6	358.1	355.8	427.6	431.0	444.3	457.3	447.4
Foreign direct investment (net)	107.1	92.6	60.5	115.5	95.8	97.5	99.3	100.9	102.3
Debt financing from private creditors	0.0	0.1	0.2	6.3	6.3	0.3	25.1	21.7	14.8
Medium- and long-term financing	0.0	0.1	0.2	6.3	6.3	0.3	25.1	21.7	14.8
To commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
To corporate private sector	0.0	0.1	0.2	6.3	6.3	0.3	25.1	21.7	13.8
Short-term financing (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Official grants and loans 3/	157.0	181.1	220.0	208.3	289.6	265.1	273.5	283.2	292.8
External grants (net)	135.2	162.7	176.5	191.4	243.6	224.0	236.6	249.9	262.7
South African Customs Union nonduty receipts	113.7	118.5	125.2	146.2	170.2	152.2	159.8	168.3	176.3
Other	21.5	44.3	51.3	45.1	73.5	71.8	76.7	81.6	86.5
Multilateral creditors	21.7	18.4	42.0	16.9	44.3	40.5	36.4	33.3	30.1
Bilateral creditors	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial creditors	0.1	0.0	1.5	0.0	1.7	0.6	0.4	0.0	0.0
Lesotho Highland Development Authority	67.8	87.9	66.4	70.5	68.5	53.4	28.1	29.1	27.5
External grants	12.9	9.6	7.3	7.7	10.1	7.0	0.0	0.0	0.0
External loans	54.9	78.2	59.1	62.7	58.4	46.4	28.1	29.1	27.5
IMF disbursements	8.8	4.6	9.6	9.6	4.8	0.0	0.0	0.0	0.0
Errors and omissions	-105.1	8.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other net financial flows	8.6	-60.5	1.5	-54.4	-37.5	14.5	18.4	22.3	10.0

Sources: Central Bank of Lesotho, and Fund staff estimates and projections.

1/ Excluding the IMF.

2/ Original maturity of less than one year. Stock at the end of the previous periods.

3/ Excluding Lesotho Highland Development Authority.

Table 11. Lesotho: Indicators of Financial Obligations to the Fund, 2001/02-2008/09

	Act.	Act.	Proj.					
	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Debt service to the Fund								
In millions of U.S. dollars	4.5	3.5	1.7	0.2	0.2	1.6	3.0	3.0
In millions of SDRs	3.6	2.6	1.3	0.1	0.1	1.2	2.2	2.2
In percent of exports of goods and nonfactor services	1.3	0.8	0.3	0.0	0.0	0.2	0.4	0.4
In percent of debt service of nonfinancial public sector	11.0	10.5	4.5	0.4	0.4	4.1	7.9	7.8
In percent of gross international reserves	1.1	0.9	0.4	0.0	0.0	0.4	0.7	0.6
Gross Fund financing								
In millions of U.S. dollars	8.7	4.8	9.6	4.8	0.0	0.0	0.0	0.0
In millions of SDRs	7.0	3.5	7.0	3.5	0.0	0.0	0.0	0.0
In percent of Lesotho's financing needs ^{1/}	3.6	1.5	2.7	1.1	0.0	0.0	0.0	0.0
Fund credit outstanding								
In millions of U.S. dollars	17.5	20.8	28.8	33.7	33.7	32.2	29.3	26.4
In millions of SDRs	14.1	15.1	21.0	24.5	24.5	23.5	21.4	19.3
In percent of quota	40.3	43.4	60.2	70.2	70.2	67.2	61.2	55.2
In percent of exports of goods and nonfactor services	5.3	4.7	5.1	5.4	5.0	4.4	3.7	3.1
In percent of total debt outstanding	3.3	3.9	5.2	6.0	5.9	5.6	5.0	4.4
Memorandum item:								
U.S. dollar/SDR exchange rate	1.25	1.37	1.37	1.37	1.37	1.37	1.37	1.37

Sources: Central Bank of Lesotho; and Fund staff estimates and projections.

^{1/} Gross financing needs are defined as the sum of the current account deficit before grants, amortization of medium-and long-term debt, repayment to the Fund, reduction in payments arrears, and targeted accumulation of gross assets of the banking system.

Table 12. Lesotho: Phasing of Disbursements Under the PRGF Arrangement, 2001-04

Date	Disbursement ^{1/}		Activity
	Millions of SDRs	Percent of quota	
March 9, 2001	3.5	10	Board approved new three-year PRGF arrangement.
March 31, 2001	...	...	Test date for performance criteria.
July 20, 2001	3.5	10	Board completed first review.
September 30, 2001	...	...	Test date for performance criteria.
March 18, 2002	3.5	10	Board completed second review.
March 31, 2002	...	...	Test date for performance criteria.
September 20, 2002	3.5	10	Board completed third review.
September 30, 2002	...	...	Test date for performance criteria.
June 16, 2003	3.5	10	Board completed fourth review.
June 30, 2003	...	...	Test date for performance criteria.
December 31, 2003	...	...	Test date for performance criteria.
January 16, 2004	3.5	10	Board completes fifth review.
May 15, 2004	3.5	10	Board completes sixth review.
Total	24.5	70	

^{1/} Disbursements are expected to take place approximately two weeks after the date of the Board meeting.

December 31, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Köhler:

As you know, the Fund approved a three-year arrangement under the Poverty Reduction and Growth Facility for Lesotho in a total amount equivalent to SDR 24.5 million in March 2001. I request that the sixth disbursement, in the amount of SDR 3.5 million, be made available following the successful completion of the fifth review.

The attached memorandum of economic and financial policies (MEFP) reviews performance under the program and updates the government's economic objectives and policies for the period through March 2005. The memorandum also outlines the government's preliminary economic and financial framework for 2004/05 (April-March). The government is currently finalizing a poverty reduction and growth strategy paper, which is expected to be submitted to the Boards of the World Bank and the IMF in early 2004. It is important to note, however, that the priorities contained in the draft PRSP and some programs have already been integrated into the budget cycle and will be reflected in the 2004/05 budget estimates.

All end-June quantitative performance criteria and continuous performance criteria have been observed except for the end-June performance criterion on the domestic financing requirement of the central government. In addition, and as explained in the attached MEFP, two out of seven structural performance criteria were observed. The government requests a waiver for the nonobservance of the quantitative performance criterion on the ceiling on the domestic financing requirement of the government for end-June 2003. It was not observed partly because of delayed dividend payments and transfers of tax collections, and partly due to overspending on road construction that was not anticipated until later in the year, as well as spending overruns on scholarships, drought-related agricultural support, and vehicle leases.

The government also requests waivers for the five structural performance criteria that were not observed due to: (i) integration of the recruitment of the contract representative into the work of the cabinet sub-committee on Imperial Fleet Services that included the forensic auditing of the Vehicle Lease; (ii) capacity constraints and difficulties in recruiting qualified staff.

The government has, in the meantime, intensified its efforts, and subsequently two of the delayed structural performance criteria were implemented in early December. The remaining

three structural performance criteria are expected to be completed by end-April 2004, as explained in the attached MEFP.

The government is requesting an extension of the current arrangement to June 30, 2004 to allow more time to complete the remaining structural agenda and the sixth review.

Sincerely yours,

/s/

Timothy Thahane
Minister of Finance and
Development Planning

LESOTHO

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. INTRODUCTION

1. This memorandum updates the government of Lesotho's memorandum of economic and financial policies (MEFP) dated May 15, 2003. It reviews performance through September 2003 and proposes new structural measures through April 2004. It also outlines the preliminary economic framework for the 2004/05 (April-March) financial year.
2. Medium-term economic objectives center on reducing poverty through employment creation in the private sector, attaining universal primary education and enhanced education quality at all levels, expanding access to health care, and containing the spread of HIV infections and supporting AIDS sufferers and their families. Macroeconomic stability and a sustainable financial medium-term outlook, improved efficiency, accountability, and transparency in government services, a wider provision of public infrastructure, and improved government procurement are key to achieving these objectives.
3. Several program targets were not achieved for the period under review, but as outlined below, the government is taking appropriate actions to put the program back on track. With the measures outlined below, the main objective of macroeconomic stability and a more efficient government can be realized.

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

4. Recent economic performance has been bolstered for nearly three years by sustainable economic policies. These advances have raised confidence in the economy, as evidenced by strong foreign direct investment. Access to international textile and clothing markets, particularly under the U.S. African Growth and Opportunity Act (AGOA), has allowed employment in manufacturing to reach more than 45,000 in 2003, making this sector the largest employer in the economy. In addition, higher gold prices have stabilized the downward trend in Basotho employed in South African mines. As a result, economic growth rose from 3.1 percent in 2001 to 3.8 percent in 2002 despite weather-related declines in agricultural production. Unfortunately, Lesotho's farmers received little rain from April through October 2003, which caused severe damage to the winter crops and delayed planting of the summer crops.
5. Inflation has abated during 2003, reflecting declining regional food prices and currency appreciation. The maloti gained value against the U.S. dollar from a low of approximately M 13 per dollar in early 2002 to approximately M 7 per dollar in September 2003. The gap between the interest rate on the government of Lesotho's three-month treasury bills and bills of the same duration in South Africa widened to 2 percentage points in September 2003 from a zero gap in January 2003, in part due to borrowing by the government of Lesotho in 2003.

A. HIV/AIDS

6. The government recognizes that HIV/AIDS has become a growing social and economic problem. According to the joint UN program on HIV/AIDS (UNAIDS) estimates, Lesotho faces an infection rate of 31 percent of the adult population, and about 20 percent of children under the age of 5 are orphans. Moreover, the disease creates a vicious cycle, in which farmers are unable to tend their crops because of illness while the resulting lack of food makes them more susceptible to disease.

7. The government, recognizing that Lesotho could not deal with the scourge alone, initiated a Southern African Development Community (SADC) heads of state conference to formulate a regional response. One outcome of the conference is that Lesotho will redouble its efforts to prevent a further spread of the disease through education and prevention programs. In addition, the government is now forming partnerships with the private sector to achieve this critical national goal.

B. Performance Under the Program

8. Domestic financing of the central government (a quantitative performance criterion) reached M 163 million in June 2003, a figure that the government recognizes is large for a single quarter, especially when compared with the target of M 7 million. The central bank sterilized the full monetary impact of the deficit and met the targets on international reserves and domestic assets of the central bank in June. Fiscal performance improved later in the year, and the targeted ceiling for domestic financing was observed with a large margin in September. Structural performance has been weak, and five out of seven structural performance criteria were not observed on time.

9. The government has revised its projections downward for tax and other revenue, as well as grants, through the end of 2003/04. The Government is committed to containing domestic financing at M 272 million and presented a comprehensive package of reallocations and spending cuts in October.

Fiscal policy

10. The program target for domestic financing of the government deficit was exceeded in the first quarter of the financial year because of both temporary and structural factors. Temporary factors are those that raised the deficit during the quarter but would unwind relative to the program during the remainder of the year. These included a payment for road construction that was not anticipated until later in the year, delayed dividend payments, and a transfer of some tax collections from the Lesotho Revenue Authority to the government that, delayed for technical reasons, has since been resolved. The government estimates that these factors increased the first quarter deficit by approximately M 110 million, or more than one-half of the overrun for the quarter. Because they are temporary, no corrective action for these factors is envisaged.

11. Several other developments pushed up the first quarter deficit and, unless checked and reversed with new measures, would have caused the deficit to exceed the target for 2003/04 by a wide margin. The government identified three spending areas—vehicle leases, scholar-ships, and agricultural support—as the main cause of overrun. Together, spending in these areas exceeded budget estimates by M 45 million in the first quarter.

12. The government began to consider actions as soon as the budget pressures became evident. The cabinet reached an informal agreement that one-half of the M 41 million in spending on support to farmers that was carried over from the 2002/03 financial year into 2003/04 would be offset by reallocation of votes within the Ministry of Agriculture's budget. The cabinet also approved new agricultural policy guidelines stipulating targeted agricultural subsidies rather than blanket subsidies, as was the response to adverse weather conditions in 2002/03.

13. Shortly after the 2003/04 financial year began and the new budget took effect, Parliament decided to harmonize the value-added tax (VAT) rate with that in South Africa at 14 percent, when this tax replaced the 10 percent sales tax on July 1, 2003. The government also decided to zero rate a number of basic items, such as maize meal and beans, to alleviate the impact on the poor. At the time, these measures were estimated to raise an additional M 230 million in revenue during 2003/04 (an end-June performance criterion). However, based on tax returns received until September, VAT collections are now projected to raise an additional M 113 million only, reflecting teething problems in administering the tax and a greater-than-expected share of total spending on exempt items. In addition, previous projections did not incorporate that the government will receive only eight months of VAT on services during 2003/04 because service providers have been given a one month grace period to remit payment.

14. Projections of revenue and grants for the full year have been reduced by M 142 million compared with the government's original Poverty Reduction and Growth Facility (PRGF)-supported program. In addition to the revision of VAT collections, other important corrections are the new assumption that the government will receive only one rand monetary compensation during the year and that administrative fees will be revised downward. These revenue shortfalls are partly offset by an expected overperformance of income tax collections.

15. Because of the revised revenue projections and other deviations from the budget, the government deemed it necessary to modify its spending plans and to present a comprehensive package of reallocations and spending cuts. To that end, in October the cabinet approved a memorandum and a fiscal package that contains the following measures:

- Overall budget votes have been cut by M 20 million, and this cut will be distributed in proportion to ministerial budget allocations. Ministries are also required to accommodate the VAT within their original budget allocations.

- Votes for spending on vehicle leases have been raised by M 47 million, and votes have also been raised by M 14 million as a partial compensation for the overspending on agricultural support.

As a net result, spending on goods and services is now projected to increase from M 1,152 million in the budget to M 1,193 million. The revised fiscal program, however, envisages a saving of M 81 million compared with the original program, which assumed that ministries would be fully compensated for the introduction of the VAT. The decision to include government purchases under the VAT was taken after the budget was approved. This decision was deemed necessary to create a level playing field for all businesses and to eliminate an avenue for tax evasion that existed when government purchases were exempt from the sales tax.

16. The high cost of government vehicles is an ongoing problem in Lesotho. In 2000, the government privatized the vehicle fleet to benefit from the efficiencies of private sector management and stronger monitoring and control. This has reduced the number of Government vehicles from an estimated 3,000 before privatization to about 1,800 at present. In October, the Prime Minister instructed ministries to develop a strategy to reduce the size of the vehicle fleet further to about 1,000 cars. The government is also working with the provider to lower overall costs by changing the mix of vehicles, leasing fewer 4X4 vehicles and more sedans, and by scrutinizing daily rental use. To this end, a government contract representative will be appointed by April 1, 2004 to work with the leasing company, Imperial Fleet according to the terms of the contract with that company. This representative and the leasing company will work to lower maintenance charges, which should decline as older vehicles, in service when the contract was drawn up, are replaced.

17. Lending to students through Lesotho's scholarship program, the National Manpower Development Secretariat (NMDS), rose sharply in 2001-02 when the National University of Lesotho and universities in South Africa changed admission policies to expand educational opportunities. While the government stands behind this objective, it is now recognized that costs to the scholarship fund have risen beyond initial expectations. A task force will be established by end-January to develop a comprehensive policy for the NMDS, including procedures to manage the budget, collect arrears on past loans, and establish means to administer the program in a transition to a partially self-financing revolving loan fund. The cabinet has also directed that a planned doubling of first-year students at the National University be deferred until a comprehensive targeted policy for scholarships has been implemented.

18. The spending measures approved by the cabinet in October, together with savings due to favorable developments in the exchange rate and the domestic interest rate, are projected to limit domestic financing to M 272 million in 2003/04, significantly below the targeted ceiling for the year. In view of these actions, the government is requesting a waiver for the nonobservance of the end-June 2003 performance criterion on the domestic financing requirement of the central government.

Strengthening the treasury

19. The key objectives of the treasury are to (i) submit annual accounts for audit and then review by the Public Accounts Committee; (ii) provide timely budget reports to management; (iii) manage the government's cash; and (iv) prevent and weed out corruption. The government achieved the main objectives of its structural benchmarks in this area through November, but some specifics are still outstanding.

20. The government is requesting two waivers for the nonobservance of the performance criterion related to the submission of public accounts to the Auditor General. The government presented its 2002/03 accounts, including below-the-line accounts, to the Auditor General as was required, but the submission was delayed by two months. The government also requests a waiver for the nonobservance of the performance criterion on the integration into the treasury accounting systems of loans to parastatals and ministry accounts. These loans, while included in the submission for audit, were not integrated into the treasury accounting system as specified, due to staff constraints. These loans will be entered into the system by end-March 2004, and we are proposing that the end-August 2003 performance criterion be retimed and set as a performance criterion for March 31, 2004.

21. The government is requesting a waiver for the nonobservance of the performance criterion to enter all transactions in bank accounts into the treasury ledger system. Most bank accounts are now part of the treasury system, but two diplomatic missions, which constitute only a small part of the budget, have yet to be brought into the system, mainly because of capacity constraints. In addition, some subprograms within certain ministries, for example the free primary education program, require upgraded accounting systems. The practice of reconciling all cash balances with bank balances on a monthly basis has also not yet started. Measures to address these shortcomings are outlined below. It is now expected that all transactions in bank accounts will be entered into the treasury ledger system and all cash balances reconciled with bank balances, and we are proposing that this measure be a structural benchmark for end-April 2004.

22. The government did not appoint a contract representative for the leasing of vehicle by the program deadline, but a contract representative will be appointed by April, 2004, and we are proposing that the end-July 2003 performance criterion be reset as a performance criterion for April 1, 2004. The government requests a waiver for the nonobservance, based on the actions outlined above to stem vehicle cost overruns and to offset the above budget spending with reductions in other areas.

23. The submissions of, first, the 2001/02 public accounts and, more recently, the 2002/03 public accounts to the Auditor General and the Public Accounts Committee were important steps, as they provided Parliament with a basis for reviewing government results for the first time since 1995. Moreover, the work in preparing the accounts has uncovered weaknesses in accounting procedures across ministries and within the treasury. The review of below-the-line accounts has greatly reduced uncertainties in government records, and the

government's demonstrated commitment to bolster its recordkeeping process has reduced the scope for future corruption.

24. The government is pushing ahead with new measures in the treasury (Table 2). Following the treasury restructuring blueprint, a reorganization of the treasury's top management is taking place. Positions for Deputy Accountant General will be advertised by February 28, 2004. Other objectives highlighted in the blueprint are reestablishing a cash management unit, establishing new antifraud and forensic audit units, and establishing a new information technology (IT) unit. The government recognizes the need to seek professionals who are not involved with current treasury operations. Experience has shown that officers who have training or experience in both computer systems and accounting can best meet the unique IT challenges of the treasury. This is critically important in view of the current shortcomings in preparing management reports and responding to the Government of Lesotho Financial Information System (GOLFIS) updates outlined below.

25. The treasury will develop a plan to make near-term improvements to GOLFIS. These will include linking bank payment instructions directly to GOLFIS recordkeeping and ensuring that transactions are dated on the transaction date rather than the posting date. Actions in these areas would simplify the reconciliation of bank records reconciliation and, importantly, make monthly spending reports more accurate. The near-term action plan will be completed by January, 31, 2004.

26. The government is working hard to improve accounting and reporting within line ministries. Principal secretaries have been designated as chief accounting officers of their ministries and are being held responsible for ministry finances by the Public Accounts Committee, as specified under the Finance Order of 1988. They are now required to submit monthly expenditure reports, as well as information on revenues, fees, and other income collections. The treasury is assisting several line ministries to improve their vote book procedures. In the past, below-standard vote records caused some above-budget expenditures. The government will work to computerize check writing in the free primary education program, which is expected to facilitate better reporting. Recordkeeping weaknesses in the ministries of Health, Education, and Agriculture will be addressed by deploying accounting resources, including professionals, to these ministries.

Monetary and financial system policies

27. The central bank met its quantitative and structural objectives through September 2003. To meet the monetary and international reserve targets, the bank fully sterilized the liquidity impact of the fiscal slippages in the first fiscal quarter through both treasury bill sales and, when needed, repurchase agreement operations.

28. Reforms continue in the financial sector. In June 2003, Lesotho partially liberalized its capital account. As a result, companies may now transfer funds outside the Common Monetary Area, and residents are allowed to open foreign currency accounts, subject to limits. Restrictions on long-term capital inflows have also been removed. Steps are also

being taken to ease the structural impediments to financial intermediation. In August, the government established a credit guarantee fund to facilitate commercial bank lending in the rural areas. In addition, the central bank has prepared a vision paper on developing the payments and settlement system in the country.

III. THE ECONOMIC FRAMEWORK FOR 2004/05

29. The economic framework for 2004/05 will focus on providing priority services, as identified by the Basotho during the PRSP process, while staying within the economic and financial constraints of the current situation. In particular, the government is committed to restoring economic balance by reducing the government's deficit to sustainable levels and, over time, rebuilding the nation's reserves which, are needed to protect the country against temporary adverse developments in partner economies. In this way, the assets of the Basotho, including international reserves at the central bank, will be safeguarded.

30. Fiscal revenue is in a descending trend, measured as a percent of GDP, and the medium-term projections indicate that this trend is likely to be sustained. A temporary peak in Southern African Customs Union (SACU) revenue is, however, expected to ease the fiscal constraint in 2004/05. Lesotho's 2004/05 budget process began in October when the first call circular was issued to line ministries, informing them of their resource constraints for the coming year. To underline the government's commitment to a sustainable budget, the circular was endorsed by the cabinet. According to the fiscal strategy for 2004/05, the government wants to ensure that the favorable SACU revenue projected for next year will be used to reduce the amount of outstanding domestic debt and ensure a budget surplus.

31. The poverty reduction strategy paper (PRSP) is now expected to be finalized and submitted to the World Bank and IMF in early 2004. The government intends to initiate an implementation conference in 2004 to solicit funding from the international community and then select the projects that will be implemented, given available resources.

32. To monitor program performance, quantitative and structural performance criteria and benchmarks are proposed in Tables 1 and 2 of this appendix.

33. The government of Lesotho will keep the IMF informed of the progress in the implementation of the program. In particular, the government will continue to send to the IMF fiscal and monetary data, including the financial reports of each ministry, on a monthly basis, as well as balance of payments and health and education spending data at least on a quarterly basis. It will also provide to the IMF the midyear economic budget review. It will send domestic debt (by holder and instrument), and external debt data on a monthly basis and information on monthly treasury bill auctions. A schedule for the provision of data appears in the technical memorandum of understanding.

34. The government recognizes that there have been delays in providing data in the recent past and is making every effort to rectify this situation.

35. During the PRGF arrangement period, the government does not intend to (i) impose or intensify any restrictions on payments and transfers for current international transactions; (ii) introduce or modify multiple currency practices; (iii) conclude bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement; or (iv) impose or intensify any restrictions on imports for balance of payments reasons.

Table 1. Quantitative Performance Criteria and Benchmarks
PRGF Arrangement, December 2003 - June 2004

	2003		2004		
	December		March		June
	Perf. Criteria		Benchmarks		Indicative Target
	Prog. 1/	Prog. 1/	Rev. Prog. 1/	Proj.	
(In millions of maloti)					
Ceiling on the domestic financing requirement of the central government 2/	269	341	272	-48	
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-2,411	-2,495	-2,495	-2,490	
(In millions of U.S. dollars)					
Floor on the stock of net international reserves of the Central Bank of Lesotho 3/	357	357	357	357	
Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector (cumulative from end-November 2000) 4/ 5/ 6/					
Maturity of less than one year 7/	0	0	0	0	
Maturity of one year or more	0	0	0	0	
Ceiling on the stock of external payments arrears 6/	0	0	0	0	

Sources: Ministry of Finance; Central Bank of Lesotho; and Fund staff estimates.

1/ Before application of adjusters.

2/ Data for December 2003 and March 2004 are cumulative from end-March 2003. Data for June 2004 are cumulative from end-March 2004. program exchange rates indicated in the technical memorandum of understanding (TMU).

4/ This performance criterion applies not only to debt as defined in point no. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. A loan is concessional if its grant element is at least 35 percent, calculated using a discount rate based on the ten-year average of OECD commercial interest reference rates (CIRRs) for loans of maturity of greater than 15 years; for loans of maturity of 15 years or less, the discount rate is based on the six-month average of OECD CIRRs. To both the ten-year and six-month averages, the same margin for differing repayment periods would be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

5/ Excludes borrowing for water transfer operations of the Lesotho Highlands Development Authority.

6/ Continuous performance criterion.

7/ Except for normal short-term import credits and nonresident holdings of treasury bills.

Table 2. Structural Performance Criteria and Benchmarks,
January-April 2004

Performance Criteria	Date of Implementation	Status
Structural performance criteria		
Complete action plan for near-term improvements to GOLFIS and identify resources to implement the plan, as specified in paragraph 25 of the MEFP.	January 31, 2004	
Advertise positions for Deputy Accountant General, as specified in paragraph 24 of the MEFP.	February 28, 2004	
Integrate into the treasury accounting system loans to parastatals and ministry accounts that are not being captured by the system and report such integration to the staff of the Fund, as specified in paragraph 33 of the MEFP, dated May 15, 2003.	March 31, 2004	
Appoint a government contract representative according to the terms of the Imperial Fleet contract, as specified in paragraph 16 of the MEFP.	April 1, 2004	
Structural benchmarks		
Establish a task force to recommend a comprehensive policy for the National Manpower Development Secretariat and the program it administers. The policies would cover both administrative and educational matters. The task force would report to the Minister of Finance and Development Planning.	January 31, 2004	
Present final supplementary budget for 2003/04 to Parliament.	March 31, 2004	
Enter into the treasury ledger system transactions in bank accounts, including diplomatic missions as specified in paragraph 31 of the MEFP dated May 15, 2003, and initiate practice of reconciling all cash balances with bank balances monthly.	April 30, 2004	
Implement reorganization of treasury top management and appoint two new Deputy Accountants General.	April 30, 2004	

INTERNATIONAL MONETARY FUND

GOVERNMENT OF LESOTHO

Technical Memorandum of Understanding

December 31, 2003

1. This memorandum sets forth the understandings between the government of Lesotho and the IMF staff regarding the definitions of the quantitative performance criteria and benchmarks for the three-year arrangement supported under the Poverty Reduction and Growth Facility (PRGF), as well as the respective reporting requirements. These performance criteria and benchmarks are reported in Table 1 of the government's memorandum on economic and financial policies (MEFP).
2. The remaining test dates during the financial year April 2003-March 2004 will be end-December 2003 and end-March 2004. The end-December 2003 targets will constitute quantitative performance criteria and the end-March 2004 targets will be quantitative benchmarks. In addition, the ceilings on the stock of external payments arrears and new nonconcessional external debt are continuous performance criteria.

**A. Floor on the Stock of Net International Reserves
of the Central Bank of Lesotho**

3. **Definition.** The net international reserves (NIR) are defined as the Central Bank of Lesotho's liquid, convertible foreign assets minus its convertible foreign liabilities. Pledged or otherwise encumbered assets, including, but not limited to, assets used as collateral or as guarantee for third-party external liabilities are excluded from reserve assets. Reserve assets include cash and balances held with banks, bankers' acceptances, investments, foreign notes and coins held by the Central Bank of Lesotho, Lesotho's reserve position in the Fund, and SDR holdings. Reserve liabilities include nonresident deposits at the Central Bank of Lesotho, use of IMF credit, and any other liabilities of the central bank to nonresidents. The stock of NIR at the end of each quarter is defined in U.S. dollars and will be calculated using the agreed cross exchange rates.¹
4. **Adjustment clause.** The program target for the NIR of the Central Bank of Lesotho in any quarter will be adjusted upward by the amount of any advance receipts from the Southern Africa Customs Union (SACU) in that quarter, where such advance receipts

¹ Program cross exchange rates: South African rand per U.S. dollar: 7.920; U.S. dollars per pound sterling: 1.580; U.S. dollars per SDR: 1.374; U.S. dollars per euro: 1.090; Swiss francs per U.S. dollar: 1.354; Swedish kronor per U.S. dollar: 8.505; and Botswana pula per U.S. dollar: 5.153. Program maloti per U.S. dollar exchange rate: 7.920.

constitute amounts that would otherwise have been received in a subsequent quarter. It will be adjusted for accounting practice changes implemented by the Central Bank of Lesotho that are recommended by the IMF's Statistics Department or are made in response to the IMF safeguards assessment.

5. **Supporting material.** The Central Bank of Lesotho will provide data on its NIR and on SACU receipts on a monthly basis within one week of the end of the month. The NIR data will be provided in a table showing the currency breakdown of the reserve assets and reserve liabilities of the Central Bank of Lesotho converted into U.S. dollars and maloti at the program exchange rates stipulated in paragraph 3.

B. Ceiling on the Stock of Net Domestic Assets of the Central Bank of Lesotho

6. **Definition.** The net foreign assets (NFA) of the Central Bank of Lesotho are defined as foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the central bank. The values of all foreign assets and liabilities will be calculated in U.S. dollars at the end of each quarter using the agreed cross exchange rates stipulated in paragraph 3 and converted into maloti using the U.S. dollar–loti exchange rate (also stipulated in para. 3).

7. **Definition.** The net domestic assets (NDA) of the Central Bank of Lesotho are defined as the difference between reserve money (currency in circulation plus total bank deposits at the central bank) and NFA (as defined in para. 6). The NDA thus include net claims by the Central Bank of Lesotho on the government (loans and treasury bills purchased less government deposits), claims on banks, and “other items net” (other assets, other liabilities, and the capital account).

8. **Adjustment clause.** The program target for the NDA of the Central Bank of Lesotho in any quarter will be adjusted downward by the amount of any advance receipts from SACU in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

9. **Supporting material.** The Central Bank of Lesotho will provide detailed data on its balance sheet on a monthly basis within 21 days of the end of the month. The central bank will also provide a table of selected monetary indicators covering the major elements of its balance sheet on a weekly basis.

C. Ceiling on the Domestic Financing Requirement of the Central Government

10. **Definition.** The central government includes the central administration and all district administrations. The domestic financing requirement of the central government is defined as net credit to the government from the banking system (that is, the Central Bank of Lesotho and the commercial banks) plus holdings of treasury bills and other government securities by the nonbank sector. For program monitoring purposes, the domestic financing requirement will be calculated as the change from end-March 2003 of net credit to the government by the banking system and of holdings of treasury bills and other government securities by the nonbank sector. In particular, the calculation of the domestic financing requirement shall

include changes in (i) balances held in the privatization account or balances of other accounts into which proceeds from the sale of public enterprises are deposited; (ii) the amount of outstanding treasury bills issued by the Central Bank of Lesotho for monetary policy purposes; and (iii) the balance of the blocked government deposit account used by the Central Bank of Lesotho to sterilize reserve money absorbed by monetary policy operations. The calculation of the domestic financing requirement shall exclude changes in (i) balances held in any account into which revenues collected by the customs department are held pending their transfer to the SACU revenue pool; and (ii) government liabilities stemming from the issue or retirement of treasury bills and bonds due to the recapitalization of the old Lesotho Bank. External debt service, amortization, disbursements and external grants will be calculated at program exchange rates.

11. The following adjustment clauses are in effect:

- The program assumes that customs revenue from the SACU revenue pool will be M 355.4 million in each quarter in 2003/04. The program target for the domestic financing requirement of the central government in any quarter will be adjusted downward by the amount of any excess of customs revenue received over the programmed amount in that quarter, where this excess constitutes advance receipts of amounts that would otherwise have been received in a subsequent quarter.
- The program assumes total European Union budget support grants of M 0 million in the first quarter of 2003/04, M 29.7 million in the second quarter of 2003/04, and M 0 million in the third quarter of fiscal year 2003/04. The program target for net domestic financing requirement of the central government will be adjusted downward (upward) by the amount of any early (late) payment of EU budget support grants.
- The program assumes rand monetary compensation revenues of M 44 million in the first quarter of 2003/04, M 0 million in the second quarter of 2003/04 and M 0 million in the third quarter of fiscal year 2003/04. The program target for the domestic financing requirement of the central government will be adjusted upward by the amount of any early payment of rand monetary compensation.

12. Supporting material. The Central Bank of Lesotho will provide the monetary survey and other monthly monetary statistics, as well as a table showing the details of all government financing operations from the nonbank public, on a monthly basis and within 30 days of the end of the month. The following information will be presented as memorandum items in the monetary survey: (i) the outstanding balances in the privatization account or accounts; (ii) the outstanding balance in the SACU revenue pool account mentioned in paragraph 10; and (iii) details of any monetary operations with treasury bills, including changes in government deposits as a result of such operations. The Central Bank of Lesotho will also provide a table showing the details of government debt by type and holder. The Ministry of Finance will provide detailed monthly budget operation reports and tax arrears reports.

D. Ceiling on the Amount of New Nonconcessional External Debt Contracted or Guaranteed by the Public Sector, with Original Maturity of One Year or More

13. **Definition.** The public sector comprises the central government, the Central Bank of Lesotho, and all enterprises with majority state ownership. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Included in this performance criterion are all current liabilities that are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and that require the public sector (obligor) to make one or more payments in the form of assets (including currency) at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits, and leases) will be subject to the ceiling. Borrowing for the water transport operations of the Lesotho Highlands Water Authority and loans under the PRGF arrangement will be excluded from this performance criterion. The performance criterion will be evaluated on a continuous basis as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from end-November 2000 onward.

14. **Definition.** A loan is concessional if its grant element is at least 35 percent of the value of the loan, calculated using a discount rate based on commercial interest reference rates (CIRRs) reported by the OECD. For loans of maturity of greater than 15 years, the grant element will be based on the ten-year average of OECD CIRRs. For loans of maturity of 15 years or less, the grant element will be based on the six-month average of OECD CIRRs. Margins for differing repayment periods would be added to the CIRRs: 0.75 percent for repayment periods of less than 15 years, 1 percent for repayment periods of 15 to 19 years, 1.15 percent for repayment periods of 20 to 29 years, and 1.25 percent for repayment periods of 30 years or more.

15. **Adjustment clause.** None.

16. **Supporting material.** Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the Ministry of Finance on a monthly basis within 30 days of the end of the month.

E. Ceiling on the Amount of New External Debt Contracted or Guaranteed by the Public Sector, with Original Maturity of Less than One Year

17. **Definition.** The public sector comprises the central government, the Central Bank of Lesotho, and all enterprises with majority state ownership. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Included in this performance criterion are all current liabilities that are created under a contractual arrangement through the provision

of value in the form of assets (including currency) or services, and that require the public sector (obligor) to make one or more payments in the form of assets (including currency) at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits, and leases) will be subject to the ceiling. Excluded from this performance criterion are (i) treasury bills issued for the purposes of monetary policy operations; and (ii) normal short-term import credits. The performance criterion will be evaluated on a continuous basis as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from end-March 2001.

18. **Adjustment clause.** None.

19. **Supporting material.** Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the Ministry of Finance on a monthly basis within 30 days of the end of the month.

F. Ceiling on the Stock of External Payments Arrears

20. **Definition.** During the period of the arrangement, the stock of external payments arrears of the public sector (central government, Central Bank of Lesotho, and all enterprises with majority state ownership) will continually remain zero. Arrears on external debt-service obligations include any nonpayment of interest and/or principal *in full and on time* falling due to all creditors, including the IMF and the World Bank.

21. **Adjustment clause.** None.

22. **Supporting material.** Details of arrears accumulated on interest and principal payments to creditors will be reported within one week from the date of the missed payment.

LESOTHO: FUND RELATIONS
(As of October 31, 2003)

I. **Membership Status:** Joined 07/25/1968; Article VIII

II. General Resources Account:	<u>SDR million</u>	<u>Percent Quota</u>
Quota	34.90	100.0
Fund holdings of currency	31.36	89.9
Reserve position in Fund	3.54	10.1
III. SDR Department:	<u>SDR million</u>	<u>Percent Allocation</u>
Net cumulative allocation	3.74	100.0
Holdings	0.43	11.4
IV. Outstanding Purchases and Loans:	<u>SDR million</u>	<u>Percent Quota</u>
PRGF arrangements	17.88	51.2

V. **Financial Arrangements:**

<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>
PRGF	03/09/2001	3/08/2004	24.50	17.5
Stand-By	09/23/1996	9/22/1997	7.17	0.0
Stand-by	07/31/1995	7/30/1996	7.17	0.0

VI. **Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):**

	<u>Forthcoming</u>				
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	0.0	0.4	0.0	0.4	1.8
Charges/Interest	0.1	0.1	0.1	0.1	0.1
Total	0.1	0.5	0.1	0.5	1.9

VII. **Safeguards Assessments:**

An updated Safeguards Assessment of the Central Bank of Lesotho (CBL) in July 2003 concluded that the CBL has made commendable progress in strengthening its safeguards, as recommended in the previous Safeguards Assessment of July 2001. The assessment noted that there are still some unresolved issues at various levels of the bank's operations, including the need for strengthened program data compilation procedures, timely payment of PRGF obligations to the Fund, and rapid implementation of measures to enhance the internal audit function.

VIII. Exchange Arrangements:

Lesotho's currency, the loti (plural maloti), is pegged at par to the South African rand. The Central Bank of Lesotho (CBL) deals with commercial banks mainly in South African rand. As of October 31, 2003, the rand (maloti) rate per U.S. dollar was M 6.91.

IX. Article IV Consultation:

The Executive Board concluded the last Article IV consultation (EBS/02/38; 3/4/02) on March 18, 2002. Executive Directors welcomed the improvement in the macroeconomic situation since the 1998-99 recession, with real GDP growth increasing to a moderate pace and stable inflation. They hoped that the slowdown in the global economy and possible price pressures emanating from the recent depreciation of the Lesotho loti would not delay for long a more rapid and sustained economic growth. They were encouraged by the improvement in the external current account deficit, which reflected in part a surge in clothing and textile exports under the U.S. African Growth and Opportunity Act.

Directors commended the authorities for their overall fiscal, monetary, and structural policies that will improve Lesotho's medium-term economic performance. They noted that the government is committed to a stable macroeconomic environment, privatization, market-friendly policies, and public sector reform. Directors observed that this should help Lesotho deal with the economic challenges of high rates of unemployment, poverty and incidence of HIV/AIDS. Directors encouraged the authorities to continue strengthening tax administration with the help of donors. Improving tax collection is all the more important with customs revenue declining relative to GDP. Directors also welcomed the government's commitment to improving financial management.

X. Technical Assistance:

Advisor: national accounts	STA	long-term	1998-99
Advisor: banking supervision	MAE	long term	1998-2001
Advisor: governor of the CBL	MAE	long term	1998-2001
Mission: money and banking statistics	STA	short-term	1999
Mission: money and banking statistics	STA	short-term	2000
Mission: taxation (VAT/tax administration)	FAD	short-term	2000
Advisor: taxation (VAT/tax administration)	FAD	long-term	2000/01
Mission: monetary policy implementation	MAE	short-term	2001
Mission: public accounts	FAD	short-term	2002
Mission: GDDS project for Anglophone Africa	STA	short-term	2002
Mission: balance of payments	STA	short-term	2002
Mission: safeguards assessment	FIN	short-term	2003
Mission: AML/CFT	MFD	short-term	2003
Mission: monetary policy operations	MFD	short-term	2003

XI. Resident Representatives:

There is currently no resident representative for Lesotho. The resident representative posted in South Africa will also cover Lesotho, starting in 2004.

LESOTHO: RELATIONS WITH THE WORLD BANK GROUP

A. PARTNERSHIP IN LESOTHO'S POVERTY REDUCTION STRATEGY

1. Lesotho's strategy for poverty reduction is laid out in the government's interim poverty reduction strategy paper (I-PRSP) discussed by the Executive Board of the Bank on March 6 2001 and by the Fund Board on March 9, 2001. The I-PRSP outlines the government's medium-term economic strategy that will serve as the basis for developing a poverty reduction strategy. It emphasizes economic growth and poverty reduction in the context of macroeconomic stability and contains the following elements: export-led economic growth driven by private sector development, prudent fiscal management, cautious monetary policy, strengthened capacity for national economic management, and increased efficiency and accessibility to quality social services. The I-PRSP, however, was weak with respect to sectoral policies and programs for the medium and longer term. It lists ongoing sectoral programs in trade, state enterprise reform, telecommunications, power, water, agriculture, and the social sectors without defining follow-up medium term measures and policies in these areas. These weaknesses are being addressed in the development of the full poverty reduction strategy paper (PRSP), which is expected to be finalized in early 2004 after substantial delays to the original timetable. Part of the delay was due to the national elections of May 2002, and further delays were encountered on account of the desire of the new Cabinet to merge the National Vision document with the PRSP, which the PRSP secretariat has been instructed to coordinate. A PRSP preparation status report, accompanied by a joint staff assessment, was presented to the Boards of the Bank and Fund in March 2002.

2. The World Bank and the IMF continue to cooperate closely in assisting the Government of Lesotho to implement its poverty reduction and development strategy, as presented in the I-PRSP, with each institution taking the lead in the policy dialogue in its areas of expertise. The IMF leads the dialogue on macroeconomic policy (fiscal, monetary and exchange rate policies) under the Poverty Reduction Growth Facility (PRGF)-supported program and on the following areas of structural reforms: fiscal management and tax administration reform. The Bank will continue to lead the policy dialogue on sectoral structural reforms, including employment generation through private sector development, infrastructure development, education sector, health sector, HIV/AIDS and poverty monitoring and evaluation. Areas of close collaboration include the PRSP, public sector reform, financial sector reform and the Integrated Framework for Trade. The Bank and Fund also routinely exchange views on macroeconomic policies, tax reform, and private sector development.

B. BANK-FUND COLLABORATION IN SPECIFIC AREAS

Poverty reduction strategy paper

3. The World Bank is supporting the government with the PRSP process by providing technical assistance to the PRSP Secretariat and its Technical Working Group (TWG). The leading cause of poverty in Lesotho is rising unemployment and underemployment caused by a series of structural changes which began in the early 1990s with the decline of mining in South Africa. The latter employed a third of the male Basotho labor force in the 1980s. Traditionally, a significant proportion of the Basotho labor force was absorbed in neighboring South African farms. However, with rising unemployment among unskilled South Africans, job prospects for

Basotho workers have depleted. With the return of retrenched Basotho miners, the pressure on agriculture has increased and unemployment has risen in the rural areas. In the late 1990s, the unemployment problem was exacerbated by slow economic growth and the winding down of construction activity on the Lesotho Highlands Water Project, with the exception of the garment subsector (which employs about 6 percent of the labor force). Given the absence of a productive natural resource base and a vibrant local private sector, there are few employment opportunities for Basotho workers.

4. The Bank undertook a Growth and Employment Options study,¹ which examined in a comprehensive modeling framework the trade-off between growth, employment and poverty reduction of alternative policy options to inform the development of the government's medium and longer-term poverty reduction agenda. To reduce poverty sufficiently in the medium term, high GNP per capita growth rates of at least 4 percent per annum are required. The study finds that to achieve this target, the government will have to follow a broad based strategy comprising increases in public (about 25 percent in key public infrastructure) as well as private (5-10 percent in manufacturing and agriculture) investment. These can only be achieved with supportive policy reforms in the core areas of property rights, education and technical training, governance and capacity building. Actions will need to be taken to improve the efficiency and quality of government spending as well as to create social safety nets for those who are unlikely to benefit from job creation (HIV/AIDS victims, the old and the disabled, etc.). The Bank is undertaking a public expenditure management review and financial accountability assessment, in close collaboration with the government and interested donor partners, to inform and guide the reforms needed to improve the efficiency and quality of public expenditures.

Public sector reform and public expenditure management

5. The government of Lesotho recognizes that strengthening public expenditure management is critical to reduce the high level of government spending and to maintain fiscal discipline and achieve macroeconomic stability. Recent increases in public spending, especially for lease of vehicles for government use and college scholarships (in addition to the agricultural support program to farmers) have threatened fiscal sustainability. With the support of the Fund, the government has prepared some corrective actions for the remainder of the fiscal year to enable it to offset some of the increases in expenditures in the first quarter of the fiscal year 2003/04. The Fund-supported program also includes several structural measures aimed at improving financial management. The Bank is working with the Government and key donors to prepare a program of public sector reform that will focus on public expenditure management, including financial management and decentralization for improved service delivery.

Financial sector development

6. The Bank has recently conducted a review of the Lesotho's Financial System with three major objectives: to assess the safety and soundness of selected sectors in the financial system; to evaluate major constraints facing the financial system and its ability to support private sector development; and to formulate actions and policies to address these constraints. Areas covered

¹ The report was discussed with the Government in June 2003.

include (i) macro-financial environment; (ii) safety and soundness of the banking system; (iii) Non Bank Financial Institutions; and (iv) microfinance and finance for Small and Medium Enterprises. The Bank is currently seeking inputs from the IMF and other donors before discussing it with the government.

Private sector development (PSD)

7. The Bank is engaged in the formulation of a comprehensive action-oriented PSD Strategy for Lesotho, which aims to provide concrete recommendations for increased private sector's contribution to economic growth and poverty alleviation. The strategy will be based on ongoing analytical work that will follow an integrated approach organized around the concept of the Minimum Infrastructure Platform for Growth (MIP), which consist of the combination of priority physical infrastructure investments with a specific set of investments in supporting facilities including business environment, trade and investment facilitation regulations and institutions, human capital and financial services. The analytical work is designed as a follow-up to the recently completed Integrated Framework Report (see below), UNCTAD Investment Policy Review, the Country Economic Memorandum and the PSD Mission that took place in Feb/March 2003. This is reflected in the proposed blend of implementation support/TA to the government of Lesotho, in the areas where concrete actions were extensively discussed and agreed upon with the government, and analytical work, in the areas which remain unexplored and without clear implementation plans. The ESW will be a collaborative effort of the World Bank Group including FIAS, Investment Climate Department and the RPED Team. Further, efforts will be made to closely collaborate and coordinate with the donor community, especially DFID, Ireland Aid and UNDP.

Integrated framework (IF)

8. The Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries, established in 1997, was redefined in 2000 to ensure better integration of trade with national development strategies and was complemented by a trust fund for IF activities. The government of Lesotho requested to become part of the redefined IF process. Its initial component, the Lesotho Diagnostic Trade Integration Study (DTIS), has been carried out in close consultation with the government and core agencies and donors and has benefited from several ongoing projects, including the Bank's growth and employment options study, UNCTAD's Investment Policy Review and the government's PRSP and National Vision documents. Background papers for the IF study were prepared by the IMF, ITC, UNCTAD and WTO. The study recommends that Lesotho should take advantage of its sovereign status to pursue *two parallel strategies*: one designed to lower the "costs of trading" with South Africa, other SACU partners and rest of the world, and another aimed at establishing a competitive business environment relative to other countries in the region. The former calls for the removal of various remaining barriers to trade (customs, technical regulations and standards, etc.) and movement of capital and labor within SACU, thereby transforming it into a full-fledged single market, as well as lowering the common external tariffs (CETs). The latter calls not only for the removal of various administrative barriers impeding the conduct of business activity but also the effective provision of public services including public order and good governance. A comprehensive action matrix has been prepared and is currently being discussed with the Government. The various donors have expressed interest in supporting key elements of this actions matrix through technical assistance.

Poverty and Social Impact Analysis (PSIA)

9. As part of the preparation of the proposed World Bank-financed Water Sector Improvement Project, a study was conducted using participatory processes, to examine issues related to affordability and willingness to pay for urban water supply at different levels of service. Key objectives included: establish factors affecting water consumption levels and behaviors; assess changes in the extent and nature of water supply; consider the impacts of tariffs on the very poor; establish the informal price of water; and determine how access can be maintained for the poor without other income groups drawing free water. The findings² suggest that based purely on people's ability to pay (for the currently connected customers), there is room for an increase in tariffs in all bands. Further, the study finds that about two-thirds of the nonconnected households could afford to pay three times the average amounts currently paid by the public utility's lowest band. However, the full cost of private connections can only be borne by a very small proportion of the periurban residents. In the context of the Utilities Sector Reform project, a PSIA is being carried out to assess the impact of the proposed privatization of the Lesotho Electricity Corporation. The specific objective of the proposed PSIA is to provide guidance on the expected impact of changes in tariff policy on (i) different residential consumer and income groups in different locations which currently have access; (ii) industrial and business consumers (especially SMEs) in terms of likely impact on economic performance (competitiveness, profitability) leading to income effects through their job/employment creation abilities; and (iii) different income groups which currently do not have access. The Bank and Fund are also considering to review closely the poverty and social impact of possible changes resulting from revisions in the SACU revenue-sharing formula in the context of their respective macroeconomic programs.

C. BANK GROUP ASSISTANCE STRATEGY

10. The Bank Group's assistance strategy for Lesotho for FY 04-07 is currently under preparation. It is guided by the government's I-PRSP, past development plans, its Poverty Reduction Strategy (that is at an advanced stage of preparation) and the Millennium Development Goals. It is enriched by extensive consultations with all segments of civil society over the past year and molded by lessons learned in the implementation of our previous country assistance strategies (CAS). The last CAS was discussed by the Bank's Board in May 1998 with the overarching objectives of achieving sustainable poverty reduction and improving the country's competitiveness in order to support employment creation. Our policy dialogue and assistance contributed to the maintenance of a stable macro environment and improved competitiveness. The Bank has been most successful in the *education sector*, where comprehensive reforms included a renewed emphasis on affordable access and equity, non-formal education, and early childhood development in order to achieve universal primary education by 2011. The two overarching objectives of achieving sustainable growth and improving the country's competitiveness in order to support employment creation will remain in force in the CAS for the period FY 2004-FY 2007.

² The full results can be found in "Ability & Willingness to Pay for Urban Water Supply: An Assessment of Connected and Unconnected Households in Maseru, Lesotho" by David Hall and David Cownie (available upon request from the World Bank).

11. As of October 31, 2003, IDA had approved 30 credits amounting to US\$353.6 million, of which US\$249.7 million was disbursed; US\$57.9 million was canceled; and US\$53.9 million remains undisbursed. An IBRD loan of US\$110 million was approved for Phase IA of the Lesotho Highlands Water Project (LHWP) in July 1991; of which US\$68.9 million was disbursed and US\$41.1 million canceled. A second IBRD loan of \$45 million was approved in June 1998 for Phase IB of the Lesotho Highlands Water Project, of which US\$20.2 million has been disbursed and US\$15.8 million is un-disbursed and the remainder US\$9.0 million was cancelled. The Bank Group's first operation in Lesotho was approved in February 1966. To date, the World Bank has financed six projects in education; five in roads and roads rehabilitation and maintenance; four in agriculture, three in industry, two in water supply (including highland water engineering), three in urban development, three in health, two in privatization and one in community development.

12. Currently, the IFC has no outstanding investments in Lesotho. However, the IFC African Project Development Facility (APDF) has completed two projects by providing project appraisal and assistance in the mobilization of loan financing to (a) Maseru Private Hospital, a US\$3.4 million project to build and operate a 31-bed private general and maternity hospital; and (b) Pioneer Plastics Limited, a US\$0.5 million project to install facilities to manufacture polyethylene film bags, the first of its kind to be established in Lesotho. In addition, the IFC contributed to industrial reform in Lesotho through its Foreign Investment Advisory Service (FIAS). Studies and technical advice by FIAS contributed to the design of the ongoing IDA-assisted Industry and Agro-industry development project and to the Privatization and Private Sector Development project.

Contact Persons

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Lesotho: Statistical Issues

Lesotho's statistical database is adequate for program monitoring purposes. There are, however, notable deficiencies in the quality and timeliness of core surveillance data. Addressing these should be given high priority by the government. Areas where improvements need to be made are identified below.

National accounts

GDP and economic growth are probably underestimated. Incomplete information about external flows and value added in the Lesotho Highland Water Project (LHWP) has had significant effects on the estimates of GDP and economic growth since 1998. In theory, the value added of the water sector should include the full value of water exported, but current estimates only include royalties received by LHWP. There are also concerns that BSL data on manufacturing activity is underestimated, when compared to customs data on manufactured exports.

The Bureau of Statistics of Lesotho (BSL) is responsible for the national accounts. BSL compiles current prices estimates of GDP by kind of economic activity, expenditure, and income category. Estimates of GDP at constant prices are compiled by kind of economic activity and type of expenditure. Fund missions typically make estimates of current year national accounts and projections of future years, in consultation with the authorities. Adjustments to historical data are sometimes made. Other macroeconomic indicators, such as industrial production indices, are used to monitor developments during the year. Data on employment and other labor market indicators are missing.

The 1996 STA mission noted substantial shortcomings with the national accounts data, including: the non-availability of basic underlying data in a number of areas and the need to make extrapolations on partial coverage; the use of historical and outdated input/output relationships in many instances; the use of old benchmarks estimates in deriving current series; and the use of inappropriate trend indicators in a few instances. In terms of GDP by expenditure categories, major problems included estimates of household expenditure on a residual basis, and defects in the timeliness, coverage, and commodity detail on imports.

A resident advisor provided technical assistance from July 1998 to January 2000. The expert updated the base year for the national accounts to 1995, improved the methods for compiling imports at constant prices (see below under prices), incorporated new benchmark estimates for several industries, initiated work on simplified institutional sector accounts, implemented a new computer system for compiling the estimates, and documented the compilation methodology for the national accounts. The expert also initiated several projects for improving BSL data collection efforts, work programs, and working procedures, including improving the manufacturing production index.

Prices

BSL currently produces a consumer price index (CPI) only, largely due to staff shortages. The CPI is based on the Laspeyres index formula and is compiled with weights from the 1994/95 HBS; it is published with a base of April 1997=100. In addition to the nationwide index, separate indices are compiled and published for high-income households (i.e., households earning more than M500 according to the 1994/95 HBS) in Maseru City and for low-income households (households earning less than M500) in all six lowland towns. The index for high-income households is based on different weights than the low income and nationwide indices. A 1996 STA mission found that the quality of the index was, in general good, and compared favorably with the CPI for other countries in the region.

Government finance statistics

Monthly data on government revenue and grants, current and capital expenditure, and financing are now provided by the Ministry of Finance to AFR on a monthly basis, although timeliness of reports remains problematic. There is scope for further improvement in the reporting of fiscal data. Current and capital expenditure would benefit from more disaggregated reporting, including for health and education spending; revenues should be classified according to the GFS manual; and the reporting lag of about one year for the production of the functional breakdown of expenditure should be reduced. It is also necessary to distinguish clearly between current and capital (project) grants and external loan disbursements. The Government submitted the 2001/02 fiscal accounts to the Auditor General in March 2003 and the 2002/03 fiscal accounts in October 2003. These are the first accounts to be audited since those for the 1995/96 fiscal year.

The *2002 Government Finance Statistics (GFS) Yearbook* only contains fiscal data through 1998. Quarterly fiscal data are reported for *IFS* but with a significant lag (the October 2003 issue contains data through March 2002 only).

Monetary statistics

Two STA money and banking technical assistance missions (1999 and 2000) reviewed the compilation of monetary statistics. The mid-2000 mission recommended the:

(i) adoption of new report forms for sectorized balance sheet data of the CBL and other depository corporations; (ii) expansion of the institutional coverage of the monetary statistics; (iii) improvement of the sectorization of accounts of the nonfinancial public sector; (iv) proper classification of international reserves and reserve-related liabilities, as well as of other foreign assets and other foreign liabilities; (v) revision of valuation and other accounting procedures, including the statistical treatment of Fund accounts; (vi) improvement of the coding structure of the CBL's chart of accounts; (vii) proper treatment of the donor-funded projects to ensure appropriate classification of relevant accounts; (viii) improvement of the *Guidelines for Reporting of Financial Institutions*; (ix) reclassification of other assets and liabilities to reduce the level of unclassified assets and liabilities; (x) inclusion and treatment of data on banks in liquidation in the monetary statistics; and (xi) revision of historical data to reflect these improvements.

Most of the recommendations have now been adopted. Monthly reporting of data for IFS publication is timely and has improved in terms of classification of instruments, sectorization of the domestic economy, and compilation of the monetary aggregates. However, the proposed expansion of institutional coverage, the valuation of financial instruments at market value, and the proper recording of realized and unrealized foreign exchange gains and losses are still pending. The need for reliable and timely data to monitor Lesotho's PRGF arrangement underscores the importance of full and timely implementation of all recommendations.

Balance of payments and external debt

The Central Bank of Lesotho compiles quarterly balance of payments statistics and usually with a lag of three months. However, these data are not reported to AFR or STA on a timely basis for dissemination in the Fund's statistical publications.

A STA mission in July-August 2002 concluded that the quality of Lesotho's balance of payments data is inadequate for policy purposes. The methodology underlying the compilation of the balance of payments data suffers from the use of outdated benchmark surveys and deterioration in the coverage and timeliness of some of the data sources needed. The main recommendations of the mission were as follows:

- **It is urgent to resolve both the inadequate coverage and the delayed reporting of data on exports and imports of goods.** The Department of Customs and Excise (DCE) does not provide data in a timely fashion. The CBL, therefore, generates its own estimates of exports and imports, and there are significant differences between these estimates and DCE's data. For example, CBL believes that DCE is underreporting total imports and has been making a 30 percent upward adjustment of the level of imports. There are also differences between the export and import data compiled by the CBL on one hand, and the corresponding data compiled by the BSL on the other.
- **Closer cooperation and new statistical surveys are needed, in order to improve the quality of data on exports and imports of services.** Most of the data on exports of services are based on outdated benchmark estimates adjusted for movements in Lesotho's consumer price index. Data available at the line ministries and other organizations could also be of better use for estimates of balance of payments variables. Government ministries and the CBL should, therefore, strengthen their joint cooperation and make better use of data sources in organizations like the Lesotho Highlands Development Authority, the Lesotho National Development Corporation, the South African Reserve Bank, and the Employment Bureau of Africa.

In general, the authorities need to strengthen their institutional capacity. The CBL should be given formal institutional responsibility for the compilation of balance of payments statistics. This work is currently undertaken by the CBL but there is no legislation or official decree that designates this responsibility. Together with other members of the Central Monetary Arrangement (CMA), Lesotho's authorities also need to consider measures to harmonize concepts, methodology, and data collection for regional balance of payments data. Lesotho participates in the General Data Dissemination System (GDDS) and its metadata has been published on the IMF website since August, 2003.

Lesotho: Core Statistical Indicators

(As of October 16, 2003)

	Exchange Rates	International Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Bal 2/	GDP/ GNP	External Debt 3/	Debt Service 3/
Date of latest observation	Sep. 2003	Sep. 2003	Aug. 2003	Sep. 2003	Sep. 2003	Aug. 2003	Aug. 2003	Q2 2003	Q2 2003	June 2003	2002	Mar. 2003	June 2003
Date received	Oct. 2003	Oct. 2003	Oct. 2003	Oct. 2003	Oct. 2003	Oct. 2003	Oct. 2003	Sep. 2003	Sep. 2003	Sep. 2003	Sep. 2003	Sep. 2003	Sep. 2003
Frequency of data 4/	D	W	M	W	W	D	M	Q	Q	M	A	M	M
Frequency of reporting 4/	W	W	M	W	W	M	M	Q	Q	M	A	Q	Q
Source of data	CBL	CBL	CBL	CBL	CBL	CBL	BSL	CBL	CBL	MOF	BSL	MOF	MOF
Mode of reporting 5/	E	E	E	E	E	E	E	V	V	C, E	V	E	E
Confidentiality 6/	U	E	E	E	E	U	U	U	U	E	U	U	U
Frequency of publication 4/	D	M	A	M	M	D	M	Q	Q	A	A	Q	Q

1/ Weekly data on gross official reserves and net international reserves reported with a lag of 3 to 4 weeks.

2/ Central government. 3/ Monthly data reported infrequently. 4/ D=daily; W=weekly; M=monthly; Q=quarterly; A=annually; and V=infrequently.

5/ C=cable or facsimile; E=e-mail; M=mail; and V=staff visits. 6/ U=unrestricted use; E=embargoed for a period of time

Lesotho: Selected Social and Demographic Indicators

<u>Population and health</u>			
Population (2002, in millions)	2.1	Prevalence of HIV (2001, female, percent of ages 15-24)	38.1
Annual rate of growth (2001, percent)	1.2	Fertility rate (2002, births per woman)	4.2
Population 14 years and under (2001, percent of total population)	39.6	Infant mortality (2001, per 1,000 live births)	91.0
Density (2001, people per sq km)	67.9	Under 5 mortality rate (2001, per 1,000 children)	132.0
Urban population (2001, percent of total)	28.7	Physician (1995, per 1,000 people)	0.05
Life expectancy (2002, years)	42.7	Immunization rates (2001, percent under 12 months)	
		DPT	85.0
		Measles	77.0
<u>Education</u>		<u>Income distribution</u>	
Adult literacy rate (2001, percent of total population)	83.9	Income share of the 10 percent highest earners (1995, percent of total income)	53.6
Male (percent of all adult men)	73.3	Income share of the 10 percent lowest earners (1995, percent of total income)	0.5
Female (percent of all adult women)	93.9		
Net school enrollment rate (2001)		<u>Access to safe water</u>	
Primary education (percent of total age group)	78.4	Percent of total population (2000)	78.0
Male	75.0	Urban population	88.0
Female	81.8	Rural population	74.0
Secondary education (percent of total age group)	20.6		
Male	16.2	<u>Labor force</u>	
Female	25.0	Total labor force (2001, 1,000 people)	851.7
Pupil teacher ratio in primary schools (2001)	47.9	Unemployment (1997, percent of labor force)	39.3
<u>Technology and infrastructure</u>		Male	30.7
Fixed lines and mobile telephones (1998, per 1,000 people)	14.9	Female	47.1
Internet users (2001)	5,000		
Paved roads (1998, percent of total)	17.3		

Source: *World Bank, World Development Indicators, 2003.*

**Statement by Peter J. Ngumbullu, Alternate Executive Director for Lesotho
January 21, 2004**

Key Points

- The country is suffering from a recurring food crisis.
- The authorities have embarked on a fiscal reform process aimed at improving public financial management by revamping the public sector accounting system.
- Structural Reforms have been undertaken to improve and accelerate service delivery through restructuring of institutions, improved public sector budgeting, reporting and forecasting.
- The authorities are committed to fight poverty through increasing expenditure outlays on social sectors like health, education and delivery of basic services to the poor.

Introduction

The current arrangement under the PRGF program approved in 2001, has greatly facilitated the improvement of macroeconomic management and greater discipline in spite of the many daunting challenges both in the short and medium term. The authorities have shown strong commitment to pursuing the path of adjustment and reform and are grateful to the Fund management and staff for their continuing support. The authorities have achieved the main objectives of the structural performance criteria and have also increased the pace of implementation. They therefore, request for waivers for the quantitative and structural performance criteria and an extension of the current PRGF arrangement, to enable them to complete the ongoing structural agenda as well as to prepare for the sixth review.

The country remains vulnerable to external shocks and faces numerous challenges including food shortages, HIV/AIDS, as well as the need to improve the infrastructure and diversify the economy. The authorities view the HIV/AIDS pandemic as the single most daunting challenge facing the country, which has very serious implications for productivity and human resource development. The government of Lesotho has started implementing a program of action developed by the Summit of the SADC Heads of States Conference on HIV/AIDS held in Lesotho in July last year, based on prevention and education, care and support of the infected and affected, provision of antiretrovirals, support for the orphans and provision of free primary education in line with the MDGs objectives. With a large proportion of the population residing in remote and inaccessible rural areas and relying on agriculture for their

livelihood, medium-term prospects look bleak largely, due to an impending food crisis aggravated by poor performance of the agricultural sector. This may prolong the humanitarian crisis that has plagued the country and the entire sub-region in the last few cropping seasons. The authorities have undertaken a preparedness study assisted by DFID of the U.K. to ascertain the extent of the crisis. The study is currently being reviewed.

Lesotho's economy has gained considerably from the inflow of investments into the country's textile sector boosting exports and shoring-up employment creation. This sector is still expanding and is expected to create more job opportunities in the coming years with new establishments settling in and expansion of existing ones. The country's weak institutions and human and systems capacity deficits which are now being addressed under the program have, however, constrained economic performance and have somewhat undermined the positive performance of the economy in recent years.

Fiscal Developments

The authorities have embarked on a comprehensive fiscal and institutional reform with the assistance of the Fund, to improve financial management through improving the accounting system, provision of regular and timely financial reports, as well as training staff to fill some of the critical vacant positions that are important in overseeing the country's public finances. Action has been taken to address areas that have traditionally led to overruns in the budget. The government has, for instance, changed its policy of providing loan bursary to any student who had received admission to a tertiary institution. This is in an effort to review financing of higher education such that it is in line with the long-term macroeconomic and financial frameworks of the country.

The government has also reduced its vehicle fleet by half and implemented measures that would create savings in fuel, wear and tear. These measures are already delivering savings that were not anticipated at the time of the last IMF mission to the country.

The Public Accounts Committee of Parliament is working closely with the Ministry of Finance to improve financial accountability and auditing of government records, and as a result have just recently completed auditing the 2001/2002 government financial accounts while the 2002/03 accounts are being finalized for audit. The ministry of finance in collaboration with the Public Accounts Committee of Parliament is also working on plans for auditing of accounts for the years between 1995/96 and 2000/01 for which there were no audited financial statements. This is a significant development, since the last audit report was published some 6 years ago and this testifies to the authorities' commitment to transparent governance in this area. The authorities are intent on putting in place a system to ensure regular and timely dissemination of public accounts in future. Government accounts are to be computerized to make their management much more efficient and transparent, and to improve forecasting.

The recently established Lesotho Revenue Authority (LRA) is increasingly overcoming its teething problems and it is expected to significantly improve revenue collection and tax administration. Similarly, the newly introduced Value Added Tax (VAT) collections are

recording steady increases and are expected to make a sizeable contribution to government revenues over the coming years. The VAT is also expected to meet the targeted 1 percent of GDP by the end of the financial year. The government has approved extending VAT to government ministries transactions. The authorities are planning to retire part of the accumulated government debt held in bonds by the Central Bank of Lesotho.

In addition, the authorities are committed to containing the 2003/04 budget deficit to manageable levels by cutting on non-priority expenditures. Steps have been taken to address issues of overspending on foreign travel and vehicle leases while all ministries are now expected to report regularly on their activities and those that do not conform to the new arrangement will be surcharged.

The authorities are committed to setting up a simple and easy to understand system that will ensure regular monitoring and reporting of the government's financial activities, including at local government level. They intend to manage the 2003/04 budget tightly and to reduce the budget deficit from 5.2 percent to 3.2 percent of GDP, which is below the program ceiling. Furthermore, they will introduce the Medium Term Expenditure Framework(MTEF) in 2005/06 fiscal year.

Monetary Developments

On the Monetary sub-sector, the government has embarked on an extensive, but cautious financial liberalization program aimed at further opening up the economy and to promote deeper financial sector reforms. Amongst other things, the authorities have allowed partial liberalization of the capital account which enables resident companies and private individuals to hold foreign currency denominated accounts outside the Common Monetary Area (CMA) subject to the approval of the Central Bank of Lesotho. The authorities are confident that the pegging of the local currency, the Loti, to the South African Rand under the CMA arrangement continues to serve the country well given the strong economic and social links between the two countries. They also aim to build a healthy level of international reserves, while maintaining the country's competitiveness.

Structural Reforms

The authorities have requested for waivers for the non-observance of some quantitative and structural benchmarks, which are to be fully implemented by April 2004. They believe that the main objectives of the missed structural performance have been met and there is now a good basis and momentum for the achievement of a sustained financial and fiscal reform process. These reforms have largely been constrained by the unavailability of the skilled human resources to support the transformation process. In an effort to strengthen the new financial management system and fiscal policy implementation a Deputy Accountant General will be appointed early in 2004 and the accounting system will be computerized. These measures are expected to enhance improvements in financial management, accounting and auditing, as well as budgetary commitment control.

Implementation of the privatization program, which includes a state bank, the telecommunication and the energy sectors has continued as planned. The energy and telecommunication sectors regulatory agencies will be established in 2004. The authorities are also aggressively combating fraud and corruption. The Anti-Corruption Unit is now operational and the DFID and the Irish Aid are assisting to have the office adequately and appropriately staffed to face the challenges of the job. The government is also considering forming a joint initiative to centralize these activities and also to appoint a special judge to deal with these issues expeditiously. A Local Government Act providing an institutional framework to facilitate decentralization and community empowerment has been enacted.

The country recently adopted the General Data Dissemination System (GDSS) and will rely on the technical support provided by the Fund during this crucial early period as they introduce new systems and ensure their effective utilization for policy formulation and implementation purposes. Areas of immediate concern pertain to the strengthening of data compilation, improving internal auditing at all levels and training of personnel.

PRSP

A final draft of the PRSP is going through the various approval processes and should be available within the next two months. In this finalisation process, the PRSP Steering Committee considered the proposals and reduced these in line with resource constraints and phased them by budget years. In this respect, nine (9) priority areas identified in the PRSP have been included in next year's budget which is being finalised now. What is clear is that the budget resources are far smaller than the needs and the project proposals that have been made by the communities. This is likely to lead to frustrations of unmet expectations. It will therefore be necessary in the future to find a way of managing these processes.

The authorities remain committed to improving the living standard of the population, the majority of whom reside in rural areas, and to achieve sustainable and job-creating economic growth, reduce poverty and improve social and economic indicators. They hope they would continue to count on the understanding and support of the Fund and indeed the rest of the international community in this endeavor.

Finally, the authorities consent to the publication of the report.



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 04/6
FOR IMMEDIATE RELEASE
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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with Lesotho

On January 21, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lesotho.¹

Background

Lesotho's economic growth is in a positive trend after a significant slowdown following civil unrest and political turmoil in 1998. Fiscal performance has, however, weakened with increasing budget deficits. The authorities have made significant progress in structural reform, but public expenditure management remains weak due to severe capacity constraints.

Economic growth was favorable in 2002/03, despite adverse weather conditions and the regional food shortage. Economic growth rose to almost 3¾ percent in 2002/03 from 3¼ percent the previous year due mainly to strong clothing exports to the United States under the African Growth Opportunity Act (AGOA). The rapid growth of the textile sector is expected to continue and signals that Lesotho remains competitive in global markets despite the appreciation of the loti against the U.S. dollar during the last two years. Inflation is now restrained after a temporary drought-related peak in 2002.

The overall fiscal deficit (excluding grants) worsened to 8 percent of GDP in 2002/03 from 2¼ percent in 2001/02, as a result of an upward shift in public expenditure and slow growth of

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

customs revenue. Expenditure rose on a wide array of items, including outlays on goods and services – in particular vehicle lease costs – spending on scholarships and pension, and drought-related assistance. With increased domestic financing of government deficits, interest rates came under pressure in 2003.

Lesotho faces daunting medium-term problems: (i) agricultural productivity is falling due to soil degradation; (ii) almost one third of the adult population is HIV positive and fiscal resources to address this and other problems are scarce; (iii) the growth of the textile industry is driven by preferential treatment under AGOA and may not be sustainable as trade preferences by the U.S. are phased out; and (iv) fiscal revenue is projected to decline as a proportion of GDP owing to changes in the Southern African Customs Union (SACU) revenue sharing formula. Lack of adequate infrastructure, inadequate property rights, and insufficient access to bank financing are other impediments to Lesotho's economic prospects.

Some progress has been made in the areas of tax reform and privatization, but the public sector financial management system is weak and continued reforms will be vital to bring government spending in line with its priorities.

Lesotho's Poverty Reduction Strategy Paper (PRSP) is expected to be finalized in early 2004. Nevertheless, the 2003/04 budget was based on the policy priorities agreed upon during the PRSP consultations and discussions of the 2004/05 budget are also based on these priorities.

Executive Board Assessment

Executive Directors noted that economic performance had remained favorable, with moderate growth and declining inflation, despite adverse weather conditions and a regional food shortage. Economic growth rose to almost 4 percent in 2002/03, supported by buoyant growth in textiles exports to the United States under the U.S. African Growth Opportunity Act and related strong construction activity.

Directors endorsed the authorities' medium-term strategy to achieve higher and sustainable economic growth, reduce poverty, and improve social conditions by creating appropriate conditions for private sector development and, in particular, labor-intensive industries. They noted that Lesotho must address daunting medium-term challenges, such as falling agricultural productivity, HIV/AIDS-related and other health problems, potential erosion in trade preferences, inadequate infrastructure and enforcement of property rights, and insufficient access to financial credit. Directors noted the scale of the structural problems and also the drought and food crisis facing the country, and acknowledged that Lesotho would require urgent, substantial external aid to address these issues.

Directors welcomed the authorities' efforts to bring the fiscal deficit under control, with a view to reducing reliance on domestic financing. They supported the improvement in the tax system through the introduction of the value added tax and the establishment of the Lesotho Revenue

Authority, while noting that strengthening domestic revenues is essential to offset any loss of revenues from changes in the Southern African Customs Union revenue-sharing arrangement.

Directors commended the reprioritization of government spending to create room for investment in basic health care, education, and other social services, which will be necessary to combat HIV/AIDS, and in physical infrastructure, such as water, electricity, and rail facilities. They stressed that reforms to the public financial management system will be essential to bring spending in line with government priorities, and that reporting of actual outcomes needs to be accurate and timely. To this end, they highlighted the importance of restarting the auditing of public accounts, improving forecasting, budgeting, and accounting within the public sector.

Directors saw a need to continue addressing governance issues, and in this regard supported the establishment of an Anti-Corruption Unit. They welcomed the progress in preparing the PRSP and the integration of its objectives with the budget. They recognized the importance of technical assistance in helping to remove capacity constraints.

Directors agreed that the current peg of the loti to the South African rand has served Lesotho well in view of the country's close economic integration with South Africa. Looking forward, they urged the authorities to pursue sound fiscal and monetary policies, deepen structural reforms to ensure external competitiveness and a sustainable peg, and facilitate a decline in lending rates.

Directors supported the on-going reforms to Lesotho's financial institutions and regulations, noting that these reforms are crucial to increase access to credit for the private sector, particularly for small- and medium-sized businesses. They commended the recent partial capital account liberalization, and underscored that priority should be given to strengthening property rights and the judiciary, and establishing a credit bureau and a rural guarantee fund.

Directors emphasized the need for structural reforms in the agricultural sector to address food and water shortages, and poor agricultural productivity. They commended the progress in privatization, and encouraged the authorities to move ahead with privatization in electricity and the establishment of regulatory agencies for power and telecommunications in 2004.

Directors noted that Lesotho's statistical database is broadly satisfactory for program monitoring purposes, but there are serious deficiencies in the quality and timeliness of core surveillance data. They urged the authorities to strengthen the capacity of the statistical agencies and improve the statistical database.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2003 Article IV Consultation with Lesotho is also available.

Table 1. Lesotho: Selected Economic and Financial Indicators, 1999/00-2003/04 1/

	1999/00	2000/01	2001/02	2002/03	2003/04
	Act.	Act.	Act.	Act.	Rev. Prog.
(Annual percentage change, unless otherwise specified)					
National income and prices					
Real GDP	0.5	1.9	3.3	3.8	3.9
Real GNP	-0.3	0.7	1.0	3.8	3.3
Consumer price index (average change)	7.1	6.2	11.3	9.1	6.4
Nominal GDP (in millions of maloti)	5,669	6,137	6,839	7,731	8,548
Nominal GNP (in millions of maloti)	7,183	7,685	8,374	9,466	10,399
External sector 2/					
Exports, f.o.b.	-1.6	18.4	31.7	35.9	29.0
Imports, f.o.b.	1.9	-10.0	-7.7	27.1	22.6
Net labor income	2.5	-12.5	-22.7	12.4	26.6
Nominal effective exchange rate 3/	-3.2	-11.2	-20.3	-7.3	...
Real effective exchange rate 3/	2.4	-8.5	-15.7	1.0	...
Government budget					
Revenue (excluding grants)	6.4	13.6	6.1	8.9	11.0
Total expenditure and net lending	38.3	-15.1	2.6	24.5	6.4
Current expenditure	19.3	5.0	-5.0	23.6	10.8
Capital expenditure and net lending	112.8	-59.2	45.5	28.2	-9.3
Money and credit					
Net foreign assets 4/	-9.8	5.1	85.5	-70.6	-6.0
Net domestic assets 4/	7.7	1.1	-68.5	73.4	16.6
Credit to the government 4/	57.9	20.9	3.7	15.0	8.3
Credit to the rest of the economy 5/	-7.5	1.2	-6.0	-45.8	13.3
Broad money	-2.1	6.1	17.0	2.7	10.6
Velocity (GDP/average broad money)	3.3	3.5	3.5	3.6	3.7
(In percent of GDP, unless otherwise specified)					
Investment and saving					
Investment	46.9	41.5	45.4	38.6	34.4
Gross national savings (including remittances)	24.1	23.3	32.0	21.9	22.6
Public	2.2	5.2	9.7	6.1	5.6
Private	21.9	18.1	22.3	15.7	17.0
Government budget					
Revenue	40.8	42.8	40.8	39.3	39.4
Total grants	2.3	2.0	2.8	3.8	3.2
Total expenditure and net lending	61.6	46.7	43.0	47.3	45.5
Overall balance (before grants)	-18.7	-3.9	-2.2	-8.1	-6.1

Table 1. Lesotho: Selected Economic and Financial Indicators, 1999/00-2003/04 1/

Overall balance (after grants)	-16.4	-1.8	0.6	-4.2	-2.9
Gross government domestic debt	15.4	18.4	16.4	16.6	14.8
External sector					
Current account balance (excluding official transfers)	-36.5	-33.1	-29.9	-33.0	-27.0
Current account balance (including official transfers)	-22.8	-18.2	-13.4	-16.7	-11.8
Stock of public external debt 6/	72.9	69.3	74.9	76.1	53.4
Debt-service ratio 7/	21.2	27.9	14.4	14.5	9.4
(In millions of U.S. dollars, unless otherwise specified)					
Gross official reserves (end of period)	470.1	393.3	399.7	408.4	419.8
Gross official reserves (in months of imports of goods and services)	7.4	6.7	5.3	4.4	3.9

Sources: Lesotho authorities; and IMF staff estimates and projections.

1/ Fiscal year beginning in April.

2/ In U.S. dollars.

3/ Based on partner-country data excluding South Africa. A minus sign indicates a depreciation.

4/ Change in percent of broad money at the beginning of the period.

5/ Credit to the rest of the economy affected by a write-off of bad loans in 2002/03.

6/ The programmed appreciation of the loti versus the U.S. dollar has a significant effect on the debt to GDP ratio in 2003/04.

7/ In percent of exports of goods and services.



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FOR IMMEDIATE RELEASE
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International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fifth Review Under Lesotho's PRGF Arrangement and Approves US\$5.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the fifth review of Lesotho's economic performance under an SDR 24.5 million (about US\$36.3 million) Poverty Reduction and Growth Facility (PRGF) arrangement (see [Press Release No. 01/8](#)). This opens the way for release of a further SDR 3.5 million (about US\$5.2 million), bringing the total amount drawn under the arrangement to SDR 21 million (about US\$31.1 million).

The Board also granted a waiver of nonobservance of the end-June 2003 performance criterion on the domestic financing requirement of the central bank and for five structural performance criteria.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in the [Poverty Reduction Strategy Paper \(PRSP\)](#). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

In commenting on the Board's discussion on Lesotho, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chair, stated:

“Lesotho has made commendable progress under the PRGF-supported program. Economic growth has remained satisfactory, benefiting from strong textiles exports to the United States under the U.S. African Growth Opportunity Act (AGOA). Consumer price inflation has declined, in line with developments in South Africa. Nevertheless, Lesotho faces many serious challenges in the years ahead, including falling agricultural productivity, the potential loss of trade preferences, and the high incidence of HIV/AIDS.

“The authorities have recently taken spending and revenue measures to contain excessive levels of domestic borrowing and reduce the fiscal deficit. They now expect to reduce domestic borrowing for 2003/04 to a level below that in the original program.

“The authorities have made progress in strengthening tax policy and administration. Although revenue collection has lagged program targets, the introduction of the value added tax and establishment of the Lesotho Revenue Authority (LRA) should improve the tax structure and lead to improved tax administration performance.

“The authorities are cutting nonpriority expenditures to ensure that program targets are met, but need to support these measures with further reallocation of resources to human capital and infrastructure development. A critical part of the program is to improve public expenditure management. Recent initiatives include restarting the auditing of public accounts, improving forecasting, budgeting, and accounting within the public sector, and developing institutions to improve governance.

“The authorities have begun removing structural impediments to financial development, including through partial capital account liberalization, and deregulation and privatization in the financial sector. They need to deepen reforms to foster competition in the financial system, strengthen property rights and the judiciary, and improve credit for small and medium-sized businesses.

“Lesotho’s Poverty Reduction Strategy Paper (PRSP), which has been prepared through a broad-based participatory process, is expected to be finalized in early 2004,” stated Mr. Sugisaki.