Market insight: Lesotho's 2004/2005 budget

26 February 2004

Background

Finance and National Planning Minister Timothy Thahane presented the 2004/2005 budget, entitled "Continuing to build Foundations for Sustainable Delivery of Services to the People", to the Lesotho Parliament on 16 February.

The 2003 general review

Although global economic conditions were disappointing, Lesotho managed to improve its international rating. During 2003 the country's sovereign credit rating outlook improved. Fitch Ratings upgraded Lesotho's long term foreign currency rating of B+ to a positive outlook in September. According to Fitch and quoted in the budget "Lesotho's reasonably sound macroeconomic environment, historically low net external debt, strong external liquidity and high fiscal revenues continue to offer support for the rating." Although this is an improved rating, B+ is classified as speculative grade, which is below investment grade. Lesotho's long-term local currency rating of BB was also revised to a positive outlook in September. The short-term foreign currency rating of B was unchanged. Lesotho is not rated by the other rating agencies, Moody's and Standard and Poor's.

The minister underlined the importance of improving the quality of life and the standard of living of all the country's people through effective service delivery; decentralisation of government functions; public private partnerships (PPPs); and fighting corruption.

To root out corruption specific companies were mentioned and the issue of money laundering was also raised. Overall, fiscal management has improved with the establishment of the Public Accounts Committee.

The country has gained positive returns from the US's African Growth and Opportunity Act (AGOA). The textiles and apparel sector has become the largest employer in Lesotho and its exports to the US have grown from US$216.7 million in 2001 to US$392.5 million in 2003. The sound export performance was produced in spite of the strength of the loti against the US dollar.

The minister stressed that the negative impact of the HIV/Aids pandemic in Lesotho could undo the economic advances it has achieved since independence.

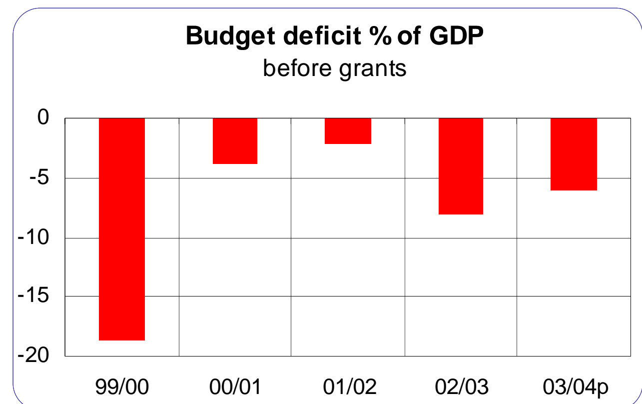
The revision of the Southern African Customs Union (SACU) revenue-sharing formula is expected to reduce government revenue. It is for this reason that the government changed from a somewhat inefficient general sales tax (GST) of 10% to a value added tax (VAT) of 14% in July 2003.

The country remains in a state of famine after three consecutive years of crop failures, which were largely the result of the regional drought. The minister said that food insecurity was expected to continue into 2004/2005. Lesotho receives food assistance from various African and Asian countries.

According to the International Monetary Fund's (IMF) Article IV Consultation with Lesotho in January, the previous as well as the current budget was based on Lesotho's Poverty Reduction Strategy Paper (PRSP), despite its expected finalisation being only early this year.

Budget performance in 2003

One of the main concerns is the budget deficit. According to the IMF's Article IV Consultation, the budgets deficits recorded are as follows:



The minister, however, said that the government managed to reduce the 2002/2003 budget deficit of 5.2% to 3% of GDP. This was achieved through additional revenue raising measures and containment of non-essential expenditure. Also the scrapping of GST and the introduction of VAT, which eliminated costly tax exemptions, added to revenue.

The deficit for 2004/05 is budgeted at 0.9% of GDP (before grants). However, a budget surplus of 2.7% of GDP (after grants) is programmed. This will be made possible by an expected windfall from SACU revenue. The minister anticipated small deficits in subsequent years.

Generally, fiscal sustainability implies that the budget deficit must not grow faster then the economy in the long run. The international rule of thumb is about 3% of GDP, but more importantly, fiscal revenue must be able to service the government's accumulated debt. The reduction of Lesotho's budget deficit is therefore in keeping with international good practice.

Macroeconomic policies for 2004

Government economic growth figures mentioned in the budget show that the economy is expected to grow at above 3% over the next few years.

	2002 actual	2003 projected	2004 forecast	2005 forecast	2006 forecast
GDP growth (%)	3.7	3.4	3.6	3.9	4.0

The minister announced the introduction of a medium-term expenditure framework in 2005 to promote greater transparency and accountability. This should allow citizens to better monitor government's fiscal actions. The framework should make government revenue and expenditure more predictable so that the public can expect fewer shocks and surprises. The IMF believes that the framework will encourage growth, reduce poverty and encourage and create labour-intensive private industries, thereby improving social upliftment.

The Lesotho Revenue Authority (LRA), which was launched last year, has had a positive impact on various aspects of tax collection. However, the IMF's assessment is that financial management in the public sector must still be improved.

Budget proposals for 2004

The minister said that he intends introducing a tax amnesty bill and a revenue appeals tribunal soon. The former offers amnesty to tax offenders until 31 March 1999; and partial amnesty (on interest and penalties) from 31March 1999 until 31 March 2003. The tribunal will be chaired by a judge where tax appeals can be heard.

Social services comprise 43.7% of the total budget; of which education absorbs the largest part and health the balance. Economic services comprise 17.6% of the total, with agriculture and roads receiving the biggest share.

Revenue measures

	Maloti million	% of GDP
Revenue	4,232.8	44.9
Tax revenue	3,692.8	39.1
Non-tax revenue	540.0	5.7
Grants	336.8	3.6

The minister did not make any adjustments to the personal and company tax rates.

The minister expects to increase revenue by 32.1% in 2004/05 compared to 2003/04. This will increase revenue to about 45% of GDP. Revenue from VAT is expected to double over the period.

Tax revenue makes up 87.2%, non-tax revenue 12.8% and grants 8% of total revenue.

Expenditure measures

	Maloti million	% of GDP
Recurrent expenditure	3,494.0	37.0
Wages & salaries	1,222.9	13.0
Other purchases	2,055.0	21.8
Interest payments	216.1	2.3
Capital expenditure	842.7	8.9

Public servants received a 5.5% salary adjustment for 2004/05. The government will also start paying old age pensions to people over 70.

Wages and salaries comprise 28.2%, interest payments 5% and capital expenditure 19.4% of total expenditure.

According to the IMF (Article IV Consultation), expenditure on items such as vehicle lease costs and drought assistance was high in 2003. The higher domestic financing of the budget deficit put upward pressure on interest rates during 2003.

Conclusion and outlook

The country faces several problems in the medium term.

The country's success in apparel and textile exports to the US under AGOA, which was launched in 2000, is also its vulnerable area, as preferential trade agreements are being phased out. The sector received investment mainly from Taiwan. Lesotho will have to produce fabric domestically (it will no longer be able to import raw materials or fabric from elsewhere) when the current AGOA II agreement expires. It is hoped that AGOA III will extend the overall programme from its original expiry date of 2008 to 2015. Also on the agenda is extending the third country apparel provisions by four years from 2004 to 2008. For this reason the minister said that the sector needs to develop new products and find new markets. The economy must continue to diversify its industrial, manufacturing and export base.

However, Lesotho's development status will enable it to gain duty-free access to other large markets, such as Australia, Canada, Japan and the European Union.

Infrastructure such as roads, electricity and communications needs to be improved. Tourism, which is often mooted as a growth engine, will be severely hampered by poor infrastructure.

The SACU's new revenue-sharing formula is widely expected to reduce government revenue, although the actual impact has not yet been determined. The agreement comes into force this year. The switch to VAT and the establishment of the LRA will go some way to helping address this problem.

The HIV/Aids pandemic will increasingly become an obstacle to development. The minister said the country had a programme in place to combat the disease, with heavy reliance on external assistance. He said that about 70 people were dying from the disease daily and there were approximately 70 000 Aids orphans. The pandemic, together with famine, low agricultural productivity, environmental and soil degradation and high levels of poverty, unless eradicated, could be catastrophic for the small country.

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