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Lesotho: 2000 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility--Staff Report; Staff Statement; Public Information Notice

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 2000 Article IV consultation with Lesotho and request for arrangements under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the combined 2000 Article IV consultation and request for arrangements under the Poverty Reduction and Growth Facility prepared by a staff team of the IMF, following discussions that ended on **November 29, 2000** 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 February 14, 2001.** 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 staff statement of **March 9, 2001** updating information on recent economic developments.

- a Public Information Notice (PIN) and a Press Release, summarizing the **views of the Executive Board as expressed during its March 9, 2001 discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

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

Interim Poverty Reduction Strategy Paper
Joint Staff Assessment of the Interim Proverty Reduction Strategy Paper
Letter of Intent by the authorities of the member country*
Memorandum of Economic and Financial Policies by the authorities of the member country*
Statistical Annex
Technical Memorandum of Understanding*

*May also be included in Staff Report.

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

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LESOTHO

Lesotho—Staff Report for the 2000 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

Prepared by the African Department

(In consultation with the Legal, Policy Development and Review, Statistics, and Treasurer's Departments)

Approved by José Fajgenbaum and Liam Patrick Ebrill

February 14, 2001

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EXECUTIVE SUMMARY

- Real GDP growth has recovered to above 2 percent following the downturn in 1998/99, but remains constrained by structural changes, such as the winding down of Phase IA of the Lesotho Highlands Water Project and the decline in mining employment in South Africa. Unemployment and poverty are widespread, and there is a serious HIV/AIDS problem. The fiscal and balance of payments situations have also deteriorated. However, inflation is relatively low, and the external debt remains sustainable.

- From January to September 2000, Lesotho satisfactorily implemented a staff-monitored economic program (SMP). The targets were met, and good progress was made in implementing structural reforms. Nonetheless, fiscal pressures were tighter than envisaged as a result of unanticipated expenditures. In December 2000, the government reached understandings with the staff on a three-year program under the Poverty Reduction and Growth Facility (PRGF).

- The budget deficit ballooned in 1999/2000 due to a declining revenue-to-GDP ratio and one-off expenditures associated with the restructuring of state entities. The budget deficit should narrow in 2000/01, though unexpected expenditures, such as the settlement of a tax dispute with South Africa, continue to exacerbate fiscal pressures. While the current account deficit has narrowed, it remains large, and inflows of official grants and foreign direct investment have become insufficient to finance it, leading to a fall in international reserves since 1999/2000.

- The program is consistent with the objective of raising economic growth and creating employment in order to fight poverty, as outlined in the government's interim PRSP. A full PRSP is expected by June 2002. The government aims to raise growth by attracting foreign direct investment and enhancing export competitiveness, while privatization will fuel private sector development.

- Lesotho's one-to-one exchange rate peg between the loti and the rand has helped maintain monetary stability and relatively low inflation. However, it is important that external balance be preserved to protect the peg. Thus, the authorities have committed themselves to maintaining gross international reserves at six months of imports and containing the current account deficit. The exchange rate regime also limits monetary policy and so raises the importance of a healthy fiscal policy. The government has agreed to pursue a path of fiscal consolidation through rises in tax revenue, expenditure cuts, and public sector reforms. The central bank will also enhance its capacity to control liquidity through the establishment of a treasury bill market.

- Structural reforms to be implemented cover the areas of tax reform and tax administration, expenditure control and rationalization, public sector reform, financial sector reform, privatization, and statistics strengthening. Particularly important will be efforts to reduce the scale of government, so as to facilitate private sector development.

- **The staff recommends that the request for the PRGF arrangement be granted.**

I. Introduction

1. **Economic performance in Lesotho has deteriorated since the late 1990s.** Between 1991 and 1998, economic growth averaged 6 percent, fueled by construction in connection with the Lesotho Highlands Water Project (LHWP). But the winding down of the initial phase of this project (Phase 1A), the decade-long retrenchment of emigrant miners in South Africa, and social unrest in 1998 have since curtailed growth. Unemployment and poverty are widespread, fiscal and balance of payments pressures have emerged, and the country is facing an HIV/AIDS crisis. A bright spot has been the surge in foreign investment in manufacturing in the past decade to take advantage of regional trading arrangements and (recently) the U.S. Trade Initiative for Africa, which has boosted employment and export revenue. However, further expansion of even this sector is being constrained by lack of infrastructure.

2. **During January-September 2000, the government implemented a staff-monitored economic program (SMP) and, in December 2000, in the context of the 2000 Article IV discussions, reached understandings with the staff on a program that would be supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF).** This report reviews recent developments, the government's program for the period October 2000-September 2003, and the quantitative and structural targets for the first year. The government's letter of intent and memorandum on economic and financial policies (MEFP), and a technical memorandum of understanding, are attached to the PRGF arrangement in Appendix I. Other appendices summarize Lesotho's relations with the Fund and the World Bank, discuss statistical issues, and present selected social and demographic indicators. A joint staff assessment (JSA) of the authorities' interim poverty reduction strategy paper (I-PRSP) has been issued separately to the Board (EBD/01/13 and EBD/01/14; 2/7/01).

3. **Lesotho has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the articles of agreement**, and maintains an exchange system free of restrictions on payments and transfers for current international transactions. Also, the staff has received the documentation regarding the Safeguards Assessment of the Central Bank of Lesotho. This documentation is under review, and the assessment is expected to be completed by the time of the next Board discussion in July 2001 to conclude the first review of the program.

II. Recent Developments and Performance Under the SMP

4. **Political calm has returned.** Discontent with the results of the April 1998 general elections, in which the ruling party won 79 of 80 parliamentary seats, culminated in military unrest, the intervention of Southern African Development Community (SADC) troops, and widespread looting and destruction of businesses. An Interim Political Authority (IPA) was set up to recommend electoral reform, and SADC troops have since withdrawn. In December 1999, political parties agreed to modify the electoral system by adding some parliamentary seats that would be filled by proportional representation, but the number of additional seats has not yet been agreed upon. A new voting system is also under discussion. New elections, originally scheduled for April 2000, have been put off to end-2001 or early 2002.

5. **Implementation of the SMP was broadly satisfactory**. All the performance benchmarks through end-September 2000 were observed (Tables 1 and 2), and good progress was achieved overall with structural reforms. Budgetary pressures in the first half of fiscal year 2000/01 (April–March) were stronger than expected, largely because of unanticipated payments to clear arrears to the Southern Africa Customs Union (SACU) revenue pool[1] and to settle a tax claim by South Africa concerning the Lesotho Highlands Water Project (LHWP).[2] Though the underlying fiscal performance was essentially on track, the authorities requested early distribution of customs revenue from the SACU revenue pool (end-September instead of early October) to offset these extraordinary payments and enable them to meet the end-September 2000 targets for net bank credit to the government and the net foreign assets of the central bank.

6. **Economic growth is resuming and inflation is declining.** The 1998 disturbances adversely affected activity, but economic growth is slowly recovering and is projected at 2.4 percent in 2000/01 (Figure 1 and Table 3), driven by manufacturing activity and the pickup of Phase 1B of the LHWP (which started in 1998). Unemployment, estimated at over 40 percent of the labor force, has been aggravated by the retrenchments in South Africa's gold mines during the last ten years, which have almost halved the number of Lesotho emigrant miners.[3] Miners' remittances have fallen from 60 percent of GDP in the late 1980s to 26 percent in 1999. Fortunately, the period of mass layoffs in the mines now seems to be over. Inflation, which largely reflects price developments in South Africa, fell from 6.8 percent in the 12 months ended October 1999 to 6 percent over the same period in 2000.

7. **The budget balance has deteriorated sharply since 1997/98.** The overall balance, after grants, turned from a surplus of 4.4 percent of GDP in 1996/97 to a deficit of 16.2 percent of GDP in 1999/2000, despite a large decline in capital spending associated with the completion of the construction works mentioned above (Tables 4 and 5, and Figure 2). This deterioration reflected mostly declining revenue relative to GDP, exceptional expenditures related to the 1998-99 closures of the state-owned Lesotho Agricultural Development Bank and Lesotho Bank, and the amortization of short-term debts of the Muela hydroelectric power plant. Through 2000/01,

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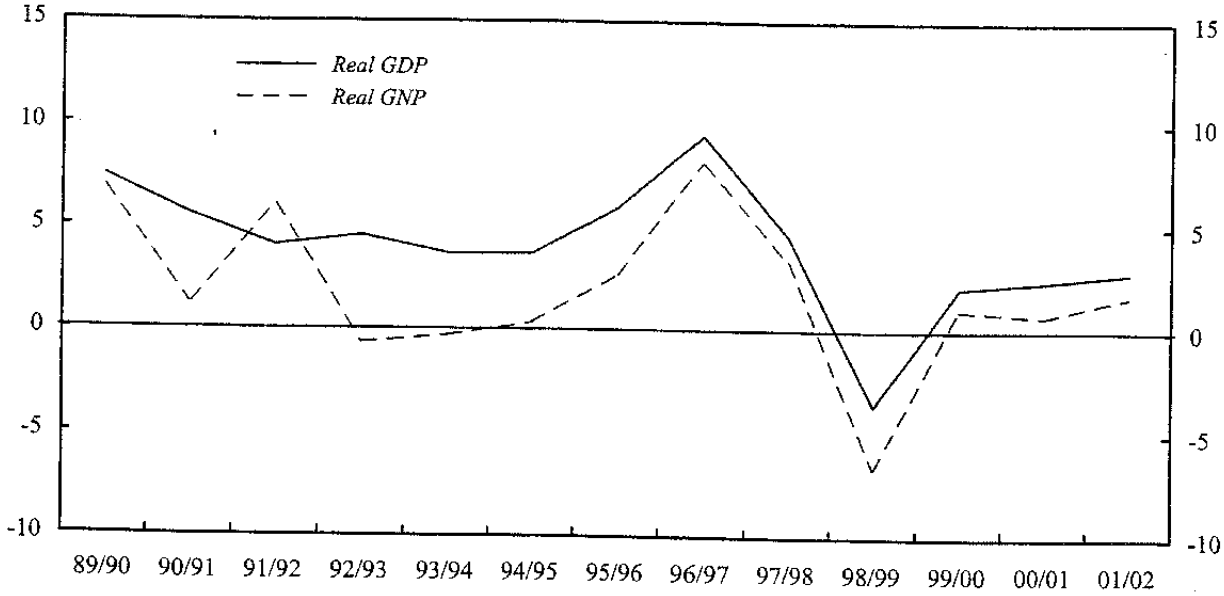
[1] Customs revenues collected by SACU members are transferred to a common revenue pool, from which they are redistributed to members according to a specified formula. Apparently by administrative error, for a brief period the Lesotho authorities were not transferring to the revenue pool amounts that they had collected.

[2] A dispute arose in connection with Lesotho's taxation of South African companies working on the LHWP, which was settled in South Africa's favor. Lesotho agreed to pay back to South Africa M 186 million (US$25 million) over ten years at 15 percent annual interest. The first installment of principal and interest was paid in April 2000, and the entire remaining balance was paid off in January 2001.

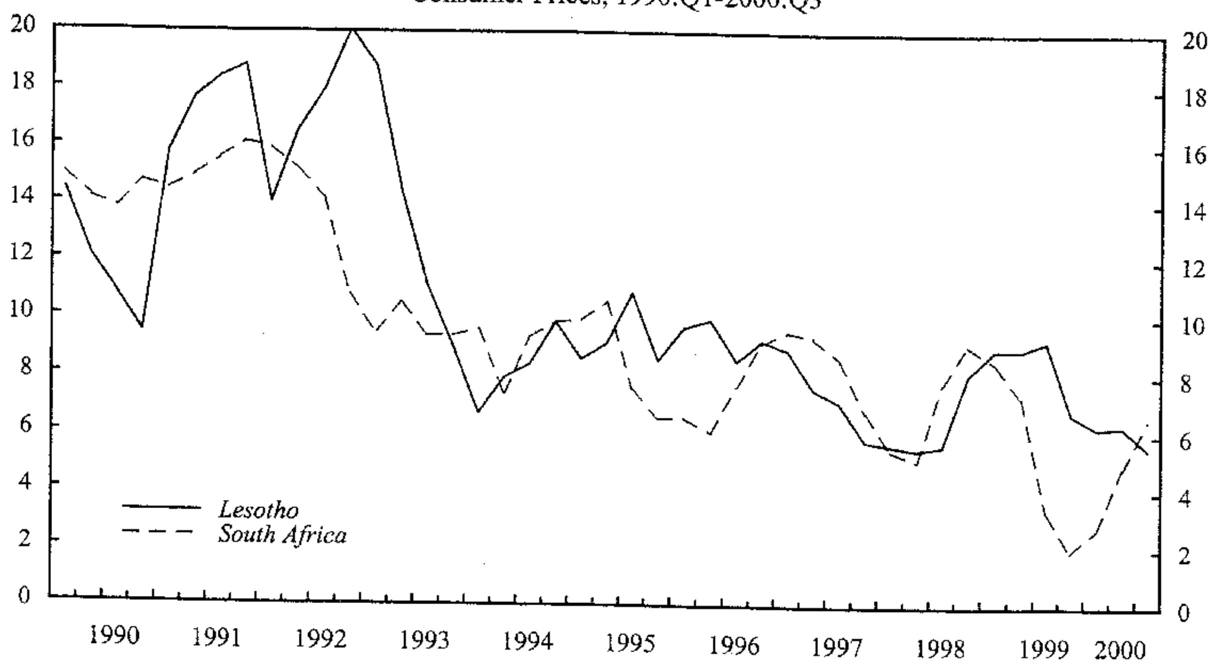
[3] In the late 1980s, about half the male labor force was employed in the mines in South Africa.

Figure 1. Lesotho: Output and Prices
(Annual percentage changes)

Real GDP and GNP, 1989/90-2001/02 1/

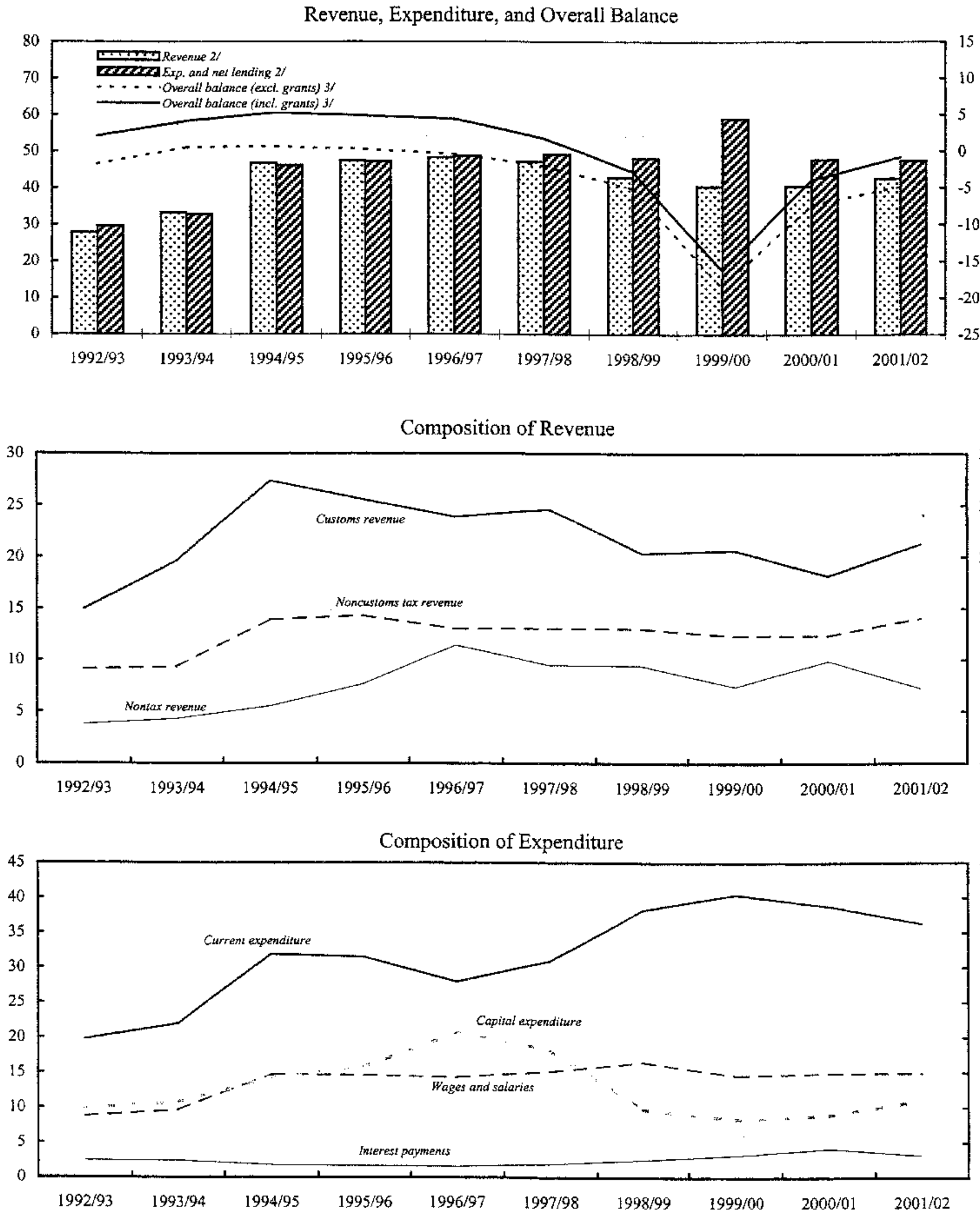


Consumer Prices, 1990:Q1-2000:Q3



Source: Lesotho authorities; and Fund staff estimates.
1/ Fiscal year begins April 1.

Figure 2. Lesotho: Fiscal Developments, 1992/93-2001/02 1/
(In percent of GDP)



Source: Lesotho authorities.
1/ Fiscal year begins April 1.
2/ Left scale.
3/ Right scale.

customs revenue has declined relative to GDP. Nontax revenue has come down to a large extent as a result of the reduction in interest income, stemming from the drawdown of government deposits at the central bank and a decline in the interest rate paid on these deposits to market rates. In the first half of 2000/01, the budget balance after grants improved to a surplus of 2.3 percent of GDP, helped by the nonrecurrence of certain expenditures that took place in 1999/2000 (Lesotho Bank closure costs and Muela debt amortization) and the early distribution of customs revenue from the SACU revenue pool referred to in paragraph 5 above. Nonetheless, budgetary pressures were stronger than expected, as mentioned in paragraph 5.

8. **External and domestic government indebtedness has increased significantly in recent years, but remains relatively low and sustainable.** In 1999, the domestic debt more than tripled to 13.6 percent of GDP as a result of a bond issue to recapitalize the Lesotho Bank prior to its privatization, while the external public debt peaked at 84.8 percent of GDP in 1998 as a result of earlier borrowing to finance construction of the Muela power plant. However, external debt service in 1999/2000 was only 8.1 percent of exports of goods, services, and income.

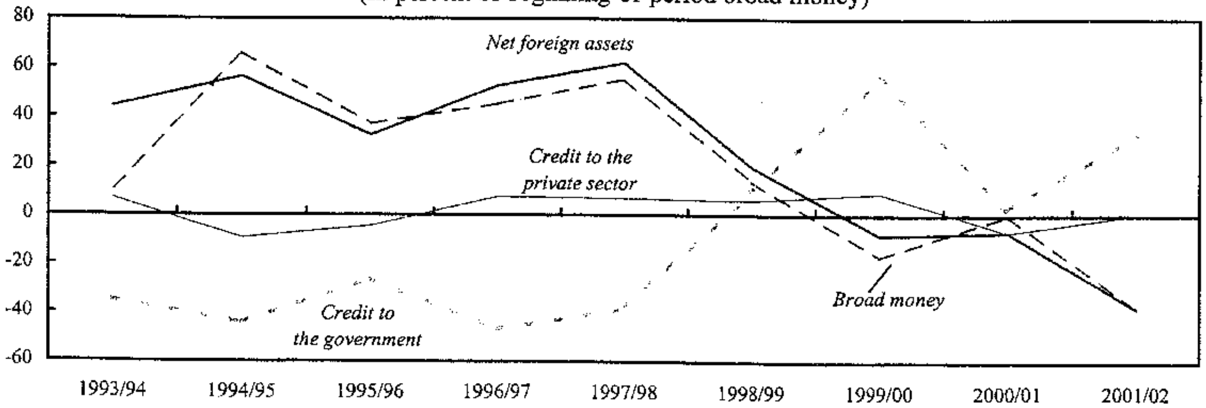
9. **Broad money and credit to the private sector have declined in the last two years** (Tables 6 and 7, and Figure 3). The decline in credit may partly reflect reporting problems associated with the closure of the two state-owned banks. However, banks complain of a lack of creditworthy borrowers, brought on by structural factors such as difficulties in recovering loans and poor financial and accounting records. These factors have led to large risk premiums on loans, and real lending rates are very high (currently about 12 percent).[4] Creditworthy borrowers can get loans at lower interest rates in South Africa. Low economic growth has also depressed credit demand. Slack credit demand has led to a considerable buildup of liquidity in the banking system, which has depressed deposit rates. Although market determined, deposit rates are currently negative in real terms as the banks seek to actually discourage deposits. This situation has led to capital flight to South Africa, where deposit rates are higher, and is a major cause of the decline in the money stock. The slack credit demand, lack of domestic money and capital markets, and foreign (South African) ownership have led the banks to invest their funds in South Africa. Capital flight by the public and foreign investment by the banks has added to the balance of payments pressures.

10. **The external current account deficit continued to narrow in 1999/2000 and in the first half of 2000/01** (Table 8), reflecting rapidly growing manufacturing exports (which in September 2000 were almost 30 percent higher than a year earlier) and lower LHWP imports. These latter two developments appeared to have offset the impact of the deterioration in the fiscal

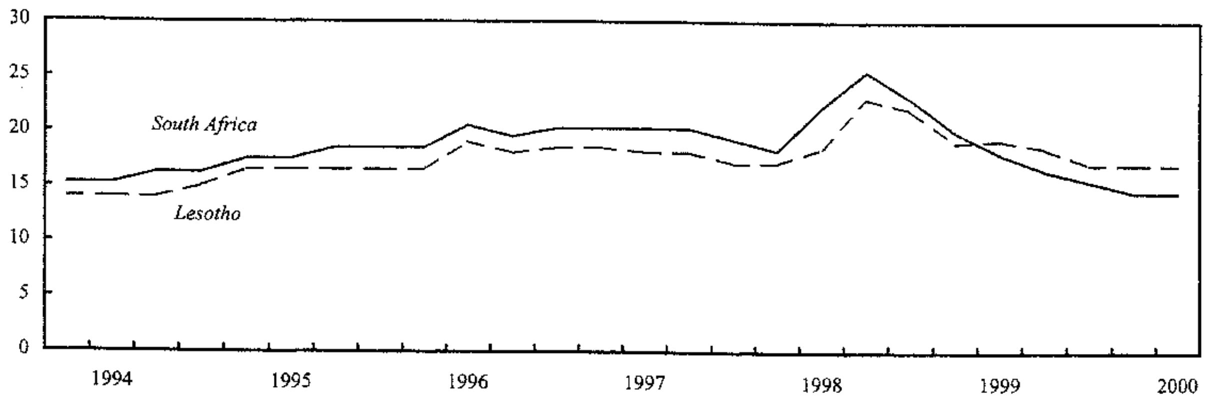
[4] Interest rates are linked to those in South Africa but are adjusted upward for risk.

Figure 3. Lesotho: Monetary Developments

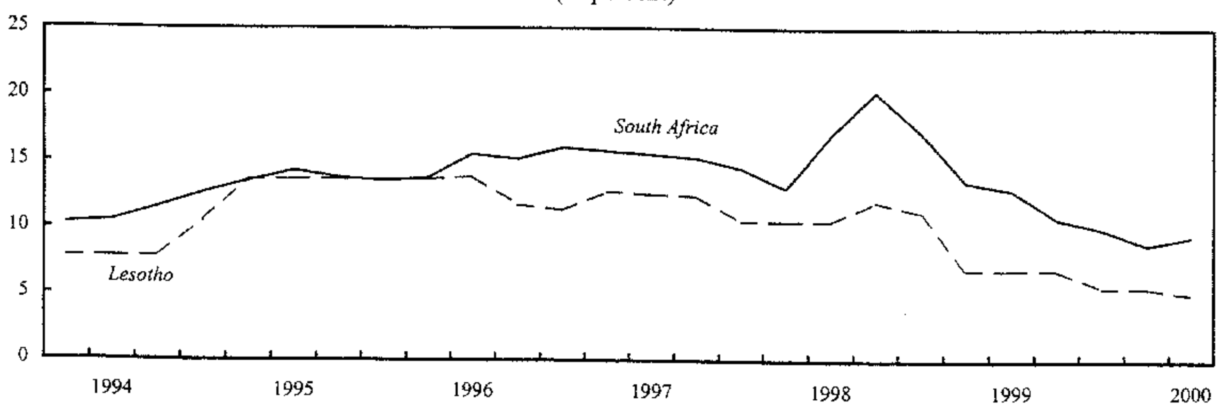
Monetary Aggregates, 1993/94-2000/01 1/
(In percent of beginning-of-period broad money)



Lending Rates, 1994:Q1-2000:Q2
(In percent)



Deposit Rates, 1994:Q1-2000:Q2
(In percent)



Source: Lesotho authorities.

1/ Fiscal year begins April.

balance and the decline in miners' remittances on the deficit.[5] The current account deficit was, until 1997/98, sustained by official grants, foreign direct investment, and public sector borrowing (much of it short term) in connection with the construction of the Muela hydroelectric power plant. Since the completion of the power plant and Phase 1A of the LHWP in 1998/99, net public sector borrowing and foreign direct investment have declined sharply, with the former becoming negative.[6] At the same time, fiscal imbalances emerged. By 1999/2000, official grants and foreign direct investment, now the main sources of external financing, could no longer sustain the current account deficit, and the balance of payments slid into deficit.

11. **Official foreign reserves have declined since 1999/2000.** Reflecting the deterioration in the balance of payments, and taking into account valuation changes, reserves fell from the equivalent of 7.9 months of imports of goods and services at end-March 1999 to about 6 months at end-September 2000. The loti, which is pegged at par with the rand, depreciated in real effective terms by 11.2 percent in the 12 months ended October 2000 (Figure 4).

12. **Under the SMP, progress with structural reforms was achieved on several fronts.** A major tax reform (introduction of a value-added tax and establishment of a National Revenue Authority), a public expenditure review, and a wide-ranging reform of the public sector have started, and a Fiscal Analysis and Policy Unit was set up at the Ministry of Finance to provide technical support on budgetary issues and program implementation. Under a privatization project being implemented with World Bank support, more than 50 state-owned enterprises and parastatals have been identified for divestiture or closure, and several major enterprises have already been privatized or closed (including the telecommunications, flour mill, airline, pharmaceutical, insurance, and government plant and vehicle pool companies). In 2000, the government initiated efforts to restructure and eventually privatize the electricity company. A telecommunications regulatory authority has been created, and a commercial court became operational in May 2000. Domestic petroleum prices are being reviewed monthly by an independent petroleum board and are adjusted automatically in accordance with a formula to reflect movements in international oil prices.

13. **Financial sector reform has made significant strides.** The banking sector underwent a major overhaul in 1998-99 with the closures of the Lesotho Agricultural Development Bank and the Lesotho Bank, which are currently under liquidation.[7] This sector now comprises two private,

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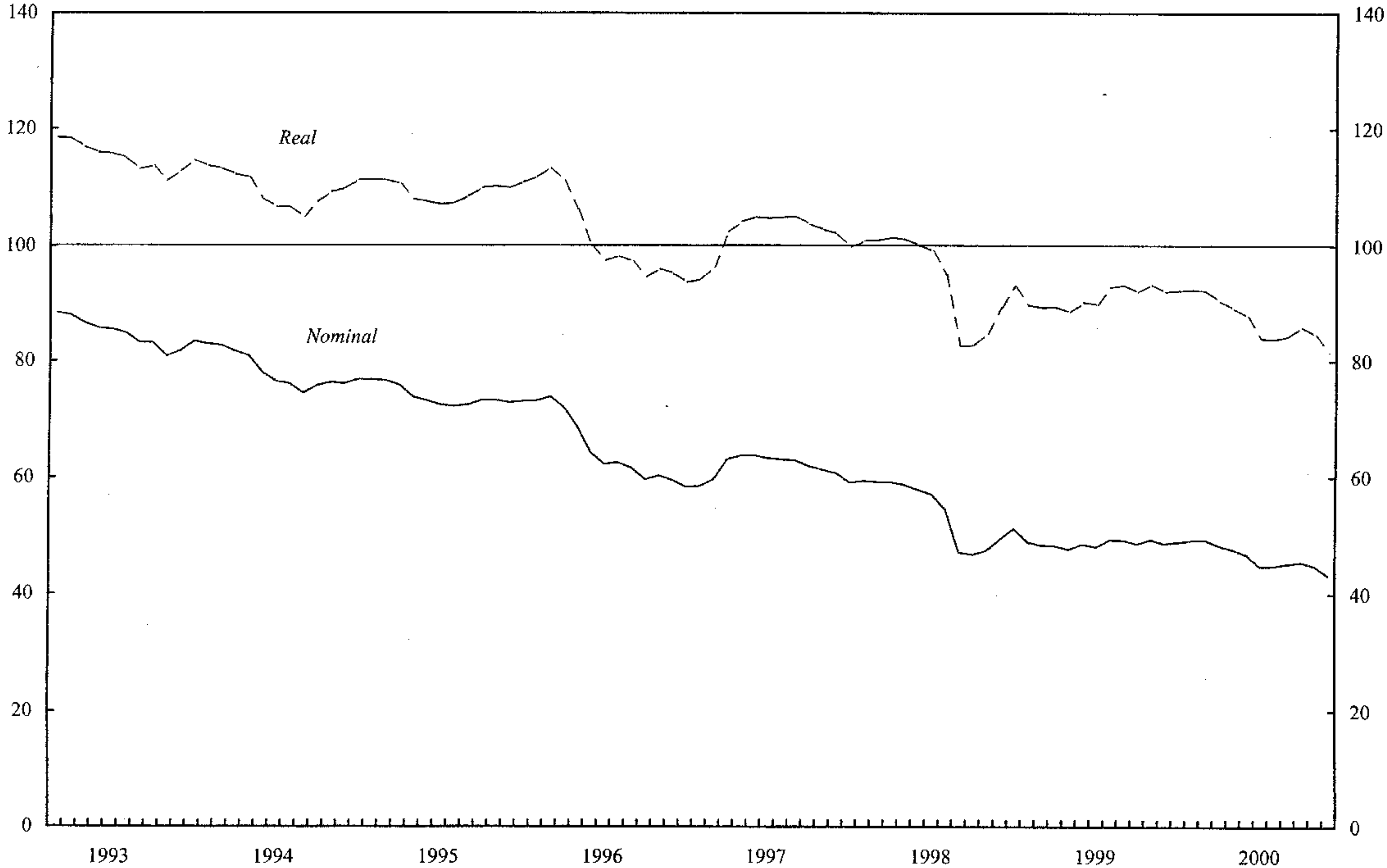
[5] The deterioration in the fiscal balance did not have a full impact on the current account deficit, as explained in Box 2.

[6] Phase 1B of the LHWP is much smaller than Phase 1A.

[7] The deposit liabilities and performing loans of the Lesotho Bank were taken over by a private bank in 1999, which received government bonds (totalling M 575.7 million) to settle the difference between the liabilities and the assets taken over.

Figure 4. Lesotho: Effective Exchange Rates, January 1993-October 2000
(Index, 1990=100)



Source: IMF, Information Notice System.

foreign-owned banks. Bank supervision improved with the enactment of the Financial Institutions Act and the Central Bank Act, the creation of a bank supervision department within the central bank, and the development of a reporting format for off-site surveillance of banks. The Financial Institutions Act brought prudential regulations up to international standards, while the Central Bank Act strengthened the powers and independence of the central bank and prohibited lending to the government except for short-term cash management purposes. Efforts have been initiated to develop a treasury bill market, introduce indirect instruments of liquidity control, improve the payments system, and streamline accounting and statistical procedures.

14. **Poverty and the escalating HIV/AIDS crisis remain major social concerns.** According to the World Bank, 40 percent of the population lives in absolute poverty and about one-fourth of all adults are HIV-positive. In consultation with the broader society, and with donor support, the government has begun devising a comprehensive poverty reduction strategy. In the meantime, it has proceeded with piecemeal efforts to improve access to social infrastructure and to education and health services. In the last few years, HIV/AIDS has become the greatest public health problem, threatening to overwhelm the country's health resources and curtail economic growth (Box 1).

Box 1. The Present HIV/AIDS Crisis in Lesotho

Like the other countries in southern Africa, Lesotho is facing an HIV/AIDS pandemic of crisis proportions. According to UNAIDS, in 1999 about 24 percent of adults of age 15-49 years were HIV positive (not counting full-blown AIDS cases). Moreover, infection rates are still on the rise, despite growing public awareness of transmission risks.

Such high HIV prevalence rates imply that about 6-10 percent of carriers will die each year, depending on their access to medical care to fight primary infections. At present, Lesotho does not have the resources to provide antiretroviral drugs, and, even if their cost could be covered, it would not be possible to effectively dispense them through the country's rudimentary health system. As of end-1999, at least 16,000 people had died of AIDS, and average life expectancy had been reduced to 52 years, from 60 years in 1991.

The expected mortality from AIDS also implies that in three-four years Lesotho will start to lose about 2 percent of its working-age population each year. A recent World Bank report projects that the annual loss of economic growth will rise from 0.6 percentage points in 2001 to 2.7 percentage points by 2015. With the public sector accounting for 43 percent of all employment, HIV/AIDS-related absenteeism, medical treatment, pension payments, and staff replacement and retraining will add up to 5 percent of the government wage bill per year. The impact of AIDS will also be harder on the poor, who are less educated about prevention and more vulnerable to rising medical costs and loss of income.

The Lesotho government's response to the crisis has been in the form of public education campaigns and, with donor support, distribution of prophylactics to individuals in high-risk groups. In response to growing public concern, these efforts have been intensified over the past two years but have so far been unsuccessful in bringing drastic changes in sexual behavior and lower infection rates.

Source: World Bank, *Lesotho: The Development Impact of HIV/AIDS*; October 18, 2000

III. The Policy Discussions: Economic Growth Issues

15. The staff and the authorities were in agreement on the nature of the economic challenges confronting Lesotho and on the appropriate policy responses. **They highlighted the need to boost employment through higher economic growth, and to diversify the production base by attracting investment to manufacturing and nontraditional activities (such as tourism).** The authorities also remained firmly committed to macroeconomic stability, which they realized was crucial for the attainment of the longer-term growth objectives. While the economic strategy emphasizes export-led growth, smallholder agricultural development is also being pursued as a key means of raising incomes and reducing poverty in rural areas. Given a population growth rate of close to 3 percent a year, the government has targeted economic growth at a minimum of 4 percent a year in the medium term.

16. **The government regarded the private sector as a key partner in the development process, and indicated it will continue to pursue policies that attract private investment and reduce its intervention in economic activity.** These include structural reforms, privatization of state-owned enterprises, liberalization of the capital account, and improvement and expansion of the infrastructure. They are set out in the authorities' MEFP. The authorities attached particular importance to reducing the cost and improving the quality of public utility services. Hence, they are focused on restructuring and privatizing the utilities. Following the telecommunications company, the electricity company is to be privatized and a study on the future of the Muela power plant is to be conducted shortly. Noncore functions, as well as the management, of the water authority may also be privatized.

17. **The authorities were concerned about the lack of savings mobilization by banks, the high cost of credit, and the lack of credit to the private sector, particularly to small and medium-sized enterprises.** The closure of the Lesotho Agricultural Development Bank left a void in rural financial intermediation, which the authorities are trying to fill through the development of rural microsavings institutions. They will keep interest rates market determined, but are seeking to lower the spread by encouraging competition in the banking system, reducing intermediation costs, and expanding local investment opportunities for banks. Thus they are trying to attract a third bank, have lowered the reserve requirement to 5 percent and unified it across all classes of deposits, and are developing a treasury bill market, as mentioned above. The authorities have recently set up a commercial court to help enforce loan contracts and reduce lending risks. The staff indicated that it fully supported these efforts.

18. **Consistent with its export-led approach to growth, the government stated that it continues to exploit regional trading initiatives (the U.S. Trade Initiative for Africa, SADC, and the Europe-African, Caribbean, and Pacific (ACP) countries' Cotonou Agreement) and reduce nontariff barriers to trade** (see MEFP). Lesotho does not have unilateral control of its tariff regime, which is currently set multilaterally within the context of SACU. Import licenses are required of all importers, and they are in most cases granted freely. However, certain imports (such as used cars) are prohibited by agreement with South Africa, in order to prevent Lesotho from being a conduit for smuggling into South Africa. Import quantities are monitored for the

same reason. There are few nontariff barriers, most of which are of a seasonal nature, designed to protect agricultural production at harvest time. Beer production is the main manufacturing activity protected, but bread imports have at times also been restricted in the past.[8] The mission urged the elimination of these nontariff barriers. The authorities defended the seasonal agricultural restrictions on the grounds that South African producers had technological and scale advantages, and were also subsidized. They claimed that dumping by South African producers in Lesotho was common. However, they agreed to review the limits on imports of beer and other products, with a view to abolishing them.

19. **The targeted increase in economic growth would require an increase in saving and investment.** Accordingly, government saving is projected to rise sharply until 2001/02 and more gradually thereafter (Table 3). Private saving, dampened by the increase in the fiscal effort, is expected to continue to decline until 2001/02 before recovering. Overall, gross national saving will rise by about 5 percentage points of GDP in the medium term. Private investment (excluding investment in the LHWP) is expected to be the main source of investment growth in the future. Investment in the water project is projected to continue to decline. Thus gross domestic investment will initially decline (dominated by the decline in LHWP investment), before recovering to about ½ of 1 percentage point of GDP above its current (2000/01) level.

IV. The Policy Discussions: Financial Management Issues

20. **Lesotho plans to continue its membership in the Common Monetary Area (CMA) and will maintain the fixed, one-to-one parity between the loti and the rand.** The staff supported this policy. Although the fixed exchange rate and the joint circulation of the loti and the rand have limited Lesotho's capacity to conduct an independent monetary policy, these arrangements have contributed to monetary stability and helped keep inflation relatively low. In addition, CMA membership is warranted by the close economic and financial integration of the Lesotho and South African economies.[9]

21. **CMA membership, economic and financial integration with South Africa, and the undeveloped financial system and consequent lack of indirect monetary policy instruments have two important policy implications for Lesotho.** First, inflation is largely imported from South Africa. Therefore, the main objective of financial management is to preserve external balance. Second, fiscal policy is all-important in Lesotho, given the limitations on the use of

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[8] Lesotho has a rating of 6 in the Fund's scale of trade restrictions, which goes from 0 to 10, with 10 representing the most restrictive trade regime. This rating is expected to improve notably as tariffs are reduced in the context of regional trade liberalization, such as under the SADC.

[9] Capital is mobile between the two countries, interest rates are linked, and the bulk of Lesotho's trade is with South Africa.

monetary policy (Box 2). There were, then, three core aspects of the discussions on financial management:

- to agree on a fiscal path that is consistent with the authorities' balance of payments targets,

- to agree on a set of measures that would strengthen the capacity of the government to attain the desired fiscal path, and

- to develop the capacity of the central bank to manage liquidity conditions, with a view to influencing balance of payments flows.

It should be noted that the government's economic growth strategy outlined above should also contribute to external balance in the medium term, because of its emphasis on export development and foreign direct investment. This emphasis constitutes a bridge between the short term and the medium term, or between the economic growth and financial management components of the program.

A. Macroeconomic Objectives

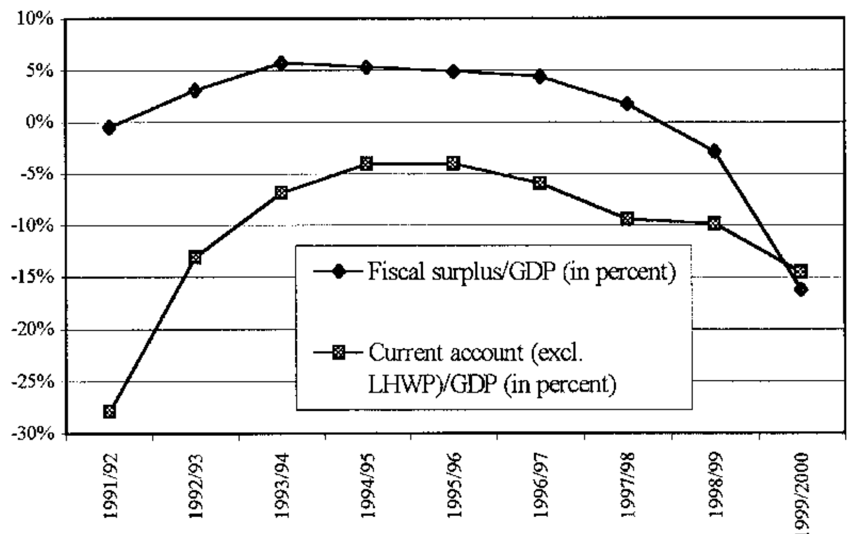
22. **The primary macroeconomic objective of the program is to keep gross international reserves at the equivalent of at least 6 months' worth of imports of goods and services.** In deciding on this target, the authorities and staff took into account Lesotho's extreme vulnerability to external developments and its fixed exchange rate system. In absolute terms, reserves are expected to continue to decline in the remainder of this fiscal year, but to gradually rise thereafter. Inflation (on an end-period basis) is projected to decline gradually to about 5 percent in the medium term, following price trends in South Africa.

23. **Other macroeconomic objectives are to contain the external current account deficit at levels that can be sustained by external grants and long-term capital and financial inflows, and to keep the external debt low and sustainable.** The current account deficit (excluding official transfers) is projected to continue to decline in the medium term, and will be fully financed by external grants, foreign direct investment, and net public sector borrowing (see Tables 3 and 8). Net public sector borrowing is projected to become positive again from 2001/02 onward, and, consistent with the debt objective, all such borrowing will be limited to concessional loans. After peaking at 14.7 percent in 2001/02, the external public debt service ratio will decline gradually to 7.6 percent by 2003/04.

Box 2. The Relationship Between Fiscal and External Balance in Lesotho

Lesotho is a small, open economy; there is a close correspondence between the fiscal balance and the external current account balance (see figure below). In the 1990s, movements in the current account balance (excluding flows on account of the LHWP), in percent of GDP, mirrored those in the fiscal balance. The relationship between the two appeared to have weakened in the late 1990s. However, this reflected the fact that the deterioration in the fiscal balance in this period stemmed mainly from noncash expenditures (issue of bonds in 1999 to the bank that took over the deposit liabilities and good assets of the Lesotho Bank) and higher debt-service payments on behalf of the Muela hydroelectric power project. When these two factors are taken into account, the close relationship between the two variables is maintained.

The Fiscal Deficit is being reflected in a Current Account Deficit



The strong relationship between the fiscal balance and the external current account balance reflects the important role of the government in the economy, the high proportion of traded goods in the economy, and the high degree of capital mobility. Government expenditure is a major component of domestic demand, the bulk of which is satisfied through imports, while monetary policy has been unable to sterilize fiscal operations. One of the objectives of the program is to develop the central bank's capacity to influence liquidity conditions and thus the balance of payments.

B. Fiscal Policy and Fiscal Reforms

24. **The most difficult part of the discussions concerned the size and speed of fiscal adjustment.** A decision on this matter involved balancing the medium-term growth and poverty objectives against the short-term balance of payments constraints. In the interest of supporting country ownership of the program, the staff always used the authorities' proposals as the starting point of the discussions; the authorities always preferred a slower path of adjustment. In the end, an adjustment path was agreed to that was a compromise between the authorities' and the staff's positions, but which was compatible with the authorities' macroeconomic objectives.

25. **In 2000/01, the budget deficit after grants is targeted to fall sharply to 3.9 percent of GDP, the decline accounted for entirely by lower expenditure** (see Tables 5 and 6). As mentioned above, there were nonrecurrent expenditures in 1999/2000, mainly in connection with the closure of the Lesotho Bank. In addition, in response to budgetary pressures, the government has instituted a 10 percent cut in nonwage, noninterest current expenditure in the remainder of the fiscal year. The deficit, in conjunction with the amortization of external debt (mainly the settlement of the tax debt with South Africa), is expected to result in a drawdown of government deposits at the central bank amounting to 7.8 percent of GDP.

26. **In 2001/02, the budget deficit after grants is targeted to shrink further to 0.8 percent of GDP, this time mostly through a revenue increase.** After declining steadily in previous years, customs revenue received from the SACU revenue pool is projected to increase in 2001/02. Noncustoms tax revenue is also expected to increase significantly with the creation of the National Revenue Authority to improve tax administration. These increases will more than offset a decline in nontax revenue stemming from the nonrecurrence of certain onetime revenues received in 2000/01. Total expenditure is targeted to fall by about 0.3 percent of GDP, as a decline in nonwage current expenditure will partially offset an increase in capital spending. Nonwage current expenditure will decline partly because there were nonrecurrent expenditures in 2000/01 (see paragraph 5), but it will also reflect lower interest payments and an attempt to hold down expenditures in nominal terms relative to GDP. The government is expected to accumulate deposits in the banking system for the first time in several years.

27. **From 2002/03 onward, the budget balance after grants will continue to improve, turning to a surplus by 2003/04.** This improvement will be achieved through increases in noncustoms tax revenue, which will just offset a renewed decline in customs revenue relative to GDP,[10] and reductions in expenditure. The cumulative adjustment in expenditure is slightly larger than that in noncustoms tax revenue. With an improving budget balance and increasing net foreign concessional borrowing, the government will continue to accumulate deposits in the banking

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[10] Customs revenue will jump to a higher level in 2001/02, but thereafter it is projected to grow only slowly in nominal terms, so that, relative to GDP, it will decline again.

system in the medium term, thereby making increasing room for the growth of credit to the private sector.

28. **A major issue was whether the fiscal adjustment should take place via increases in revenue or reductions in expenditure.** Both tax revenue and expenditure are high relative to GDP (31 percent and 48 percent, respectively, in 2000/01),[11] although this situation may partly reflect an underestimation of GDP. The mission, therefore, recommended that the overall revenue effort remain unchanged in the medium term (from 2001/02 onward), and that a strong attempt be made to bring expenditure down relative to GDP. The authorities agreed with this approach.

29. **As indicated above, the overall revenue effort will be maintained through the tax reforms being undertaken. The more difficult problem relates to expenditure control.** The 2001/02 expenditure proposals submitted by the line ministries greatly exceed the expenditure levels agreed in the program, but the Minister of Finance has given his undertaking that the budget submitted to parliament will conform to the one agreed with the staff. The two most sensitive issues were the wage bill and capital spending. The authorities aim to lower the wage bill over the medium term to about 13.5 percent of GDP, from 14.9 percent of GDP in 1999/2000. However, in the short term there will be upward pressures on the wage bill arising from the civil service reform and the restructuring of salaries, the desire to fill a large number of vacancies, and the need to increase the number of teachers as a result of the phased introduction of universal free primary education in January 2000. The staff has urged the authorities to freeze hiring until the public expenditure review has been completed.

30. **In the case of capital expenditure, the authorities were concerned that the program would limit their ability to utilize available external financing, while the staff was concerned about absorptive capacity.** However, all projects with firm financing were included in the program targets for 2000/01 and 2001/02. The staff emphasized that the program would be reviewed every six months, and that at the time of each review the program targets could be revised, if the external financing prospects had changed.

31. **A number of fiscal reforms are being implemented to improve budgetary performance, strengthen the civil service, and increase efficiency and transparency in the public sector.**[12] A National Revenue Authority is expected to replace the existing sales tax, income tax, and customs departments on September 30, 2001, and a value-added tax is scheduled to replace the sales tax on April 1, 2002. Meanwhile, the government is implementing various short-term measures to strengthen tax administration on the advice of the IMF regional tax advisor stationed in Maseru since August 2000. The public expenditure review, a "white paper" on which has been

[11] Customs revenue includes SACU grants. If these are excluded, tax revenue falls to 27.5 percent of GDP in 2000/01.

[12] Additional details are provided in the authorities' MEFP.

prepared, is expected to be completed by March 31, 2002. The authorities are also implementing a long-term Public Sector Improvement and Reform Project, the first three-year phase of which involves improvements in financial management, human resources management, governance, the administration of justice, the organization of the government machinery, the delivery of services, and the distribution of government power (decentralization). The public expenditure review and the reform project will play crucial roles in executing the proposed reduction in expenditure relative to GDP over the medium term.

C. Liquidity Management and Financial Sector Reform

32. **An important element of the program is the effort by the central bank to strengthen its capacity to influence domestic liquidity conditions and thereby help achieve the balance of payments targets.** Thus far the central bank has relied on direct instruments of liquidity management, and even these have been rarely used. Given the lack of a money market, the central bank has been unable to use indirect instruments of monetary policy. With Fund technical assistance, the central bank aims to establish by end-July 2001 a regular mechanism for treasury bill auctions that will facilitate the use of open market operations to attain the program targets for the net domestic assets of the central bank. Once the treasury bill mechanism has been put into place, the central bank plans to abolish the minimum local assets requirement (currently 60 percent) and stop remunerating excess reserves.

33. The staff supported the use of indirect instruments of monetary policy. However, it cautioned the authorities that **effective functioning of the treasury bill market would require that the authorities allow the treasury bill rate to rise to whatever level is dictated by market forces.** Given the authorities' concern about the impact of high interest rates on investment demand, and also with an eye on the budgetary costs of sterilization, there is the possibility that they would try to target the interest rate, as well as the volume of treasury bills.[13] This is especially likely in the present situation of very high liquidity in the banking system. However, the Ministry of Finance has agreed to give the central bank the authority to issue treasury bills in whatever amounts are needed for liquidity control purposes, and the central bank has assured the staff that the auction mechanism will be driven solely by liquidity considerations. Also, the staff pointed out that, while sterilization would result in higher interest payments by the government, these could be at least partially offset by larger profit transfers from the central bank to the government. The amounts of these transfers would need to be agreed between the government and the central bank.

34. **With the privatization of the two loss-making state-owned banks, the banking system is now in sound financial condition.** The central bank will continue to strengthen bank supervision and enforce the prudential regulations, and to modernize the payments system. Also, the central

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[13] As mentioned above, interest rates follow closely those in South Africa, so there is only limited scope for the authorities to influence the rates.

bank is studying the possibility of completely liberalizing the capital account, and discussions are underway with South Africa on this issue (see paragraph 19 of the authorities' MEFP).

V. The Policy Discussions: Poverty and Social Sector Issues

35. **Economic growth and employment generation remain the linchpin of the government's plans to reduce poverty**, and the I-PRSP briefly outlines the medium-term growth strategy the government intends to pursue in that respect.[14] The strategy described above is fully consistent with that outlined in the I-PRSP.

36. **The program is expected to have a positive impact on poverty reduction** through economic growth and through increased emphasis on the social sectors in the budget. The staff agreed to a larger budget deficit for 2000/01 and 2001/02 than it initially thought desirable from a macroeconomic perspective, in order to accommodate the additional capital spending, which it felt would contribute to growth and poverty reduction. In 2001/02, capital spending is projected to increase by 2.2 percentage points of GDP because of the restructuring of the electricity company in preparation for its privatization, the construction of additional factory space to allow the manufacturing sector to continue to expand, and the ongoing phased introduction of universal free primary education. These expenditures will also carry over into subsequent years, which, together with the need for increased infrastructure, explain why capital expenditure is kept at a higher level in the medium term.

37. **In 2001/02, the program also targets an increase in the share of health and primary education in total current spending.** The specific targets are being finalized now by the authorities in the context of the budget for 2001/02. Thereafter, social sector spending targets will be fixed in the context of the poverty reduction strategy. In addition to universal free primary education, which is being phased in over several years, the government is trying to provide free emergency hospital care to some terminally ill AIDS patients.[15] The budget also includes funding for the Lesotho Fund for Community Development, which finances rural development projects.

38. **There are not expected to be any adverse price effects as a result of the program.** The automatic adjustment of domestic petroleum prices in line with movements in international prices will continue, but this measure does not appear to have generated any significant adverse effects as inflation has been coming down. However, the authorities are making a strong effort to reduce utility costs and improve the quality of utility services through restructuring and privatization of the utility companies. For example, electricity prices are expected to decline as a result of the reforms taking place in the electricity sector. As mentioned above, efforts are also being made to

[14] See the joint staff assessment of the interim PRSP.

[15] Hospital fees remain in place for most patients.

reduce bank interest rate spreads and develop rural microfinance schemes, which would have a favorable impact on small and medium-sized enterprises and on microenterprises in rural areas.

39. **One possible adverse effect of the program would be the downsizing of the civil service.** Although this is expected to take place through attrition and elimination of "ghost" workers rather than through retrenchment, it would also mean the placing of limits on additional employment in the government. Should the private sector be unable to take up the slack, the result would be higher unemployment in the medium term. However, given the expectations of a pickup in economic growth, this outcome is unlikely.

VI. Performance Benchmarks

40. To monitor program implementation, **quantitative and structural performance criteria and benchmarks are specified in Tables 1 and 2 of the government's MEFP.** The quantitative targets will be evaluated quarterly, beginning with end-December 2000. The end-March 2001 benchmarks will constitute performance criteria. The first review under the program is scheduled for completion by end-July 2001.

41. **Structural performance benchmarks and criteria have been set in the areas of tax reform, tax administration, expenditure control and rationalization, financial sector reform, and statistics strengthening, all core areas of Fund responsibility.** The performance benchmarks do not cover civil service reform (except for the financial management component) and privatization, although these are important elements of the program. During program reviews, the staff will report on the progress made in implementing the reforms in these two areas, drawing on the World Bank staff's assessment of such progress. The World Bank does not plan to have a Poverty Reduction Support Credit (PRSC) for Lesotho in the near future, but it does have three sector projects in the areas of public sector reform, electricity sector reform, and privatization. These will be the vehicles for monitoring the progress of reform in these areas.

VII. The Environment for Program Implementation and Program Risks

42. Over the years, Lesotho has established a positive track record of implementation of Fund programs and of cooperation with Fund staff. **Thus, the major country risk would appear to be of a political nature.** The political upheaval of 1998 led to a postponement of plans to implement a Fund-supported program and to a fall in private investment, but the return of political calm and the resumption of the ongoing dialogue among political factions in the country has restored investor confidence in Lesotho.

43. **There is some risk in relying on expenditure cuts to achieve the desired fiscal adjustment in the first year of the program**, in view of the forthcoming elections. Already there are pressures from within and outside the government to increase spending, particularly on wages and salaries and on capital spending, as mentioned above. However, the authorities have said that they are firmly committed to implementing the program as agreed, especially as regards

expenditure control, and so far have been able to resist demands for higher spending in the budget for 2001/02.

44. **The external environment is also another source of risk, given the extreme openness of Lesotho's economy.** The leading manufacturing sector is export based and would be seriously affected by a rise of protectionist trends abroad. Moreover, firms in this sector are of the assembly type that can quickly and easily relocate to other places as the business climate changes. Thus, Lesotho has to make a strong effort to produce an attractive business environment in order to attract as well as to retain investors. Also, the economy is substantially dependent on foreign aid, the flows of which are often unpredictable and beyond the control of the government. Shortfalls in aid disbursements would make it difficult to meet the program targets.

45. **The technical capacity to implement the program is limited by a lack of qualified staff in the civil service.** The success of new reforms will continue to entail substantial technical assistance, in particular in the areas of tax policy and tax administration, government financial management, public sector reform, private sector development, privatization, financial sector reform, and statistics. Fortunately, the authorities have secured assistance from multilateral and bilateral donors, including the Fund and the World Bank, in undertaking the reforms in these areas.

46. **As indicated in Appendix IV, there is significant room for improvement of the statistical database, especially in the areas of national accounts and the balance of payments.** The Bureau of Statistics is understaffed and very weak, although it is being strengthened through technical assistance from the European Union in conjunction with Statistics Sweden. Nevertheless, the database is adequate for Article IV consultation purposes.

47. **However, effective program monitoring will require an improvement in the quality, timeliness, and frequency of production of data, especially fiscal data.** There is a major risk that the quantitative benchmarks will not be observed because data are not made available in time for corrective action to be taken. To remove this impediment, the program has two benchmarks relating to the production of fiscal and monetary data. Lags in the production of balance of payments data will also need to be reduced to no more than 45 days. The lack of monitorable indicators is even more of a problem in the social sectors, though this issue is being addressed in the context of the PRSP. A committee has been set up to oversee implementation of the program, comprising representatives from the line ministries and the central bank. It will be meeting on a weekly basis. The recently established Fiscal Analysis and Policy Unit in the Ministry of Finance, in collaboration with the central bank, is expected to play a central role in program monitoring. The unit is currently hiring additional staff, and is being strengthened through technical assistance from the European Union and the United Kingdom. Institutional strengthening through the civil service reform will also help improve monitoring capability in the medium term.

VIII. External Financing Requirements

48. Notwithstanding the recent improvement in the current account and the good prospects for export growth, **Lesotho's external financing requirements will remain large in the medium term** (Table 9). However, no financing gaps are projected after PRGF-related disbursements.

49. **In 2000/01 and 2001/02, one-third of the gross external financing requirements will be met by private sector inflows, nearly all in the form of foreign direct investment, and the remainder by concessional bilateral and multilateral financing.** On average over these two years, external grants will account for 80 percent of concessional financing, bilateral loans for 15 percent, and multilateral loans for 5 percent. Key multilateral donors are the IMF, the World Bank, the European Union, and the African Development Bank.

50. **Proposed Fund financing over the three years of the PRGF arrangement amounts to SDR 24.5 million** (70 percent of quota), disbursed in seven equal semiannual tranches beginning in February 2001 (Table 10). This access level takes into account Lesotho's outstanding obligations to the Fund (24.4 percent of quota at December 31, 2000), its good record of repayments and continued good capacity to repay the Fund, its balance of payments need, and the strong fiscal adjustment envisaged.

51. **Debt-service payments to the Fund, taking into account the disbursements under the proposed PRGF loan, are projected to decline from 2.2 percent of exports of goods and nonfactor services in 2000/01 to 0.7 percent in 2003/04** (Table 11). In relation to the total debt service of the nonfinancial public sector, they peak at 10.9 percent in 2001/02 and then decline sharply to 4.4 percent in 2003/04. Lesotho generally has serviced its obligations to the Fund in a timely manner, although there have been frequent administrative delays in making payments that need to be addressed. There are no new developments increasing the risk of default.

IX. Staff Appraisal

52. **The Lesotho economy is experiencing a downturn of economic growth, high unemployment and poverty, and fiscal and balance of payments pressures.** To address these problems, the authorities have formulated a three-year program that proposes a combination of growth-oriented policies to stimulate investment and exports and boost employment, and prudent financial management to restore external balance. The program relies mainly on fiscal policy to control aggregate demand, given the limitations of monetary policy, but it also seeks to develop the central bank's capacity to influence liquidity conditions as a supplement to fiscal policy.

53. **The strategy proposed is appropriate for Lesotho.** The structural nature of the problems and the persistence of poverty make the PRGF the proper instrument of Fund assistance. The outward-looking approach and emphasis on the private sector are the only viable alternatives in Lesotho's circumstances, but the strategy also correctly stresses small and microenterprise development, such as smallholder agriculture, to broaden the base of growth and maximize employment generation. The short-term and medium-term policies complement each other, as

stability is essential to growth, which, owing to its export-led nature, will in turn feed back positively onto the balance of payments. The staff would encourage the authorities to eliminate the remaining nontariff barriers to help diversify the production base and attract investment in nontraditional activities.

54. **The program focuses on a few, albeit critical, structural reforms.** These include the reform of tax policy and tax administration, expenditure control and rationalization, reform of the budgetary process, public sector reform, privatization, financial sector reform, and statistics strengthening. Again, the staff considers this a wise approach, given the limited technical capability in the government. It would have been desirable to have a more ambitious timetable for some of the reforms, but the need for technical assistance has dictated the pace of progress in most cases.

55. **The size of the proposed fiscal adjustment is adequate because it is consistent with an improvement in the external current account balance and the maintenance of gross international reserves at the targeted level.** The adjustment is executed through both increases in noncustoms tax revenue and current expenditure reductions; however, on average over the three-year program period, the cumulative adjustment in current expenditure is slightly larger. This distribution of the adjustment burden is appropriate, given the substantial scope for increasing noncustoms tax revenue due to tax evasion and the high ratio of current expenditure to GDP. Capital expenditure is kept constant (relative to GDP), which is desirable given the objective of raising economic growth.

56. **There is clearly a need to lower and rationalize government expenditure.** A reduction in the size of government would facilitate the authorities' outward-looking approach to economic growth, with its stress on the private sector. In particular, the staff would have liked to have seen a reduction in the wage bill relative to GDP in 2001/02, in line with the authorities' medium-term objective, but it understands the constraints involved. Ideally, the expenditure decline should occur in the context of the public expenditure review, and the staff would urge the government to complete this review as early as possible. The public sector reform and improvement project is also a potentially powerful instrument for improving financial management and the budgeting process, as well as the efficiency and transparency of public sector operations, and it merits high priority.

57. **The reduction or elimination of subsidies and transfers to public enterprises is an important element of the fiscal adjustment.** Thus, the privatization of public enterprises and closure of loss-making ones will play a major role in strengthening the budget, in addition to encouraging private sector development. Significant progress is being made.

58. **The current monetary arrangement with South Africa has served Lesotho well, especially by keeping inflation low, and its continuation is therefore warranted.** However, the arrangement would need to be backed by financial discipline. The central bank is correct in trying to develop its capacity to maintain such discipline through open market operations in treasury bills. In the past, the central bank has been in effect a passive onlooker, while fiscal policy

slippages fed through to the balance of payments. With the targeting of net domestic assets and the introduction of the treasury bill auction mechanism, the central bank is poised to play a more active role in liquidity management, with a view to influencing reserve levels.

59. **The efforts of the central bank to reduce the wide interest rate spreads, encourage financial intermediation, mobilize domestic savings, and reduce capital flight are welcome.** Again, though, this will not be an easy task because borrowers and lenders have easy access to the South African financial markets and because of the structural factors mentioned earlier. The banking system is sound, but the existence of only two banks casts doubts on the competitiveness of the system. The staff supports the central bank's efforts to increase the number of banks.

60. **The program is consistent with the economic strategy outlined in the I-PRSP** and makes provision for an increase in spending on health and education. It is not expected to have significant adverse short-term effects on poverty. The World Bank staff concurs with this assessment.

61. **The environment in which the program will be implemented is generally favorable.** The authorities are strongly committed to the program, which augurs well for its implementation. Nevertheless, they would need to be vigilant to prevent policy slippages during the run-up to the elections that are expected to take place by early 2002. The benefits of certain key reforms and measures, such as the value-added tax, privatization, and containment of the fiscal deficit, would need to well publicized to allay possible public concern and mobilize support for the program. However, the staff's main concern is with possible inadequate monitoring, which was a problem during the implementation of the SMP. In this regard, the authorities will need to make a strong effort to improve the quality, timeliness, and frequency of reporting of key statistical data.

62. In view of the above appraisal, **the staff recommends that the request for the PRGF arrangement be approved.**

63. **It is proposed that the next Article IV consultation be held on the standard 12-month cycle.**

Table 1. Lesotho: Quantitative Benchmarks Under the Staff-Monitored Program

(In millions of maloti, unless otherwise indicated)

	1999	2000					
	December	March		June		September	
	Prel.	Prog.	Prel.	Prog.	Prel.	Prog.	Prel.
	(In millions of maloti)						
Floor on central government revenue (cumulative from end-September 1999)	560	1,148	1,250	1,686	1,794	2,250	2816
Ceiling on the stock of net credit to the government by the banking system	-942	-939	-938	-950	-722	-999	-1087
Floor on the stock of net foreign assets of the Central Bank of Lesotho	2,974	2,908	2,988	2,878	2,815	2,863	3,155
Ceiling on the amount of new non-concessional debt contracted or guaranteed by the central government (cumulative net disbursements since end-December 1999) 1/2/							
Maturity of less than one year 3/	0	0	0	0	0	0	0
Maturity of one year or more	0	0	0	0	0	0	0
Ceiling on the accumulation of external payments arrears	0	0	0	0	0	0	0

1/ 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 margins for differing repayment periods would be added (0.75 percent for repayments 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).

2/ Excludes borrowing for water transfer operations of the Lesotho Highlands Water Authority.

3/ Except for normal short-term import credits.

Table 2. Lesotho: Structural Benchmarks Under the Staff-Monitored Program

	Timing	Implementation Status
Create and fully staff a VAT Implementation Unit to oversee the introduction of the VAT	March 31, 2000	Unit was set up in mid-September 2000. It was delayed pending arrival of an FAD long-term tax advisor.
Introduce a mechanism for automatic adjustment of domestic prices of petroleum products in line with Movements in international prices	March 31, 2000	Observed
Submit legislation to introduce value-added tax (VAT) to Parliament	April 30, 2000	Submitted on May 19, 2000.
Appoint the Director and staff of the Fiscal Analysis and Policy Unit in the Ministry of Finance	May 31, 2000	Director and staff appointed in early June 2000.
Bring to the point of sale the Lesotho Telecommunications Corporation	June 30, 2000	Observed
Develop a reporting format for offsite surveillance of commercial banks	June 30, 2000	Observed
Develop and begin implementing an action plan for strengthening tax administration based on a comprehensive study of the problems of tax administration	September 30, 2000	Observed. Action plan was developed by FAD mission of March/April 2000

Table 3. Lesotho: Selected Economic and Financial Indicators, 1996/97-2003/04 1/

	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
				Act.	Prog.	Prog.	Prog.	Prog.
	(Annual percentage change, unless otherwise specified)							
National income and prices								
Real GDP	9.5	4.6	-3.6	2.1	2.4	2.8	4.0	4.0
Real GNP	8.1	3.4	-6.6	1.1	0.7	1.7	4.2	3.3
Consumer price index (end of period)	8.8	7.3	8.9	6.3	6.0	5.7	4.9	4.9
Nominal GDP (in millions of maloti)	4,216.3	4,764.2	5,078.8	5,730.9	6,197.1	6,762.4	7,352.2	7,968.8
Nominal GNP (in millions of maloti)	5,627.1	6,305.4	6,488.9	7,246.5	7,706.4	8,318.6	9,070.7	9,779.6
External sector 2/								
Exports, f.o.b.	50.1	8.7	19.5	4.3	25.2	15.1	10.3	9.7
Imports, f.o.b.	18.5	8.4	-5.6	8.1	1.9	6.6	8.8	7.2
Net labor income	3.6	11.4	-7.7	8.8	0.3	0.6	5.5	4.5
Real effective exchange rate 3/	-2.0	-2.9	-12.6	0.7	...	...	...	...
Government budget								
Revenue (excluding grants)	20.7	10.4	-3.3	6.4	8.3	14.9	7.9	8.7
Total expenditure and net lending	22.5	14.1	4.1	38.3	-12.3	8.4	6.9	5.6
Current expenditure	5.4	25.0	31.8	19.3	3.7	2.2	6.2	5.6
Capital expenditure and net lending	56.6	-0.6	-42.9	-3.2	15.5	35.4	9.3	5.5
Money and credit 4/ 5/								
Net foreign assets	52.6	61.9	22.1	-8.2	-10.7	20.2	14.6	14.8
Net domestic assets	-35.1	-44.6	-10.3	6.5	10.1	-11.4	-6.9	-7.2
Credit to the government	-47.0	-38.5	10.8	56.2	29.5	-1.4	-5.8	-12.4
Credit to the rest of the economy	5.4	-0.6	10.3	-4.0	0.2	7.4	7.7	7.2
Broad money	17.5	17.3	11.8	-1.7	-0.6	8.8	7.7	7.6
Velocity (GDP/average broad money)	4.3	4.1	3.7	4.3	4.6	4.5	4.6	4.6
	(In percent of GDP, unless otherwise specified)							
Investment and saving								
Investment	57.2	52.2	36.8	27.7	26.3	24.4	25.9	26.8
Public	20.7	18.2	9.8	8.4	8.9	9.8	9.9	10.2
Private	10.0	6.6	5.1	6.6	7.4	8.1	9.4	10.2
LHWP	26.5	27.4	21.9	12.8	10.0	6.6	6.5	6.4
Gross national savings (including remittances)	27.0	21.3	11.8	5.3	7.9	10.6	11.6	12.8
Public	20.5	16.2	4.5	-0.1	2.4	7.1	7.7	8.6
Private	6.4	5.0	7.2	5.4	5.4	3.5	3.9	4.2
Government budget								
Revenue	48.3	47.2	42.8	40.4	40.4	42.6	42.2	42.4
Total grants	4.8	3.8	2.4	2.3	3.4	4.1	4.1	4.1
Total expenditure and net lending	48.7	49.2	48.0	61.6	47.7	47.4	46.6	45.4
Overall balance (before grants)	-0.4	-2.0	-5.2	-18.5	-7.3	-4.8	-4.4	-3.0
Overall balance (after grants)	4.4	1.8	-2.9	-16.2	-3.9	-0.8	-0.2	1.0
Primary balance (excluding grants)	1.1	-0.1	-2.7	-15.3	-3.1	-1.7	-1.4	-0.3
Government domestic debt	6.7	4.6	4.4	13.6	13.4	12.0	9.5	5.7
External sector								
Current account balance (excluding official transfers)	-49.8	-50.7	-40.7	-36.0	-33.1	-31.4	-30.8	-30.3
Current account balance (including official transfers)	-30.3	-31.0	-25.0	-22.4	-18.4	-13.9	-14.3	-14.0
Stock of external debt	66.2	69.4	84.8	76.7	67.2	63.6	61.1	59.2
Debt-service ratio 6/	4.5	4.0	6.6	8.1	14.7	8.8	8.3	7.6
	(In millions of U.S. dollars, unless otherwise specified)							
Overall balance of payments	113.4	153.6	63.6	-52.0	-22.8	37.3	26.5	27.0
Gross official reserves (end of period)	525.1	606.3	552.9	471.1	358.9	382.7	403.1	429.4
Gross official reserves (in months of imports of goods and ser	5.8	8.7	7.9	7.7	6.3	6.3	6.3	6.3

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

1/ Fiscal year beginning in April.

2/ In maloti.

3/ Based on partner country data (excluding South Africa).

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

5/ Monetary data for the period 1996/97-1998/99 are very provisional as the Lesotho Bank published no regular accounts for the period from December 1996 to September 1998.

6/ In percent of exports of goods, services, and income.

Table 4. Lesotho: Central Government Operations, Annual, 1996/97-2003/04 1/

	1996/97	1997/98	1998/99	1999/00	2000/01 Prog.	2001/02 Prog.	2002/03 Prog.	2003/04 Prog.
	(In millions of maloti)							
Revenue	2,034.6	2,247.0	2,173.6	2312.8	2,505.8	2,879.1	3105.8	3377.2
Tax revenue	1,553.8	1,794.9	1,694.7	1888.8	1,892.8	2,389.1	2,601.3	2,823.0
Customs revenue	1,006.0	1,172.7	1,034.4	1183.1	1,126.2	1,438.2	1465.5	1562.9
Noncustoms tax revenue	547.8	622.2	661.3	705.7	766.6	950.9	1135.9	1260.1
Income taxes	299.0	340.1	387.0	419.5	436.0	530.0	633.9	704.2
Sales tax / value-added tax (VAT)	193.9	223.5	233.3	238	270.0	360.0	438.4	489.4
Petrol levy	46.0	47.4	35.9	43.6	56.0	57.6	59.8	62.2
Other tax revenues	8.9	11.2	5.1	4.6	4.6	3.3	3.8	4.4
Nontax revenue	480.8	452.1	478.9	424	613.0	490.0	504.5	554.2
Grants	203.4	178.7	120.0	130	208.8	274.0	304.9	325.0
Total expenditure and net lending	2,052.7	2,342.1	2,438.4	3373.4	2,958.0	3,207.0	3428.8	3619.5
Current expenditure	1,179.0	1,473.8	1,942.7	2318.5	2,403.8	2,456.4	2608.6	2754.5
Wages and salaries	604.4	721.3	837.6	835.9	925.0	1,010.0	1076.1	1143.1
Interest payments	66.3	90.0	128.5	183.4	257.7	216.0	221.5	219.0
External	36.6	59.9	96.2	101.6	142.7	127.4	129.1	132.4
Domestic	29.7	30.1	32.3	81.8	115.0	88.6	92.3	86.6
Of which: bank restructuring	0.0	0.8	13.2	45.0	65.0	57.2	51.4	45.6
Other expenditure	508.3	662.5	976.7	1299.2	1,221.1	1,230.4	1311.0	1392.5
Goods and services	268.2	323.6	504.1	1028.8	1,006.0	997.0	1,062.3	1,128.3
Of which: SACU arrears	...	...	...	...	98.9	...	...	...
Of which: National Revenue authority	...	...	...	...	1.0	64.7	0.0	0.0
Of which: VAT implementation	...	...	...	...	0.0	2.0	0.0	0.0
Transfers and subsidies	240.1	338.9	472.6	270.4	215.1	233.4	248.7	264.1
Of which: LHDA/Muela	0.0	0.0	0.0	0	0.0	0.0	0.0	0.0
Capital expenditure	873.7	868.3	495.7	479.9	554.2	750.6	820.2	865.0
Domestically funded	252.3	247.4	233.2	250	280.0	297.0	280.0	280.0
Externally funded	621.4	620.9	262.5	229.9	274.2	453.6	540.2	585.0
Grant funded	193.4	178.7	120.0	130	159.8	214.0	244.9	265.0
Loan funded	428.0	442.2	142.5	99.9	114.4	239.6	295.3	320.0
o/w utility sector loans						87.9	90.8	53.9
Net lending 2/	0.0	0.0	0.0	575	0.0	0.0	0.0	0.0
Overall balance before grants	-18.1	-95.1	-264.8	-1060.6	-452.2	-327.8	-323.0	-242.3
Excluding exceptional factors 3/	-18.1	-95.1	-264.8	-221.8	-478.3	-239.9	...	...
Overall balance after grants	185.3	83.6	-144.8	-930.6	-243.4	-53.8	-18.1	82.7
Excluding exceptional factors 3/	185.3	83.6	-144.8	-91.8	-269.5	34.1	...	...
Total financing	-185.3	-83.6	144.8	930.6	243.4	53.8	18.1	-82.7
Financing abroad	347.2	345.5	18.1	-70.9	-238.4	76.4	121.2	155.0
Loan drawings	428.0	442.2	142.5	99.9	149.4	307.6	363.3	388.0
Amortization	-80.8	-96.7	-124.4	-170.8	-387.8	-231.2	242.1	233.0
Domestic financing	-543.0	-489.3	181.5	1001.3	481.8	-22.5	-103.2	-237.7
Bank	-527.7	-507.7	167.0	973.1	501.8	-22.5	-103.2	-237.7
Nonbank	-15.3	18.4	14.5	28.2	-20.0	0.0	0.0	0.0
Residual	10.5	60.2	-54.8	0.2	0.0	0.0	0.0	0.0

Table 4. Lesotho: Central Government Operations, Annual, 1996/97-2003/04 1/ (concluded)

	1996/97	1997/98	1998/99	1999/00	2000/01 Prog.	2001/02 Prog.	2002/03 Prog.	2003/04 Prog.
Residual	10.5	60.2	-54.8	0.2	0.0	0.0	0.0	0.0
				(In percent of GDP)				
Revenue	48.3	47.2	42.8	40.4	40.4	42.6	42.2	42.4
Customs revenue	23.9	24.6	20.4	20.6	18.2	21.3	19.9	19.6
Noncustoms tax revenue	13.0	13.1	13.0	12.3	12.4	14.1	15.4	15.8
Nontax revenue	11.4	9.5	9.4	7.4	9.9	7.2	6.9	7.0
Grants	4.8	3.8	2.4	2.3	3.4	4.1	4.1	4.1
Total expenditure and net lending	48.7	49.2	48.0	58.9	47.7	47.4	46.6	45.4
Current expenditure	28.0	30.9	38.3	40.5	38.8	36.3	35.5	34.6
Wages and salaries	14.3	15.1	16.5	14.6	14.9	14.9	14.6	14.3
Interest payments	1.6	1.9	2.5	3.2	4.2	3.2	3.0	2.7
Other expenditure	12.1	13.9	19.2	22.7	19.7	18.2	17.8	17.5
Of which: bank restructuring	0.0	6.8	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services	6.4	6.8	9.9	18.0	16.2	14.7	14.4	14.2
Transfers and subsidies	5.7	7.1	9.3	4.7	3.5	3.5	3.4	3.3
Capital expenditure	20.7	18.2	9.8	8.4	8.9	11.1	11.2	10.9
of which utility sector loan						1.3	1.2	0.7
Net lending 2/	0.0	0.0	0.0	10.0	0.0	0.0	0.0	0.0
Overall balance before grants	-0.4	-2.0	-5.2	-18.5	-7.3	-4.8	-4.4	-3.0
Excluding exceptional factors 3/	-0.4	-2.0	-5.2	-3.9	-7.7	-3.5	...	...
Overall balance after grants	4.4	1.8	-2.9	-16.2	-3.9	-0.8	-0.2	1.0
Excluding exceptional factors 3/	4.4	1.8	-2.9	-1.6	-4.3	0.5	...	...
Financing abroad	8.2	7.3	0.4	-1.2	-3.8	1.1	1.6	1.9
Domestic financing	-12.9	-10.3	3.6	17.5	7.8	-0.3	-1.4	-3.0
Memorandum items:								
Defense, public order, and security	5.2	6.9	7.8	8.5	8.6	...	...	...
Health, education, and social services	16.1	15.0	17.3	16.4	16.3	...	...	...
GNP at current prices (in millions of maloti)	5,627.1	6,305.4	6,488.9	7,246.5	7,706.4	8,318.1	9,069.7	9,776.8
GDP at current prices (in millions of maloti)	4,216.3	4,764.2	5,078.8	5,730.9	6,197.1	6,762.4	7,352.2	7,968.8

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

1/ Fiscal year from April to March.

2/ Net lending in 1999/2000 consists of recapitalization of the old Lesotho Bank of M 575.7 million.

3/ Exceptional factors in 1999/2000 include the recapitalization of the old Lesotho Bank amounting to M 575.7 million and the early repayment of domestic loans on behalf of the LHDA/Muela Hydropower Project amounting to M 263.8 million. In 2000/01, they include one-off expenditure of M 98.9 million in payments of arrears to SACU, and revenue of M 85 million in dividend payments from Lesotho Flour Mills and privatisation revenues of M 40 million from the sale of the vehicle pool. In 2001/02, exceptional funds are spent on the utility (electricity) sector in preparation for privatisation.

Table 5. Lesotho: Central Government Operations, Quarterly, 2000/01-2001/02 1/

	1999/00		2000/01 (Cumulative)				2001/02 (Cumulative)			
	SMP	Act.	Q2-SMP	Q2-Act.	Q3-Prog.	Q4 Prog.	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.
					(In millions of maloti)					
Revenue	2,189.5	2,312.8	1,101.7	1,566.6	1,873.1	2,505.8	652.1	1,354.6	2,116.0	2,879.1
Tax revenue	1,824.8	1,888.8	902.5	1,220.0	1,417.0	1,892.8	556.4	1,145.1	1,791.5	2,389.1
Customs revenue	1,183.1	1,183.1	563.0	844.5	844.5	1,126.2	359.6	719.1	1,078.7	1,438.2
Noncustoms tax revenue	641.7	705.7	339.5	375.5	572.5	766.6	196.8	426.0	712.7	950.9
Income taxes	357.5	419.5	175.0	218.6	327.0	436.0	99.4	227.1	387.2	530.0
Sales tax / value-added tax (VAT)	245.4	238.0	137.2	130.6	205.6	270.0	82.3	172.0	286.7	360.0
Petrol levy	35.0	43.6	24.2	24.3	36.3	56.0	14.3	25.4	36.4	57.6
Other tax revenues	3.8	4.6	3.1	2.0	3.6	4.6	0.8	1.7	2.5	3.3
Nontax revenue	364.7	424.0	199.2	346.6	456.1	613.0	95.7	209.4	324.5	490.0
	0.0									
Grants	150.0	130.0	134.5	60.2	93.2	208.8	83.5	137.0	220.5	274.0
	0.0									
Total expenditure and net lending	3,223.2	3,373.4	1,246.1	1,486.7	2,142.2	2,958.0	784.8	1,601.6	2,391.6	3,207.0
Current expenditure	2,183.5	2,318.5	994.0	1,248.8	1,806.1	2,403.8	598.2	1,223.2	1,820.7	2,456.4
Wages and salaries	827.0	835.9	419.4	446.8	671.8	925.0	244.0	497.3	748.4	1,010.0
Interest payments	230.8	183.4	79.4	134.2	182.5	257.7	46.7	110.6	149.5	216.0
External	117.1	101.6	35.8	87.9	103.0	142.7	24.5	66.3	83.1	127.4
Domestic	113.7	81.8	43.6	46.3	79.5	115.0	22.2	44.3	66.5	88.6
Of which : bank restructuring	44.5	45.0	29.5	30.3	49.5	65.0	15.3	29.5	43.4	57.2
Other expenditure	1,125.7	1,299.2	495.2	667.8	951.8	1,221.1	307.6	615.2	922.8	1,230.4
Goods and services	323.6	1,028.8	...	561.8	787.5	1,006.0	249.3	498.5	747.8	997.0
Of which : National Revenue authority	...	...	...	...	...	1.0	21.4	42.7	53.7	64.7
Of which : VAT implementation	...	...	...	...	...	0.0	0.5	1.0	1.5	2.0
Transfers and subsidies	338.9	270.4	...	106.0	164.3	215.1	58.4	116.7	175.1	233.4
Of which : LHDA/Muela	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	464.0	479.9	252.1	237.9	336.1	554.2	186.6	378.5	570.9	750.6
Domestically funded	214.0	250.0	45.3	113.6	170.4	280.0	74.3	148.5	222.8	297.0
Externally funded	250.0	229.9	206.8	124.3	165.7	274.2	112.4	230.0	348.2	453.6
Grant funded	130.0	130.0	107.0	60.2	90.0	159.8	53.5	107.0	160.5	214.0
Loan funded	120.0	99.9	99.8	64.1	75.7	114.4	58.9	123.0	187.7	239.6
Net lending 2/	575.7	575.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unexplained expenditure 3/	81.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance before grants	-1,033.7	-1,060.6	-144.4	79.9	-269.1	-452.2	-132.7	-247.1	-275.6	-327.8
Overall balance after grants	-883.7	-930.6	-9.9	140.1	-175.9	-243.4	-49.2	-110.1	-55.1	-53.8
Total financing	883.7	930.6	9.9	-140.1	175.9	243.4	49.2	110.1	55.1	53.8
Financing abroad	-22.0	-70.9	10.9	-52.2	-66.6	-238.4	40.7	83.6	139.2	76.4
Loan drawings	120.9	99.9	95.0	64.1	75.7	149.4	82.4	215.7	321.5	307.6
Amortization	-142.9	-170.8	-84.1	-116.3	-142.3	-387.8	-41.6	-132.1	-182.3	-231.2
Domestic financing	987.3	1,001.3	-1.0	-88.2	242.5	481.8	8.5	26.5	-84.0	-22.5
Bank	971.3	973.1	-16.2	-149.8	262.5	501.8	8.5	26.5	-84.0	-22.5
Nonbank	16.0	28.2	15.2	61.6	-20.0	-20.0	0.0	0.0	0.0	0.0
Residual	-62.1	0.2	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0

Table 5. Lesotho: Central Government Operations, Quarterly, 2000/01-2001/02 1/

	1999/00		2000/01 (Cumulative)				2001/02 (Cumulative)			
	SMP	Act.	Q2-SMP	Q2-Act.	Q3-Prog.	Q4 Prog.	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.
					(In percent of GDP)					
Revenue	38.2	40.4	19.0	25.3	30.2	40.4	9.6	20.0	31.3	42.6
Customs revenue	20.6	20.6	9.7	13.6	13.6	18.2	5.3	10.6	16.0	21.3
Noncustoms tax revenue	11.2	12.3	5.9	6.1	9.2	12.4	2.9	6.3	10.5	14.1
Nontax revenue	6.4	7.4	3.4	5.6	7.4	9.9	1.4	3.1	4.8	7.2
Grants	2.6	2.3	2.3	1.0	1.5	3.4	1.2	2.0	3.3	4.1
Total expenditure and net lending	56.2	58.9	21.5	24.0	34.6	47.7	11.6	23.7	35.4	47.4
Current expenditure	38.1	40.5	17.1	20.2	29.1	38.8	8.8	18.1	26.9	36.3
Wages and salaries	14.4	14.6	7.2	7.2	10.8	14.9	3.6	7.4	11.1	14.9
Interest payments	4.0	3.2	1.4	2.2	2.9	4.2	0.7	1.6	2.2	3.2
Of which : bank restructuring	0.8	0.8	0.5	0.5	0.8	1.0	0.2	0.4	0.6	0.8
Other expenditure	19.6	22.7	8.5	10.8	15.4	19.7	4.5	9.1	13.6	18.2
Goods and services	5.6	18.0	...	9.1	12.7	16.2	3.7	7.4	11.1	14.7
Transfers and subsidies	5.9	4.7	...	1.7	2.7	3.5	0.9	1.7	2.6	3.5
Of which : LHDA/Muela	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	8.1	8.4	4.3	3.8	5.4	8.9	2.8	5.6	8.4	11.1
Net lending 2/	10.0	10.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unexplained expenditure 3/	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance before grants	-18.0	-18.5	-2.5	1.3	-4.3	-7.3	-2.0	-3.7	-4.1	-4.8
Overall balance after grants	-15.4	-16.2	-0.2	2.3	-2.8	-3.9	-0.7	-1.6	-0.8	-0.8
Financing abroad	-0.4	-1.2	0.2	-0.8	-1.1	-3.8	0.6	1.2	2.1	1.1
Domestic financing	17.2	17.5	0.0	-1.4	3.9	7.8	0.1	0.4	-1.2	-0.3
Memorandum items:										
Defense, public order, and security	...	8.5	...	4.5	...	8.6	...	...	...	...
Health, education, and social services	...	16.4	...	6.8	...	16.3	...	...	...	...
GNP at current prices (in millions of maloti)	7,246.5	7,246.5	7,139.3	7,706.4	7,706.4	7,706.4	8,318.1	8,318.1	8,318.1	8,318.1
GDP at current prices (in millions of maloti)	5,730.9	5,730.9	5,796.0	6,197.1	6,197.1	6,197.1	6,762.4	6,762.4	6,762.4	6,762.4

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

1/ Fiscal year from April to March.

2/ Net lending in 1999/2000 consists of recapitalization of the old Lesotho Bank of M 575.7 million.

3/ At the time of the formulation of the staff-monitored program, there was a discrepancy between the monetary and fiscal data, which was classified as unexplained expenditure. Subsequently, this discrepancy was identified and properly classified.

Table 6. Lesotho: Monetary Survey, March 1997 - March 2004

	March 1997	March 1998	March 1999	SMP March 2000	Act. March 2000	SMP Sept. 2000	Act. Sept. 2000	Prog. Dec. 2000	Prog. March 2001	Prog. June 2001	Prog. Sept. 2001	Prog. Dec. 2001	Prog. Mar. 2002	Prog. March 2003	Prog. March 2004
								(In millions of maloti)							
Net foreign assets	2,538.9	3,356.2	3,698.3	3,336.7	3,556.7	3,301.7	3,673.4	3,471.1	3,371.5	3,431.1	3,478.6	3,648.8	3,713.5	3,978.0	4,268.3
Central Bank	2,316.2	3,045.5	3,284.7	2,907.5	2,987.8	2,862.5	3,151.0	2,938.3	2,830.1	2,881.6	2,921.6	3,084.1	3,141.0	3,365.4	3,600.1
Commercial banks	222.7	310.7	413.6	429.2	568.9	439.2	522.4	532.8	541.4	549.5	557.1	564.7	572.4	612.6	668.2
Net domestic assets	-1,218.9	-1,807.4	-1,967.5	-1,600.1	-1,855.3	-1,512.6	-2,037.7	-1,812.8	-1,655.5	-1,675.3	-1,686.3	-1,819.3	-1,846.1	-1,967.7	-2,105.2
Domestic credit	-687.8	-1,203.7	-877.8	3.5	25.5	51.1	-145.0	278.5	531.1	571.9	617.6	524.9	632.3	667.3	568.4
Claims on central government (net)	-1,569.9	-2,077.6	-1,910.6	-939.3	-937.5	-999.1	-1,087.3	-675.0	-435.7	-427.2	-409.2	-519.7	-458.3	-561.4	-799.1
Central bank	-1,580.2	-2,086.2	-1,884.4	-1,489.8	-1,447.1	-1,492.0	-1,606.8	-1,208.6	-982.0	-985.0	-978.9	-1,101.5	-1,052.4	-1,191.1	-1,466.1
Commercial banks	10.4	8.6	-26.2	550.5	509.6	492.0	519.5	533.6	546.3	557.9	569.7	581.8	594.2	629.7	667.0
Claims on the rest of the economy	882.1	873.9	1,032.8	942.8	963.0	1,050.2	942.3	953.4	966.8	999.0	1,026.8	1,044.7	1,090.5	1,228.8	1,367.5
Other items (net)	-531.1	-603.7	-1,089.7	-1,603.6	-1,880.8	-1,563.7	-1,892.6	-2,091.3	-2,186.6	-2,247.1	-2,304.0	-2,344.3	-2,478.3	-2,635.1	-2,673.5
Money and quasi money (M2)	1,320.0	1,548.8	1,730.8	1,736.6	1,701.4	1,789.0	1,635.7	1,658.3	1,716.0	1,755.9	1,792.3	1,829.5	1,867.4	2,010.3	2,163.1
Money	626.2	809.6	973.5	975.7	982.6	1,005.2	938.4	951.3	984.5	1,007.3	1,028.2	1,049.6	1,071.3	1,153.3	1,241.0
Currency outside DMBs	86.8	91.1	120.8	146.5	111.1	150.9	123.9	125.6	130.0	133.0	135.7	138.5	141.4	152.2	163.8
Demand deposits	539.4	718.4	852.7	829.2	871.5	854.3	814.5	825.8	854.5	874.4	892.5	911.0	929.9	1,001.1	1,077.2
Quasi money	693.9	739.2	757.3	760.9	718.8	783.9	697.3	706.9	731.5	748.5	764.1	779.9	796.1	857.0	922.1
Time deposits	220.0	226.3	210.8	220.6	204.0	227.2	176.5	178.9	185.2	189.5	193.4	197.4	201.5	216.9	233.4
Savings deposits	473.9	512.9	546.6	540.3	514.8	556.6	520.8	528.0	546.4	559.1	570.7	582.5	594.6	640.1	688.7
						(Annual change in percent of beginning of yr. M2, unless otherwise specified)									
Net foreign assets	52.6	61.9	19.8	-20.9	-8.2	-8.9	14.0	2.8	-10.9	-0.5	-11.9	10.7	19.9	14.2	14.4
Central bank	45.2	55.2	13.8	-21.8	-17.2	-15.3	2.4	-2.1	-9.3	4.0	-14.0	8.8	18.1	12.0	11.7
Commercial banks	7.4	6.7	5.9	0.9	9.0	6.4	11.6	5.0	-1.6	-4.5	2.1	1.9	1.8	2.2	2.8
Net domestic assets	-35.1	-44.6	-9.3	21.2	6.5	19.0	-13.3	-2.8	11.7	5.9	21.5	-0.4	-11.1	-6.5	-6.8
Claims on central government (NET)	-47.0	-38.5	9.6	56.1	56.2	17.4	12.0	16.1	29.5	17.7	41.5	9.4	-1.3	-5.5	-11.8
Claims on the rest of the economy	5.4	-0.6	10.3	-5.2	-4.0	-5.4	-12.0	1.1	0.2	2.5	5.2	5.5	7.2	7.4	6.9
Claims on the rest of the econ. (yrly. change)	7.4	-0.9	18.2	-8.7	-6.8	-7.7	-17.2	2.0	0.4	4.3	9.0	9.6	12.8	12.7	11.3
Other items (net)	6.4	-5.5	-28.1	-29.7	-45.7	7.0	-13.3	-20.1	-18.0	-14.3	-25.1	-15.3	-17.0	-8.4	-1.9
Money and quasi money (M2)	17.5	17.3	11.8	0.3	-1.7	10.1	0.7	0.0	0.9	5.3	9.6	10.3	8.8	7.7	7.6
Quasi money (yrly. change)	11.0	6.5	2.4	0.5	-5.1	9.3	-2.8	-1.0	1.8	3.0	9.6	10.3	8.8	7.7	7.6

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

Table 7. Lesotho: Central Bank Balance Sheet, March 1997 - March 2004

	March 1997	March 1998	March 1999	March 2000	Sept. 2000	Prog. Dec. 2000	Prog. March 2001	Prog. June 2001	Prog. Sept. 2001	Prog. Dec. 2001	Prog. Mar. 2002	Prog. March 2003	Prog. March 2004
	(In millions of maloti)												
Net foreign assets	2,316.2	3,045.5	3,284.7	2,987.8	3,151.0	2,938.3	2,830.1	2,881.6	2,921.6	3,084.1	3,141.0	3,365.4	3,600.1
Foreign assets	2,322.4	3,052.4	3,422.3	3,090.9	3,245.6	3,033.0	2,924.8	2,976.3	3,016.2	3,178.7	3,235.7	3,460.0	3,694.7
Foreign liabilities	6.2	6.9	137.6	103.1	94.6	94.6	94.6	94.6	94.6	94.6	94.6	94.6	94.6
Net domestic assets	-2,068.5	-2,639.4	-2,770.1	-2,395.4	-2,594.6	-2,351.0	-2,218.2	-2,246.1	-2,265.2	-2,413.1	-2,466.7	-2,709.3	-2,977.9
Net claims on government	-1,580.2	-2,086.2	-1,884.4	-1,447.1	-1,606.8	-1,208.6	-982.0	-985.0	-978.9	-1,101.5	-1,052.4	-1,191.1	-1,466.1
Claims on government	293.3	145.4	201.8	247.7	109.2	109.2	109.2	109.2	109.2	109.2	109.2	109.2	109.2
Government deposits	1,873.5	2,231.6	2,086.2	1,694.9	1,716.0	1,317.8	1,091.2	1,094.2	1,088.1	1,210.7	1,161.6	1,300.3	1,575.3
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
Other items net	-488.2	-553.2	-885.7	-948.3	-987.8	-1,142.4	-1,236.2	-1,261.0	-1,286.3	-1,311.6	-1,414.3	-1,518.2	-1,511.8
Other assets	-47.7	65.0	45.1	61.9	141.1	143.1	148.1	151.5	154.6	157.9	161.1	173.5	186.6
Other liabilities	360.8	535.2	849.0	912.1	1,030.2	1,185.4	1,280.7	1,306.5	1,332.8	1,359.0	1,462.6	1,570.3	1,567.8
Capital account	79.7	83.1	81.8	98.1	98.8	100.1	103.6	106.0	108.2	110.5	112.8	121.4	130.6
Reserve money	247.8	406.1	514.6	592.4	556.4	587.3	611.9	635.6	656.3	671.0	674.3	656.1	622.2
Maloti outside banks	86.8	91.1	120.8	111.1	123.9	125.6	130.0	133.0	135.7	138.5	141.4	152.2	163.8
Currency in comercial banks	27.1	26.9	26.5	24.6	21.8	22.1	22.9	23.4	23.9	24.4	24.9	26.8	28.8
Commercial banks deposits	133.9	288.0	367.3	456.7	410.7	439.6	459.1	479.2	496.7	508.0	508.0	477.1	429.5
Memorandum items													
Loti/US$ dollar	4.42	5.03	6.19	6.56	7.26	7.85	8.15	8.23	8.30	8.38	8.46	8.59	8.62
Net foreign assets in US$	523.74	604.92	530.69	455.35	434.23	374.31	347.26	350.28	351.86	368.04	371.44	391.58	417.57

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

Table 8. Lesotho: Balance of Payments, 1996/97 - 2003/04 1/

	1996/97	1997/98	1998/99	1999/2000 Projection SMP	1999/2000 Actual	2000/01 Prog.	2001/02 Prog.	2002/03 Prog.	2003/04 Prog.
	(In millions of U.S. dollars)								
Trade balance	-798.3	-822.0	-589.9	-583.6	-608.0	-487.5	-439.5	-458.7	-477.4
Exports	191.1	197.3	191.5	185.1	188.4	199.7	200.9	214.1	230.6
Imports, f.o.b.	-989.4	-1,019.3	-781.4	-768.6	-796.4	-687.1	-640.4	-672.8	-708.0
Services (net)	13.2	-19.2	-11.1	0.8	-1.8	-4.7	-5.6	-6.3	-6.4
Receipts	69.3	47.8	39.9	50.9	45.6	41.7	38.6	40.1	42.4
Of which: Water royalties (and power sales)	33.9	14.3	13.2	21.8	13.0	12.1	11.6	12.2	12.9
Payments	-56.1	-67.0	-51.0	-50.0	-47.4	-46.4	-44.1	-46.4	-48.8
Income (net)	314.6	326.7	242.6	216.1	245.9	207.3	186.8	199.3	206.2
Labor income (net)	301.0	318.5	238.6	202.9	244.9	208.0	182.9	186.4	191.1
Receipts	359.9	377.4	284.5	239.7	278.2	229.8	212.3	215.7	219.7
Of which: miners' wages	299.7	316.0	231.1	183.3	224.0	181.3	165.9	167.1	168.7
Payments	-58.9	-58.8	-45.9	-36.8	-33.3	-21.8	-29.4	-29.3	-28.6
Investment income (net)	13.7	8.1	4.0	13.3	1.0	-0.6	3.9	12.9	15.1
Receipts	67.7	68.6	64.8	50.6	44.1	34.8	35.1	44.0	46.5
Payments	-54.1	-60.4	-60.8	-37.4	-43.1	-35.4	-31.2	-31.0	-31.5
Of which: interest on debt	-13.3	-14.2	-17.8	-19.3	-17.4	-21.2	-15.4	-15.2	-15.3
Unrequited transfers	185.9	201.7	139.5	160.1	155.9	128.0	145.6	144.0	150.4
Official	183.3	199.4	136.9	157.5	153.9	125.1	142.6	141.0	147.3
Southern African Customs Union nonduty receipt	154.5	177.7	115.2	135.7	135.7	109.8	122.5	120.6	126.2
Rand compensation	10.5	9.8	10.0	10.1	10.1	8.9	8.3	8.4	8.6
Other	18.3	11.9	11.6	11.7	8.1	6.5	11.9	12.0	12.5
Private	2.6	2.3	2.7	2.7	2.1	2.9	2.9	3.0	3.1
Current account (including official transfers)	-284.6	-312.8	-218.9	-206.4	-208.0	-156.8	-112.7	-121.7	-127.3
Current account (excluding LHWP)	-295.8	-289.7	-73.2	...	-267.4	-224.6	-242.5	-253.7	-274.0
Capital and financial account	257.7	241.5	212.3	206.4	183.8	153.8	112.7	121.7	127.3
Capital account (transfers received)	47.2	37.9	16.4	24.3	21.1	21.9	25.7	28.4	30.2
Of which: LHWP 2/	14.5	8.0	2.4	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	210.5	203.6	195.9	182.0	162.7	131.8	87.0	93.3	97.1
Direct investment	250.6	297.7	217.0	123.1	152.9	98.2	100.2	101.9	103.9
Other investment	73.3	33.8	-7.7	-2.3	-52.4	-23.6	13.4	17.8	20.2
Assets	3.5	-59.6	18.3	-2.4	-30.7	8.9	-3.7	-4.7	-6.3
Liabilities	69.8	93.4	-26.0	0.2	-21.8	-32.5	17.1	22.5	26.6
Loans	76.1	79.7	5.7	0.3	-12.9	-25.7	17.1	22.5	26.6
General government	77.4	80.5	5.8	0.4	-12.7	-25.5	16.2	21.8	26.2
Disbursements	95.4	93.7	26.1	23.6	15.0	27.8	43.9	49.4	51.9
Repayments	-18.0	-13.2	-20.3	-23.2	-27.7	-53.3	-27.6	-27.6	-25.7
Private (net)	-1.3	-0.8	-0.1	-0.1	-0.2	-0.2	0.8	0.7	0.3
Other liabilities	-6.3	13.8	-31.7	-0.1	-8.9	-6.8	0.0	0.0	0.0
CBL liabilities	-0.1	0.1	-1.3	0.0	-5.6	-1.7	0.0	0.0	0.0
Commercial banks' liabilities	-6.2	13.6	-30.4	-0.1	-3.3	-5.2	0.0	0.0	0.0
Change in reserve assets 3/	-113.4	-153.6	-63.6	61.2	52.0	22.8	-37.4	-26.5	-27.0
Valuation changes on reserves (gains +)		25.7	50.2	...	10.2	34.4	10.9	4.9	1.0
Errors and omissions	26.9	71.3	6.5	0.0	24.2	3.0	0.0	0.0	0.0

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

1/ Financial year is April-March.

2/ Lesotho Highlands Water Project.

3/ Transaction-based data, excluding the effects of exchange rate changes; a minus sign indicates an increase in reserves.

Table 9. Lesotho: External Financing Requirements and Sources, 1999/2000-2003/04
(In millions of U.S. dollars)

	1999/2000	2000/01 Prog.	2001/02 Prog.	2002/03 Prog.	2003/04 Prog.
1. Gross financing requirements	-341.0	-317.8	-320.4	-316.7	-327.3
External current account deficit (excl. off. transfers)	-361.9	-281.9	-255.3	-262.7	-274.5
Debt amortization	-25.3	-53.4	-23.1	-23.8	-23.3
Medium and long term debt 1/	-25.3	-53.4	-23.1	-23.8	-23.3
Public sector	-21.8	-48.1	-23.1	-23.8	-23.3
Commercial banks	-3.3	-5.2	0.0	0.0	0.0
Corporate private sector	-0.2	-0.2	0.0	0.0	0.0
Short term debt 2/	0.0	0.0	0.0	0.0	0.0
Repayment of arrears	0.0	0.0	0.0	0.0	0.0
Gross reserves accumulation	52.0	22.8	-37.4	-26.5	-27.0
IMF repurchases and repayments	-5.9	-5.2	-4.5	-3.9	-2.4
2. Available financing	341.0	317.8	320.4	316.7	327.3
Foreign direct investment (net)	152.9	98.2	100.2	101.9	103.9
Debt financing from private creditors	8.6	7.3	7.0	7.3	7.7
Medium and long term financing	8.6	7.3	7.0	7.3	7.7
To public sector	8.6	7.3	7.0	7.3	7.7
Of which: bop financing 3/	0.0	0.0	0.0	0.0	0.0
To commercial banks	0.0	0.0	0.0	0.0	0.0
To corporate private sector	0.0	0.0	0.0	0.0	0.0
Short term financing (net)	0.0	0.0	0.0	0.0	0.0
Of which: bop financing 3/	0.0	0.0	0.0	0.0	0.0
Official 4/	161.9	145.6	179.6	183.1	191.5
External grants (net)	153.9	125.1	142.6	141.0	147.3
Of which: SACU non-duty receipts	135.7	109.8	122.5	120.6	126.2
bop support3/		4.1	7.2	7.0	6.8
Multilateral creditors	1.6	1.1	6.1	3.6	2.2
Existing credit lines (through end-2000)	1.6	1.1	6.1	3.6	2.2
New credit lines (through end-2000)					
Of which: bop financing 3/	0.0	0.0	0.0	0.0	0.0
Bilateral creditors	6.4	19.5	30.9	38.6	42.0
To public sector	6.4	19.5	30.9	38.6	42.0
Existing credit lines (through end-2000)	1.6	0.0	2.5	2.1	0.7
New credit lines (through end-2000)	4.9	19.5	28.4	36.4	41.3
Of which: bop financing 3/	0.0	0.0	0.0	0.0	0.0
To private sector					
IMF	0.0	4.7	9.3	9.3	9.4
Accumulation of arrears (exceptional)	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0
Other flows 5/	17.7	62.0	24.4	15.1	14.8

Source: Central Bank of Lesotho and staff estimates and projections.

1/ Excluding the IMF.

2/ Original maturity of less than 1 year. Stock at the end of the previous periods.

3/ Includes those transactions that are undertaken for the purpose of financing a balance of payments deficit or an increase in reserves.

4/ Includes both loans and grants.

5/ Includes all other net financial flows, and errors and omissions.

Table 10. Lesotho: Phasing of Disbursements Under the PRGF Arrangement

Date	Disbursement [1/]		Activity
	Millions of SDR	Percent of Quota	
March 2, 2001	3.5	10	Board approves new three-year arrangement and endorses first-year program.
March 31, 2001	N.A.	N.A.	Test date for performance criteria.
July 31, 2001	3.5	10	Board completes first review.
September 30, 2001	N.A.	N.A.	Test date for performance criteria.
January 31, 2002	3.5	10	Board completes second review and endorses second-year program.
March 31, 2002	N.A.	N.A.	Test date for performance criteria.
July 31, 2002	3.5	10	Board completes third review.
September 30, 2002	N.A.	N.A.	Test date for performance criteria.
January 31, 2003	3.5	10	Board completes fourth review and endorses third-year program.
March 31, 2003	N.A.	N.A.	Test date for performance criteria.
July 31, 2003	3.5	10	Board completes fifth review.
September 30, 2003	N.A.	N.A.	Test date for performance criteria.
January 31, 2004	3.5	10	Board completes sixth review.
	24.5	70	

[1/] Disbursements are expected to take place approximately two weeks after the date of the Board meeting.

Table 11. Lesotho: Indicators of Financial Obligations to the Fund, 2000/01-2003/04

	Program			
	2000/01	2001/02	2002/03	2003/04
Debt service to the Fund				
In millions of U.S. dollars	5.3	4.7	3.4	1.8
In millions of SDRs	4.1	3.6	2.6	1.4
In percent of exports of goods/nonfactor services	2.2	1.9	1.3	0.6
In percent of debt service of nonfinancial public sector	7.3	10.9	8.0	4.3
In percent of gross international reserves	1.1	1.3	0.9	0.4
Gross Fund financing				
In millions of U.S. dollars	4.6	9.1	9.1	9.1
In millions of SDRs	3.5	7.0	7.0	7.0
In percent of Lesotho's financing needs 1/	1.4	2.8	2.9	2.8
Fund credit outstanding				
In millions of U.S. dollars	13.6	18.3	24.2	31.9
In millions of SDRs	10.5	14.1	18.6	24.5
In percent of quota	29.9	40.3	53.4	70.2
In percent of exports of goods and nonfactor services	5.6	7.6	9.5	11.7
In percent of total debt outstanding	2.5	3.3	4.1	5.2
Memorandum item:				
US$/SDR exchange rate	1.3	1.3	1.3	1.3

Sources: Central Bank of Lesotho; and 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.

February 12, 2001

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

Dear Mr. Köhler:

Following the successful implementation of a staff-monitored program during the period January-September 2000, the Government of Lesotho and the staff of the International Monetary Fund have reached understandings on a three-year successor economic program for Lesotho. In support of its program, the Government hereby requests a three-year arrangement with the Fund under the Poverty Reduction and Growth Facility in a total amount equivalent to SDR 24.5 million.

The attached Memorandum on Economic and Financial Policies sets forth the government's economic objectives and policies for the three-year period and its action plan for the first year of the program. The Government has prepared and submitted to the IMF and the World Bank an Interim Poverty Reduction Strategy Paper, and has started to prepare a full PRSP.

The Government of Lesotho believes that the policies and measures set forth in the attached Memorandum are adequate to achieve the objectives of the program, but will take any further measures that may become necessary for this purpose. During the period of the arrangement, the Government will consult with the Fund on the adoption of any measures that may be appropriate, at the initiative of the Government or whenever the Managing Director of the Fund requests such a consultation. Moreover, after the period of this arrangement and while the Government has outstanding financial obligations to the Fund arising from loan disbursements under this arrangement, the Government will consult with the Fund from time to time, at the initiative of the Government or whenever the Managing Director of the Fund requests consultation on the Government's economic and financial policies. These consultations may include correspondence and visits of Fund officials to Lesotho, or visits of Lesotho officials to the Fund. The Government will provide the Fund with such information as the Fund requires to assess the Government's progress in implementing the economic and financial policies described in the Memorandum.

In collaboration with Fund staff, the Government will review the progress in implementing the program every six months. The first review is scheduled to be completed no later than July 31, 2001, and the second no later than January 31, 2002.

Sincerely yours,

/s/
Kelebone A. Maope
Minister of Finance and
of Development Planning

LESOTHO

MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES

I. INTRODUCTION

1. This memorandum sets forth the Government of Lesotho's economic objectives and policies for the period October 2000–September 2003 and its economic program for the period October 2000–September 2001.

2. Until the late 1990s, economic performance in Lesotho was favourable. Construction under Phase IA of the Lesotho Highlands Water Project (LHWP) and rapid expansion of manufacturing production and exports propelled economic activity, and real GDP growth averaged over 6 percent in the decade ending in 1997. Monetary and economic integration with South Africa resulted in relatively low inflation, and prudent fiscal management led to the accumulation of sizeable government deposits in the banking system and a comfortable net international reserve position.

3. Economic performance began to deteriorate in the late 1990s with the winding down of activity in Phase IA of the LHWP, a slowdown of manufacturing growth as a result of the emergence of a shortage of factory space in the manufacturing sector, and declining miners' remittances from South Africa (where employment for Basotho workers has fallen with the ongoing rationalisation of mining production). Though phase IB of the LHWP started in 1998, it is smaller than Phase IA and its economic impact has been lower. The political disturbances of September 1998, which resulted from discontent with the results of the 1998 general elections and led to the intervention of Southern African Development Community (SADC) troops, also adversely affected economic activity. As a result, real GDP declined by almost 4 percent in fiscal year 1998/99 (April/March), and grew by only 2 percent in 1999/2000 (Table 1).

4. The decline in foreign direct investment and in miners' remittances, the slowdown of manufacturing growth, and the emergence of fiscal pressures have led to a deterioration in the balance of payments. Gross international reserves fell from the equivalent of 8.7 months of imports of goods and services at end-1997/98 to 7.7 months at end-1999/2000. These fiscal pressures have stemmed from declining customs revenue relative to GDP, weak tax administration, costs associated with the closure of the Lesotho Agricultural Development Bank in September 1998 and the privatization of the Lesotho Bank in August 1999, debt service obligations and costs associated with the construction of the Muela hydroelectric power plant, and the need for new elections as part of the compromise reached by political parties following the civil disturbances of September 1998.

5. Lesotho needs to diversify its production base by attracting investment in manufacturing and other non-traditional activities, such as tourism. Employment generation through economic growth is the linchpin of the government's efforts to reduce poverty.

However, the government is aware of the need for prudent financial management to generate confidence in the economy and preserve macroeconomic stability. Though inflation is currently relatively low (6 percent in the 12 months ending October 2000), the recent deterioration in the balance of payments is a source of concern. This memorandum therefore elaborates a mix of policies that would simultaneously boost economic growth and improve the balance of payments.

6. In December 1999 the Government of Lesotho launched a nine-month economic program that was monitored informally by the staff of the International Monetary Fund. This was the first step in the design of a medium-term economic program to tackle Lesotho's economic problems, which are largely structural in nature. The staff-monitored program emphasized growth-oriented policies as well as fiscal restraint and core reforms in tax policy and tax administration, privatisation, financial sector reform, bank restructuring and supervision, and institution strengthening. The policies set out below are a continuation of those implemented during that program.

7. The government has prepared an Interim Poverty Reduction Strategy Paper (I-PRSP), and is in the process of producing a full PRSP. The full PRSP will eventually serve as a guide to future revisions of the government's macroeconomic strategy. The economic objectives and policies described below are consistent with those that are expected to emerge from the PRSP when it is completed in about a year's time.

II. Medium-Term Economic Objectives And Policies

8. The government will target an economic growth rate of at least 4 percent a year in the medium term, sufficient to increase real per capita GDP by at least one percent a year, and gross international reserves at the equivalent of at least 6 months of imports of goods and services. Inflation, which is largely imported from South Africa, is projected to fall to about 5 percent a year on an end-period basis by the end of 2002/03, in line with trends projected for South Africa.

9. Given Lesotho's small size, limited natural resource endowment, and low domestic savings, policies to attract foreign direct investment and enhance export competitiveness will play a crucial role. Foreign investment will be boosted in both traditional industries (agriculture, garments, and electronics) and nontraditional ones (other manufacturing and tourism) through macroeconomic and political stability, enhancements in the efficiency of public utilities, maintenance of competitive tax rates, flexible labour market policies, removal of legal and administrative barriers to investment, improvement of the system of economic justice, and expansion of the infrastructure. All areas of the economy will be opened to foreign investment.

10. Private sector development will also be encouraged through privatisation of state-owned enterprises. The government's policy is to privatise all commercially viable enterprises, and to liquidate nonviable ones. Current privatisation efforts are focused on the

banking, insurance, and utilities sectors. Central government operations will also be privatised where possible, and the vehicle fleet has already been privatised.

11. The expansion of exports will be the primary means of boosting economic growth and strengthening the balance of payments. To this end, the government will continue to encourage and take advantage of regional trading initiatives, and will help firms maximise their access to the SADC and other foreign markets by gathering and disseminating information about potential market opportunities. It will also keep the trading system free of quantitative restrictions on imports. The existing limits on imports of beer and other products will be reviewed with the objective of abolishing them.

12. On the macroeconomic front, Lesotho will continue its membership in the Common Monetary Area (CMA), and will maintain the fixed, one-to-one parity between the loti and the rand. While CMA membership, the fixed exchange rate, and the joint circulation of the loti and the rand within the country have limited Lesotho's capacity to conduct independent monetary policy, these arrangements have contributed to monetary stability and helped keep inflation relatively low.

13. Given the limitations on the use of monetary policy, fiscal prudence is crucial. The government's medium-term objective will be to limit the budget deficit to levels that will serve to contain aggregate demand, and that can be financed by external grants and concessional loans. This will require efforts to mobilise revenue and contain expenditure. Tax administration is being strengthened through the establishment of a National Revenue Authority (NRA), and a value added tax (VAT) is being introduced to increase tax efficiency and equity and widen the tax base. The government will adjust specific taxes and fees regularly in line with inflation to prevent an erosion of the real revenue base.

14. Expenditure control will focus on current expenditure, but only capital projects that are economically viable and are consistent with the government's development priorities will be included in the public sector investment program. A wide-ranging and long-term Public Sector Reform and Improvement Project is being implemented. One component of the first phase is financial management improvement, which will focus on expenditure control and the budgeting process. Right-sizing of the civil service is also an important objective. The intention is to lower the central government wage bill to about 13.5 percent of GDP over the medium-term through natural attrition and elimination of "ghost" workers. Civil service reform will also include the revision of the compensation system, decompression of wages and salaries, and introduction of incentives and a performance appraisal system. Expenditure priorities will increasingly reflect emphasis on the social sectors and on poverty-reduction strategies. In particular, with the support of international donors, the government is taking steps to control the high incidence of HIV infection in Lesotho.

15. Other components of the Public Sector Reform and Improvement Project involve governance (including improvement of the effectiveness of Cabinet and the decision-making process), human resource management (including civil service reform), administration of justice (reform of the legal and judicial system), restructuring and reorganization of the

government machinery, improvement in the delivery of basic services, and decentralization of government. An Anti-Corruption Act has been passed and an Anti-Corruption Office will be created shortly.

16. In recent years the government has increased its borrowing on nonconcessional terms, which has contributed to the recent fiscal problems. To contain the fiscal burden and keep the external debt within manageable limits, the government will hereafter restrict its external financing to grants and concessional loans.

17. Domestic petroleum prices are now being reviewed monthly and adjusted automatically in accordance with a formula to allow for a full passthrough of international oil price changes. This policy will continue in the future. In addition, power to adjust petroleum prices has been vested in a Petroleum Board, which will become operational at the end of January 2001.

18. The Central Bank of Lesotho will try to strengthen its capacity to influence domestic liquidity conditions and thereby ease balance of payments pressures. To this end it is moving to develop a treasury bill market and introduce other indirect instruments of liquidity management. The central bank will also continue its efforts to enforce prudential regulations, modernize the payments system, encourage competition in the banking system, revise legislation regulating insurance companies, and improve the production of the monetary statistics. Interest rates will continue to be market-determined.

19. Currently, except for very limited controls on commercial banks, there are no exchange controls on capital movements within the CMA. The central bank is considering the possibility of abolishing all capital controls applying to commercial banks within the CMA and to all countries outside the CMA, thereby completely liberalizing the capital account. Discussions have already started with South Africa on this issue. By promoting free movement of capital, the government hopes to make Lesotho more attractive to private investors.

III. The Economic Program for the Period October 2000–September 2001

20. During the first year of the three-year economic program, October 2000–September 2001, the government will begin to take specific actions consistent with the medium-term economic objectives and policies outlined above. International reserves are projected to fall by US$87 million in the second half of 2000/01, reflecting in part exceptional outlays by the government to settle a tax claim by South Africa concerning the LHWP, but to begin a gradual recovery thereafter.

21. The government will target a budget deficit after grants of 3.9 percent of GDP in 2000/01 and 0.7 percent of GDP in 2001/02. When exceptional revenue and expenditure items are excluded, the budget balance shifts from a deficit of 4.3 percent of GDP in 2000/01 to a surplus of 0.6 percent of GDP in 2001/02 (exceptional items relate to payment of arrears to SACU, a one-time collection of dividends from a privatised enterprise, and revenue from

the sale of the vehicle fleet in 2000/01; and to the costs of restructuring the Lesotho Electricity Corporation in 2001/02).

22. The NRA is expected to start operating on September 30, 2001. Until then, the government will continue to take short-term measures to improve sales and income tax administrations based on the recommendations of the IMF tax advisor stationed in Maseru. The revenue gains already being realised from these measures are expected to be further boosted when the NRA becomes operational. Noncustoms tax revenue are therefore expected to increase slightly in 2000/01 and by 1.7 percentage points of GDP in 2000/01. Preparations are also ongoing for the introduction of the VAT, which is planned for April 1, 2002. Administrative fees and charges for public services will be adjusted to keep them growing at least in line with inflation.

23. The government has already taken several steps to contain expenditure in the second half of 2000/01. These include a cut of 10 percent in non-wage, non-interest current expenditure and a freeze of special expenditures. As a result, current expenditure will fall by 1.7 percentage points of GDP in this fiscal year. Expenditure restraint will continue to be exercised in 2001/2, when current expenditure is targeted to fall by a further 2.6 percentage points of GDP. The decline will be achieved partly through amortization of debt, and hence lower interest payments. More importantly, non-interest, nonwage current expenditure will be held just below its levels of 2000/01 in absolute terms, despite one-time costs (amounting to 1 percent of GDP) associated with the establishment of the National Revenue Authority. This will be possible because certain expenditures that took place in 2000/01 will not recur in 2001/02. In support of economic growth, the government is budgeting a rise in capital spending from 8.9 percent of GDP in 2000/01 to 11.1 percent of GDP in 2001/02. This increase will be used mainly for the restructuring and privatisation of the Lesotho Electricity Corporation, the further strengthening of infrastructure in the manufacturing sector, and the expansion of primary education.

24. The government will complete a public expenditure review by March 31, 2002, to facilitate expenditure rationalisation and control and help determine its spending priorities. For this purpose, a working group will be constituted and its terms of reference defined by May 15, 2001. Increased emphasis will be given to infrastructure and the social sectors in the budget for 2001/02. In line with this emphasis, the government will increase the share of health sector spending in total recurrent spending. The government will maintain the share of the education sector in total current spending at its current level of approximately 25 percent, but, within this sector, will increase the share of resources allocated to primary education.

25. To help control bank liquidity and attain the programmed level of net international reserves, the Central Bank of Lesotho will target its net domestic assets at the levels determined in the monetary program. The Central Bank will therefore shortly begin to issue treasury bills solely for monetary control purposes. To facilitate monetary management, an automatic treasury bill auction mechanism is expected to be established by mid-2001. In addition, the government will provide a written authorisation to the Central Bank of Lesotho to issue up to M 500 million in treasury bills for monetary control purposes. The proceeds of

any such sale of treasury bills will be put in a blocked account and will not be available to the central government to finance government operations.

26. The Central Bank of Lesotho will reduce and eventually abolish the commercial bank minimum local assets requirement (currently 60 percent of deposit liabilities), and stop remunerating bank excess reserves, when the treasury bill auction mechanism is put into place. The liquidation of the nonperforming loans of the Lesotho Bank, which were not taken over by the new bank under the terms of the privatisation agreement, is expected to start in March 2001 and be completed by mid-2002. Bank supervision will continue to be strengthened, and a study on the modernization of the national payments system is expected to be completed by September 2001.

27. The government will continue its efforts to restructure and privatise the utilities sector. The privatisation of the telecommunications company has been completed, and in early 2001 a private company will take over the management of the Lesotho Electricity Corporation (LEC). The management company will restructure the LEC and prepare the enterprise for privatisation in mid-2002. A study on the future of the Muela hydroelectric power plant will also be commissioned in 2001, with the objective of assessing the feasibility of privatising the plant. At a minimum, the Lesotho Highlands Development Authority, which administers both the electricity and the water transfer components of the LHWP, will be restructured to enable the power plant to operate as a commercial entity, with its own independent accounting records. The government is currently developing a policy regarding the water sector. It is focusing on privatising the non-core activities of the Water and Sewerage Authority (WASA), and will consider utilising a management contract for WASA similar to that of the LEC.

28. The government will continue to push ahead with modernization of the legal and regulatory framework for private sector development. The commercial court that became functional in May 2000 will be strengthened, the labour court is being modernized and the judicial system is being strengthened. The public service law is being streamlined to make the civil service more accountable and professional. Also, additional staff is being recruited in the Fiscal Analysis and Policy Unit that was set up in the Ministry of Finance in mid-2000 as a key step in increasing capacity in the area of economic management.

29. Consistent with the strengthened fiscal stance and improved external competitiveness, the external current account deficit, excluding official transfers, is projected to fall from 36 percent of GDP in 1999/2000 to 31.4 percent of GDP by 2001/02. The deficit is expected to be financed primarily by official transfers and non-debt-creating long-term capital inflows (mostly foreign direct investment), and is therefore considered sustainable. The domestic and external debt will remain relatively low and manageable.

30. The program is fully financed. Gross external financing requirements amount to US$318 million in 2000/01 and US$320 million in 2001/02. One third of these will be met by private sector inflows, nearly all of it in the form of foreign direct investment, and the remainder by concessional bilateral and multilateral financing. On average over the two

years, external grants account for 80 percent of concessional financing, bilateral loans for 15 percent, and multilateral loans for 5 percent.

IV. Program Monitoring

31. To monitor the progress of policy implementation under the program, quantitative and structural benchmarks and performance criteria are set out in Tables 1 and 2.

32. The Government will take steps to improve the statistical data base to facilitate program monitoring. The Bureau of Statistics is being strengthened. In addition, delays in the production of financial and fiscal data will be reduced. In particular, detailed monthly budget reports will be produced.

33. The Government of Lesotho will keep the IMF informed of the progress in the implementation of its program. In particular, the government will send to the IMF fiscal and monetary data on a monthly basis, starting in January 2001, and balance of payments data at least on a quarterly basis.

34. During the program 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. Lesotho: Quantitative Benchmarks and Performance Criteria, October 2000—September 2001

	2000 September Actual	2000 December	2001 March 1/	2001 June	2001 September 1/
		Program			
		(In millions of maloti)			
Ceiling on the domestic financing requirement of the Central Government (cumulative from end-September 2000)	-	331	570	578	596
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-2598	-2,355	-2,222	-2,250	-2,270
		(In millions of US dollars)			
Floor on the stock of net international reserves of the Central Bank of Lesotho	435	375	348	351	352
Ceiling on the amount of new non-concessional debt contracted or guaranteed by the public sector (cumulative from end-November 2000) 2/ 3/					
Maturity of less than one year 4/	0	0	0	0	0
Maturity of one year or more	0	0	0	0	0
Ceiling on the stock of external payments arrears 5/	0	0	0	0	0

1/ Performance criteria.

2/ 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 OECD commercial interest reference rates (CIRRs). For loans of maturity greater than 15 years the grant element will be based on the ten-year average of OECD CIRRs. For loans of maturity 15 years or less, the discount rate is based on the six-month average of OECD CIRRs. Margins for differing repayment periods would be added to the CIRRs (0.75 percent for repayments 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).

3/ Excludes borrowing for water transfer operations of the Lesotho Highlands Water Authority.

4/ Except for normal short-term import credits.

5/ This quantitative target is a continuous performance criterion.

Table 2. Lesotho: Structural Benchmarks and Performance Criteria, October 2000–September 2001

		Action	Implementation Date
A.	Tax Administration		
	1.	Implement border surveillance initiative as recommended by the IMF tax advisor to strengthen valuation of import cargoes for sales tax purposes	February 28, 2001
	2.	Introduce measures for cross-checking of import valuation with South Africa value-added tax refund agent at the principal border posts	February 28, 2001
	3.	Increase the number of audit/collection staff in the income tax department by 10 graduates and in the sales tax department by 5 graduates	March 31, 2001
B.	National Revenue Authority		
	1.	Appoint implementation manager (interim Commissioner-General)	February 28, 2001
	2.	Appoint implementation steering committee chaired by the Minister of Finance	March 31, 2001
	3.	National Revenue Authority becomes operational *	September 30, 2001
C.	Value-Added Tax		
	1.	Commence publicity and education campaign through, inter alia, television, radio, and newspaper advertising *	April 1, 2001
	2.	Commence registration drive and visits to traders	July 1, 2001
	3.	Complete installation and testing of VIPS computer software	August 31, 2001
D.	Expenditure Control and Rationalization		
	1.	Identify, and develop a timetable for eliminating, all off budget transactions	March 31, 2001
	2.	Set up a working group to complete the public expenditure and budget management review, and obtain Cabinet approval of its terms of reference	May 15, 2001
	3.	Complete the computerisation of the human resources information system and link up with the payroll for the management of the wage bill in at least eight Ministries	March 31, 2001
E.	Financial Sector Reform		
	1.	Authorize Central Bank to issue treasury bills for up to M500 million for liquidity control purposes	February 1, 2001
	2.	Establish a regular auction mechanism for treasury bills *	August 1, 2001
F.	Statistics Strengthening		
	1.	Compile detailed monthly budget execution reports within 30 days of the month's end	First report to be produced by January 31, 2001
	2.	Compile monthly monetary survey within 30 days of the month's end in the format recommended by the IMF's Money and Banking Statistics mission report of October 2000	First report to be produced by March 31, 2001

* Denotes performance criterion.

INTERNATIONAL MONETARY FUND

GOVERNMENT OF LESOTHO

Technical Memorandum of Understanding

February 12, 2001

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 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 test dates for assessing observance of the quantitative targets in the first year of the program will be end-December 2000, end-March 2001, end-June 2001, and end-September 2001. The end-March 2001 and end-September 2001 quantitative targets will constitute performance criteria, and the end-June 2001 benchmarks will constitute indicative performance criteria. In addition, the ceiling on the stock of external payments arrears is a continuous performance criterion. The first review under the program is scheduled for completion by July 31, 2001, on the basis of the end-March 2001 performance criteria; the second review is scheduled for completion by January 31, 2002, on the basis of end-September 2001 performance criteria.

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

3. **Definition:** The international reserves (NIR) are defined as the Central Bank of Lesotho's liquid, convertible foreign assets minus its liquid, 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 will be calculated in United Stated dollars using agreed end-period program exchange rates (maloti per U.S. dollar).

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 non-duty receipts from the Southern Africa Customs Union (SACU) in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

5. **Supporting material:** The Central Bank of Lesotho will provide data on its NIR and on SACU non-duty 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 breakdown of the foreign assets and foreign liabilities of the Central Bank of Lesotho in maloti and in U.S. dollars.

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

6. **Definition:** The net domestic assets (NDA) of the Central Bank of Lesotho are defined as the difference between reserve money (currency issued plus total bank deposits at the central bank) and net foreign assets (calculated at program exchange rates as stipulated in paragraph 3). The net foreign assets are defined as foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the Central Bank of Lesotho. 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).

7. **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 non-duty receipts from the Southern Africa Customs Union (SACU) in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

8. **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 on a weekly basis a table of selected monetary indicators covering the major elements of its balance sheet.

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

9. **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, and other claims on, the government from the banking system (Central Bank of Lesotho and the commercial banks), plus net credit to, and other claims on, the government from the non-bank sector. It will be calculated as the cumulative change from the end-September 2000 stock of net credit to, and other claims on, the government by the banking and nonbanking sectors. Changes in balances held in the privatization account or accounts into which the proceeds from the sale of public enterprises are deposited shall be included in the calculation of the domestic financing requirement, while changes in balances held in any account into which revenues collected by the customs department are held pending their transfer to the SACU revenue pool shall be excluded. The amounts of treasury bills issued or retired by the Central Bank of Lesotho for monetary control purposes, as well as the corresponding changes in the balance of the blocked government account that the Central Bank of Lesotho uses to manage the sale and retirement of treasury bills for monetary control purposes, will be included in net credit to the government.

10. **Adjustment clause:** The program assumes that customs revenue from the SACU revenue pool will be received as follows: M281.6 million in the last quarter of fiscal year 2000/01 and M359.6 million in each quarter in fiscal year 2001/02. 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.

11. **Supporting material:** The Central Bank of Lesotho will provide the monetary survey, 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 outstanding balances in the privatization account or accounts, and in the SACU revenue pool account mentioned in paragraph 9, will be separately identified in the monetary survey. The Central Bank will also provide tables showing the details of any monetary operations with treasury bills, including the changes in government deposits stemming from such operations.

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

12. **Definition:** The public sector comprises the central government, the Central Bank of Lesotho, and all enterprises with majority state ownership. 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 greater than 15 years, the grant element will be based on the ten-year average of OECD CIRRs. For loans of maturity 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. 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 will be excluded from this performance criterion. The performance criterion will be evaluated as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from end-November 2000.

13. **Adjustment clause:** None.

14. **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

15. **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. Normal short-term import credits, will be excluded from this performance criterion. The performance criterion will be evaluated as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from end-September 2000.

16. **Adjustment clause:** None.

17. **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

18. **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 remain zero. Arrears on external debt service obligations include any non-payment of interest and/or principal *in full and on time* falling due to all creditors, including the IMF and the World Bank.

19. **Adjustment clause:** None.

20. **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: Relations with the Fund
As of December 31, 2000

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

II. General Resources Account:	SDR Million	%Quota
Quota	34.90	100.0
Fund Holdings of Currency	31.36	89.9
Reserve position in Fund	3.54	10.1

III. SDR Department:	SDR Million	%Allocation
Net cumulative allocation	3.74	100.0
Holdings	0.51	13.6

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
Enhanced Structural Adjustment Facility (ESAF) arrangements	8.53	24.4

V. Financial Arrangements:

Type	Date	Date	(SDR Million)	(SDR Million)
Stand-by Arrangement	09/23/1996	09/22/1997	7.17	0.00
Stand-by Arrangement	07/31/1995	07/30/1996	7.17	0.00
Stand-by Arrangement	09/23/1994	07/31/1995	8.37	0.00

VI. Projected Obligations to Fund: 1/ (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	12/31/2000	2001	2002	2003	2004	2005
Principal		3.4	2.9	1.8	0.4	0.0
Charges/Interest		0.2	0.2	0.1	0.1	0.1
Total		3.6	3.1	1.9	0.5	0.1

1/ The projection of charges and interest assumes that overdue principal at the report date (if any) will remain outstanding, but forthcoming obligations will be settled on time.

VII. Exchange Rate Arrangement

Lesotho's currency, the loti (plural maloti), continues to be pegged at par to the South African currency, the rand. For the 12-month period ended October 2000, the nominal effective exchange rate (excluding the rand) depreciated by 11.3 percent and the real effective exchange rate depreciated by 11.2 percent, according to preliminary calculations (based on composition of partner countries, excluding South Africa). The Central Bank of Lesotho (CBL) deals with commercial banks mainly in South African rand. As of December 31, 2000, the rand (maloti) rate per U.S. dollar was M6.78.

VIII. Article IV Consultation

The Executive Board concluded the 1999 Article IV consultation (SM/99/148) on July 12, 1999. At that time, Executive Directors welcomed the authorities' decision to embark on a program of economic reforms in the context of a medium-term Fund-supported program. They urged the authorities to press ahead with a broad-based structural adjustment program, emphasizing, in particular, reforms in the utility sector, privatisation, the institution of investor-friendly tax and labour market systems, ad the simplification of the regulatory framework for processing investment. They stressed the need to strengthen and rationalise the fiscal situation by building an effective domestic revenue mobilization capacity, implementing the value-added tax expeditiously, reducing expenditure, and re-prioritizing public outlays to accommodate increased expenditure on social services and capital projects. Directors also urged the authorities to continue the financial sector reforms and to take steps to strengthen technical and managerial capacity in the public sector.

IX. Technical Assistance

Mission: taxation (value-added tax (VAT))	FAD	short term	1992-96
Mission: taxation (income and sales tax)	LEG	short term	1993-95
Mission: bank operations	MAE	short term	1995
Advisor: governor of the CBL	MAE	long term	1995-98
Mission: organizational issues	MAE	short term	1995
Mission: bank supervision	MAE	short term	1995
Mission: taxation (sales tax/VAT)	FAD	short term	1996
Mission: government financial management	FAD	short term	1996
Mission: multisector statistics mission	STA	short term	1996
Mission: balance of payments statistics	STA	short term	1996
Mission: banking supervision	MAE	short term	1997
Government expenditure management	FAD	long term	1997-98
Advisor: banking supervision	MAE	long term	1998-2001
Advisor: national accounts	STA	long term	1998-99
Advisor: governor of the CBL	MAE	long term	1998-2001

Mission: monetary statistics	STA	short term	1999-2000
Mission: taxation (VAT/Tax administration)	FAD	short-term	2000
Advisor: taxation (VAT/Tax administration)	FAD	long-term	2000/01

X. **Resident Representative**: None

Lesotho: Financial Relations with the World Bank Group

The attached table summarizes the World Bank's lending operations. As of December 31, 2000, IDA had approved 28 credits amounting to US$304.0 million, of which US$202.8 million was disbursed; US$54.4 million was canceled; and US$50.1 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 June 1998 for Phase IB of the Lesotho Highlands Water Project, of which US$11.1 million has been disbursed and US$33.9 million undisbursed. 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 each in private sector development and water supply; two each in rural development, urban development, and health/population; one each in agriculture, infrastructure, and land management/conservation.

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.

Lesotho: World Bank Lending Operations

(As of December 31, 2000; in millions of U.S. dollars, unless otherwise indicated)

Sector	Disbursed Credits		Disbursing Credits and Loans				Total Approved	Total	Total Disbursed	Percent	Percent of Total
	Original amount	Disbursed 1/2/	Original amount	Disbursed 2/	Undisbursed 2/	(F) =	Credit Loans	Disbursed	and Undisbursed	of Total	Disbursed and
	(A)	(B)	(C)	(D)	(E)	(D) + (E)	(G)=(A)+(C)	(H)=(B)+(D)	(I)=(E)+(H)	Disbursed	Undisbursed
Credits:											
Education	77.7	60.7	0.0	0.0	0.0	0.0	77.7	60.7	60.7	21.5	19.2
Transport 3/	84.4	52.9	0.0	0.0	0.0	0.0	84.4	52.9	52.9	18.7	16.7
Agricultural/land management and conservation	34.4	14.8	0.0	0.0	0.0	0.0	34.4	14.8	14.8	5.2	4.7
Industry	27.5	24.5	0.0	0.0	0.0	0.0	27.5	24.5	24.5	8.7	7.7
Water supply	6.0	5.1	0.0	0.0	0.0	0.0	6.0	5.1	5.1	1.8	1.6
Urban development	26.4	10.8	0.0	0.0	0.0	0.0	26.4	10.8	10.8	3.8	3.4
Health and population	22.1	14.9	0.0	0.0	0.0	0.0	22.1	14.9	14.9	5.3	4.7
Lesotho Highlands Water Project	9.8	10.4	0.0	0.0	0.0	0.0	9.8	10.4	10.4	3.7	3.3
Privatization	11.0	8.6	0.0	0.0	0.0	0.0	11.0	8.6	8.6	3.1	2.7
Social Protection	4.7	0.0	0.0	0.0	0.0	0.0	4.7	0.0	0.0	0.0	0.0
Total	304.0	202.8	0.0	0.0	0.0	0.0	304.0	202.8	202.8	71.7	64.0
Loans											
Lesotho Highlands Water Project	0.0	0.0	155.0	80.0	33.9	113.9	155.0	80.0	113.9	28.3	36.0
Total credits and loans	304.0	202.8	155.0	80.0	33.9	113.9	459.0	282.8	316.7	100.0	100.0
Repayments		33.0		16.1				49.1			
Cancellation	95.5		-41.1				54.4				
Total obligation		169.7		63.9				233.6			

Source: IBRD.

1/ Original principal less cancellations.

2/ Reflects adjustment for exchange rate movements.

3/ Infrastructure Project and Road Rehabilitation and Maintenance Project.

Lesotho: Statistical Issues

National accounts

The Bureau of Statistics of Lesotho (BSL) compiles annual estimates of GDP by kind of economic activity at current prices. Current price estimates of GDP by type of expenditure and income category are also produced, with one major component of each estimated as a residual. The income and outlay account, the capital accumulation account, and the rest of the world current account are also prepared. Estimates of GDP at constant 1980 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 relevant institutions. Sometimes, adjustments to historical data are made on the basis of available information. The production of other macroeconomic indicators, such as a monthly or quarterly industrial production index is needed to monitor developments during the year. Data on employment and other labor market indicators are missing.

The 1996 STA mission noted that the national accounts data still suffered from several substantial shortcomings, namely: 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 the GDP by expenditure categories, a major problem was the derivation of estimates of household expenditure as a residual and major weakness in the timeliness, coverage, and commodity detail on imports. In addition, as the constant price series were constructed in 1980 prices, there was an urgent need to change the base year.

In order to facilitate necessary improvements and expansion of the national accounts and related basic statistics, long-term technical assistance in the form of a resident advisor was provided 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 has initiated several projects for improving the BSL data collection efforts, work programs and working procedures, including improving the manufacturing production index.

The lack of reliable information on LHWP external flows and domestic value-added since 1998 undermines the robustness of recent estimates of GDP.

Prices

Due to lack of staff resources, the BSL currently produces only a consumer price index (CPI); as of the 1996 multisector mission, no other indices such as a producer price index

(PPI), export, or import indices were in production, although an import index was formerly maintained but discontinued in 1991.

The Lesotho CPI is not a monthly series, but is compiled quarterly and produced in a timely manner in January, April, July, and October of each year. With the assistance of the Fund's resident advisor, the index was updated and is now compiled using weights from the 1994/95 HBS, and is presented with 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 M 500 according to the 1994/95 HBS) in Maseru City and for low income households (households earning less than M 500) in all six lowland towns. The index for high income households is based on different weights than the low income and nationwide indices. The CPI is based on the Laspeyres index formula, and the advisor removed the (minor) index formula errors detected by the 1996 STA mission. Besides these index formula errors, and the then-outdated weights. the 1996 STA mission found that the quality of the index in general was good, and compared favorably with the CPI for other countries in the region.

In addition, the expert developed an import price index based on price data from trading partners.

Government finance statistics

Monthly data on government revenue (and grants), current and capital expenditure, and financing of the deficit/surplus are provided by the Ministry of Finance to missions. However, it would be useful if these data were reported to AFR on a regular (monthly) basis and with further disaggregation. There is scope for further improvement in the reporting of current and capital expenditure data. There is also a need to distinguish clearly between current and capital grants.

Government finance statistics (GFS) through 1998 have been reported to STA for publication in the 1999 *GFS Yearbook*. There has been a substantial improvement in the annual data reported, mainly as regards data on the composition of expenditure. Quarterly fiscal data are reported for *IFS* but with a lag (the January 2001 issue only contains data through March 2000).

Monetary statistics

A multisector statistics mission that visited Lesotho in 1996 considered several possible approaches to estimate foreign currency co-circulation, and presented a numerical exercise on the estimation of South African rand that circulate in Lesotho as legal tender.

Until September 1997 money and banking statistics were comprehensive and compiled in accordance with the Fund's statistical methodology. Between September 1997 and June 1998 the compilation of monetary statistics was interrupted as a result of the failure of the information system in the largest commercial bank. For this period, only estimates of this bank's balance sheet positions were incorporated in the monetary survey. The reporting of monetary data to STA was renewed in July 1998, but there were concerns about the reliability of commercial banks' analytical accounts. The data reported to AFR are highly aggregated. There is an urgent need to improve quality and timeliness of monetary data used for monitoring the financial program with the Fund. Hence, two money and banking technical assistance missions visited Maseru during October 27–November 11, 1999, and July 31–August 14, 2000, to review the production of the monetary statistics.

The July–August 2000 STA mission on money and banking recommended the (1) adoption of new formats for the report forms containing sectorized balance sheet data for compiling the analytical accounts of the CBL and of the other depository corporations; (2) expansion of the institutional coverage of the monetary statistics; (3) improvement of the sectorization of accounts of the nonfinancial public sector; (4) proper classification of international reserves and reserve-related liabilities, as well as of other foreign assets and other foreign liabilities; (5)revision of valuation and other accounting procedures, including the statistical treatment of Fund accounts; (6) improvement of the coding structure of the CBL's chart of accounts; (7) proper treatment of the donor-funded projects to ensure appropriate classification of relevant accounts; (8) improvement of the *Guidelines for Reporting of Financial Institutions*; (9) reclassification of other assets and liabilities to reduce the level of unclassified assets and liabilities; (10) inclusion and treatment of data on banks in liquidation in the monetary statistics; (11) revision of historical data to reflect these improvements; and (12) compilation of data on other (non-depository) financial institutions so as to produce a financial survey. At present, work on the recommended actions is in progress.

Balance of payments and external debt

Detailed balance of payments statistics are prepared by the Central Bank of Lesotho on a quarterly basis, and the time lag has been recently reduced to three to six months. However, these data are not reported to AFR or STA on a timely basis for dissemination in the Fund's statistical publications. The quality of the data could be improved, in particular by developing a dependable method of estimating imports, given the ease of circulation of people and merchandise between South Africa and Lesotho, and by monitoring private foreign investment. The compilation of detailed external debt data is adequate for public and publicly-guaranteed debt, but little information is available on private sector and parastatal nonguaranteed debt.

In the last two years, coverage of LHWP-related imports, services, income, and financing has deteriorated considerably to the point where it can be deemed that hardly no reliable information is available. The recommendations of a 1996 technical assistance mission on improving balance of payments coverage have only been partially followed up.

Lesotho: Core Statistical Indicators
(As of January 25, 2001)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govt. Balance	GDP/GNP	External Debt
Date of latest observation	Dec. 2000	Dec. 2000	Dec. 2000	Dec. 2000	Sep. 2000	Aug. 2000	Sep. 2000	Sep. 2000	Sep. 2000	Sep. 2000	Dec. 1999	Mar. 2000
Date received	Nov. 2000	Jan. 2001	Jan. 2001	Jan. 2001	Nov. 2000	Oct. 2000	Oct. 2000	Nov. 2000	Nov. 2000	Nov. 2000	Nov. 2000	Nov. 2000
Frequency of data 1/	D	M	M	M	M	M	Q	Q	Q	Q	A	A
Frequency of reporting 1/ 2/	M	M	M	M	M	Q/V	Q	Q/V	Q/V	Q/V	V	V
Source of data 3/	S	S	S	S	S	S	S	S	S	S	S	S
Mode of reporting 2/	F	F	F	F	F	F/V	F/V	F/V	F/V	F/V	V	V
Frequency of publication 1/	Q	Q	Q	Q	Q	Q	Q	Q	Q	Q	A	A
Confidentiality 4/	U	E	E	E	U	U	U	U	U	E	U	U

1/ A=annually; D=daily; M=monthly; Q=quarterly.
2/ F=cable or fax; V=staff visits or Article IV consultations.
3/ S=Central Bank of Lesotho, Bureau of Statistics, or Ministry of Finance.
4/ U=unrestricted use; E=embargoed for a period of time.

Lesotho: Selected Social and Demographic Indicators

Population			
Population (1998; in millions)	2.1		
Annual rate of growth (1992-98)	2.2		
Population 14 years and under (percent, 1997)	40		
Density (persons per 1,000 hectares, 1996)	685		
Population characteristics (1998)		Health	
Life expectancy at birth (years)	55	Population per physician (1990-95)	16,895
Male (years)	57	Population per nurse (1993)	3,000
Female (years)	55	Immunization rate	
Infant mortality (per thousand)	93	(percent under 12 months)	
Crude death rate (per thousand)	13	Measles (1995-98)	53
Crude birth rate (per thousand)	35	DPT (1995-98)	57
Fertility rate	4.6	HIV prevalence (1999) 1/	23.6
Urban population (percent)	26		
Access to safe water (1993-96)		Distribution of land	
Percentage of population	62.0	Percentage of arable land	
Urban	64.0	1960	13.0
Rural	60.0	1997	10.7
Education		Labor force (1998)	
Adult literacy rate (in percent; 1998)	82	Total (millions)	1.0
Male	71	Female (percent)	36.8
Female	93		
Enrollment rate (1997)			
Primary school (net)	69		
Male	63		
Female	74		
Secondary school (net)	73		
Pupil-teacher ratio in primary school (1997)	47		

Sources: *African Development Indicators 2000*, World Bank; and *World Development Indicators, 2000*, World Bank.

1/ This is as a percent of adults aged 15-49 years old, estimated by UNAIDS.

Statement by the IMF Staff Representative
March 9, 2001

This statement summarizes information which has become available since the staff report (EBS/01/18) was circulated to the Executive Board on February 15, 2001. The information does not change the thrust of the staff appraisal.

1. Inflation for the 12 months ended January 31, 2001 was 6 percent (end-of-period basis), which was in line with projections for fiscal year 2000/01 (April–March).

2. Underlying fiscal performance was on track in the first quarter of the program period, October–December, 2000. The overall budget deficit after grants in this quarter was 2.6 percent of GDP, below the programmed figure of 2.8 percent of GDP. Higher revenue and slightly lower capital expenditure than programmed offset higher nonwage current expenditure. Wages and salaries were slightly lower than programmed. However, external amortization payments were higher than expected, in part because of advance payments of debt service obligations that were due in January 2001, which resulted in a shortfall of net external financing and corresponding overshooting of net domestic financing by one half of a percent of GDP. The authorities have instituted a freeze on nonwage, non-interest current spending commitments, except in the education and health sectors, for the remainder of this fiscal year to ensure that the end-March 2001 performance criterion on net domestic financing of the budget is observed.

3. Apart from net domestic financing by the government, preliminary information indicates that all the other quantitative benchmarks for end-December 2000 were met.

4. All the structural benchmarks as of end-February 2001 were observed, except that relating to the appointment of an interim Commissioner-General for the National Revenue Authority. The authorities report that a person has been identified for the position, but not yet appointed. An official of the Ministry of Finance has been acting as implementation manager, pending the appointment of the interim Commissioner-General, so that preparations for the introduction of the Revenue Authority in September 2001 have not been held up.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/51
FOR IMMEDIATE RELEASE
May 21, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Lesotho

On March 9, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lesotho.[1]

Background

Lesotho continues to face considerable economic challenges since the sharp downturn in growth in 1998/99 aggravated by political riots. Real GDP growth has recovered to above 2 percent, helped by a recovery in manufacturing. Still, growth remains constrained by structural changes such as the winding down of Phase I of the Lesotho Highlands Water Project and the decline in mining employment in South Africa. Unemployment, estimated at over 40 percent, and poverty are widespread and there is a serious HIV/AIDS problem. The fiscal and balance of payments situations have also deteriorated. However, inflation is relatively low and the external debt remains sustainable.

Declining revenue-to-GDP and one-off expenditures associated with the restructuring of a public enterprise and state banks caused the budget deficit in 1999/2000 to rise to 16 percent of GDP. The budget deficit should narrow in 2000/01, though unexpected expenditures such as the settlement of a tax dispute with South Africa continue to highlight fiscal pressures. While the current account deficit has narrowed, it remains large and inflows of official grants and foreign direct investment have become insufficient to finance it, leading to a fall in international reserves since 1999/2000.

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[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. This PIN summarizes the views of the Executive Board as expressed during the March 9, 2001 Executive Board discussion based on the staff report.

Lesotho's one-to-one exchange rate peg between the loti and the rand has helped maintain monetary stability and relatively low inflation at 6 percent. The authorities have committed to maintain gross international reserves at six months of imports and contain the current account deficit. The exchange rate regime also limits monetary policy and so raises the importance of a healthy fiscal policy. The government has agreed to pursue a path of fiscal consolidation through increases in tax revenue, cuts in current expenditure, and public sector reforms. The central bank will also enhance its capacity to control liquidity through the establishment of a treasury bill market.

Lesotho has made good progress in implementing structural reforms. These include the start of a major tax reform aiming at introducing value-added tax and a National Revenue Authority, and a public sector reform project. Restructuring of the electricity company is underway with plans for privatization in 2002. Financial sector reform has also made significant advancement with the restructuring and privatization of the two state banks and major improvements in bank supervision.

The government aims to raise growth and boost employment through attracting foreign direct investment and enhancing export competitiveness, while continued privatization will fuel private sector development. Structural reforms to be implemented cover the areas of tax reform and tax administration, expenditure control and rationalization, public sector reform, financial sector reform, privatization and statistics strengthening.

Executive Board Assessment

Executive Directors noted that Lesotho is facing a downturn of economic growth, high unemployment and poverty, and fiscal and balance of payments pressures as a result of long-term structural changes affecting the economy. Correction of these problems will require bold and sustained action by the authorities over the medium term. Directors therefore commended the authorities for adopting a growth-oriented adjustment program in the context of a three-year PRGF arrangement aimed at restoring the economy to a path of high and sustained growth. In view of Lesotho's limited capacity to implement wide-ranging reforms, Directors welcomed the program's focus on a number of key areas in which progress is most needed. They also welcomed that the authorities have secured technical assistance from bilateral and multilateral agencies, including from the Fund, in undertaking the reforms in these areas.

Given recent budgetary pressures, Directors underlined the importance of the authorities' commitment to fiscal consolidation, to be achieved through a compression in current expenditure and an increase in noncustoms tax revenue. Directors drew attention to the need to lower and rationalize government expenditure over the medium term, taking note in particular of the need to contain growth in the wage bill, while preserving priority social and capital investment expenditures. They encouraged the authorities to complete the public expenditure review as early as possible and to speed up the public sector reform project. They saw these measures as supporting the budgeting process and improving the efficiency and transparency of government operations. Tax administration also needed to be strengthened.

Directors agreed that the current monetary regime with South Africa has served Lesotho well, and has helped keep inflation relatively low, but observed that the fixed exchange rate needed to be backed by financial discipline. Thus they welcomed the central bank's efforts to refine its policy instruments in the area of open market operations. Directors also supported the authorities' efforts to address the structural weaknesses that affect Lesotho's financial sector and contribute to the lack of savings mobilization and financial intermediation. They noted that, following closure of the two loss-making state-owned banks, the banking system is now in better health. They stressed the importance of reinforcing bank supervision and of continued efforts to ensure the enforcement of loan contracts, and welcomed recent steps to increase the competitiveness of the financial system.

Directors observed that, given its size and geographical location, emphasis on outward-looking policies supported by private-sector development is the best option for Lesotho. They, therefore, welcomed the authorities' efforts to privatize state-owned enterprises. Directors also supported the stress on small and micro enterprise development, such as small-holder agriculture, to broaden the base of growth and maximize employment generation.

Directors stressed that Lesotho would need to take maximum advantage of the opportunities afforded by its close economic ties with South Africa and by regional trading arrangements, to attract foreign investment and diversify its production base. This would require appropriate policies to enhance external competitiveness and improve the business environment. In this context, Directors encouraged the authorities to eliminate the remaining non-tariff barriers.

Directors mentioned that, although the statistical database was adequate for purposes of the Article IV consultation, it still contains major weaknesses, especially in national accounts and the balance of payments. They, therefore, urged the authorities to improve the quality, timeliness and frequency of reporting of key statistical data.

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.

Lesotho: Selected Economic Indicators 1/

	1998	1999	2000 Prog.	2001 Prog.
	(Annual percentage change, unless otherwise specified)			
National income and prices				
Real GDP	-3.6	2.1	2.4	2.8
Real GNP	-6.6	1.1	0.7	1.7
Consumer price index (end of period)	8.9	6.3	6.0	5.7
Nominal GDP (in millions of maloti)	5,078.8	5,730.9	6,197.1	6,762.4
Nominal GNP (in millions of maloti)	6,488.9	7,246.5	7,706.4	8,318.6
External sector 2/				
Exports, f.o.b.	19.5	4.3	25.2	15.1
Imports, f.o.b.	-5.6	8.1	1.9	6.6
Net labor income	-7.7	8.8	0.3	0.6
Real effective exchange rate 3/	-12.6	0.7	...	...
Government budget				
Revenue (excluding grants)	-3.3	6.4	8.3	14.9
Total expenditure and net lending	4.1	38.3	-12.3	8.4
Current expenditure	31.8	19.3	3.7	2.2
Capital expenditure and net lending	-42.9	-3.2	15.5	35.4
Money and credit 4/ 5/				
Net foreign assets	22.1	-8.2	-10.7	20.2
Net domestic assets	-10.3	6.5	10.1	-11.4
Credit to the government	10.8	56.2	29.5	-1.4
Credit to the rest of the economy	10.3	-4.0	0.2	7.4
Broad money	11.8	-1.7	-0.6	8.8
Velocity (GDP/average broad money)	3.7	4.3	4.6	4.5
	(In percent of GDP, unless otherwise specified)			
Investment and saving				
Investment	36.8	27.7	26.3	24.4
Public	9.8	8.4	8.9	9.8
Private	5.1	6.6	7.4	8.1
LHWP	21.9	12.8	10.0	6.6
Gross national savings (including remittances)	11.8	5.3	7.9	10.6
Public	4.5	-0.1	2.4	7.1
Private	7.2	5.4	5.4	3.5

Lesotho: Selected Economic Indicators 1/

	1998	1999	2000 Prog.	2001 Prog.
Government budget				
Revenue	42.8	40.4	40.4	42.6
Total grants	2.4	2.3	3.4	4.1
Total expenditure and net lending	48.0	61.6	47.7	47.4
Overall balance (before grants)	-5.2	-18.5	-7.3	-4.8
Overall balance (after grants)	-2.9	-16.2	-3.9	-0.8
Primary balance (excluding grants)	-2.7	-15.3	-3.1	-1.7
Government domestic debt	4.4	13.6	13.4	12.0
External sector				
Current account balance (excluding official transfers)	-40.7	-36.0	-33.1	-31.4
Current account balance (including official transfers)	-25.0	-22.4	-18.4	-13.9
Stock of external debt	84.8	76.7	67.2	63.6
Debt-service ratio 6/	6.6	8.1	14.7	8.8
	(In millions of U.S. dollars, unless otherwise specified)			
Overall balance of payments	63.6	-52.0	-22.8	37.3
Gross official reserves (end of period)	552.9	471.1	358.9	382.7
Gross official reserves (in months of imports of goods and services)	7.9	7.7	6.3	6.3

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

1/ Fiscal year beginning in April.

2/ In maloti.

3/ Based on partner country data (excluding South Africa).

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

5/ Monetary data for the period 1998 are very provisional as the Lesotho Bank published no regular accounts for the period from December 1996 to September 1998.

6/ In percent of exports of goods, services, and income.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 01/8
FOR IMMEDIATE RELEASE
March 9, 2001

International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves Three-Year, US$32 Million PRGF Loan for Lesotho

The International Monetary Fund (IMF) approved today a three-year loan for SDR 24.5 million (about US$32 million) under the Poverty Reduction and Growth Facility (PRGF)[1] to support Lesotho's efforts to foster macroeconomic stability, promote accelerated growth, improve social services, and reduce poverty. The IMF Executive Board decision will enable Lesotho to draw immediately up to SDR 3.5 million (about US$5 million).

Following the Executive Board discussion on Lesotho, Shigemitsu Sugisaki, Deputy Managing Director, said:

"The Fund commends the Lesotho authorities on having made a good start with their new three-year economic program. The program, which relies on fiscal restraint and structural reform, provides a framework to promote economic growth and reduce poverty. The fiscal strategy aims at short-term external stability and medium-term growth and poverty reduction, in particular, through the removal of key infrastructure bottlenecks and increased spending on health and education.

"On monetary policy, the central bank's efforts to develop its capacity to influence domestic liquidity conditions and, ultimately, the balance of payments are welcome steps.

"Structural reforms under the program focus on a limited number of key areas, including tax administration and tax policy, expenditure control and rationalization, public sector reforms, privatization, and financial sector reforms. The authorities should make every effort to overcome the constraints under which they operate and to adhere to the agreed implementation timetable.

[1] On November 22, the IMF's concessional facility for low-income countries, the Enhanced Structural Adjustment Facility (ESAF), was renamed the Poverty Reduction and Growth Facility (PRGF), and its purposes were redefined. It is intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a poverty reduction strategy paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. At this time for Lesotho, pending the completion of a PRSP, a preliminary framework has been set out in an interim PRSP, and a participatory process is underway. It is understood that all policy undertakings in the interim PRSP beyond the first year are subject to reexamination and modification in line with the strategy that is to be elaborated in the PRSP. Once completed and broadly endorsed by the Executive Boards of the IMF and the World Bank, the PRSP will provide the policy framework for future reviews under the PRGF arrangement. PRGF loans carry an interest rate of 0.5 percent a year and are repayable over 10 years with a 5 ½ year grace period on principal payments.

Technical assistance, including from the Fund, will play a crucial role in supporting the authorities with the implementation of their entire reform agenda.

"The benefits of certain key reforms and measures, such as the value added tax, privatization, and fiscal prudence, would need to be well publicized to mobilize support. Regular and effective monitoring of program implementation is crucial, and therefore, the authorities' commitment to improve the quality, timeliness, and frequency of reporting of key statistical data is vital. The authorities are also encouraged to make further progress aimed at securing effective expenditure management. The Fund endorses Lesotho's Interim Poverty Reduction Strategy Paper (IPRSP) and looks forward to the timely preparation of a full PRSP based on an effective consultation process," Mr. Sugisaki said.

ANNEX

Program Summary

Lesotho's real GDP growth has recovered to above 2 percent following the downturn in 1998/99, but remains constrained. Unemployment and poverty are widespread, and there is a serious HIV/AIDS problem. During January-September 2000 the government implemented an IMF staff-monitored economic program that was broadly satisfactory. Although economic growth is resuming, inflation declining, and the external debt remains sustainable, the fiscal and balance of payments positions have deteriorated.

Lesotho's **economic program** aims to raise economic growth and create employment in order to fight poverty, as outlined in the government's interim Poverty Reduction Strategy Paper (PRSP). The program aims to raise growth by attracting foreign direct investment and enhancing export competitiveness, while privatization will fuel private sector development.

The **primary macroeconomic objective** is to keep gross international reserves at the equivalent of at least six months' worth of imports of goods and services. In this, the authorities have taken into account Lesotho's extreme vulnerability to external developments and its fixed exchange rate system. The program also aims for economic growth of 2.4 percent in 2000/01 and inflation of about 6 percent, largely reflecting price developments in South Africa. Lesotho's monetary policy of a one-to-one exchange rate peg between the loti and the rand will help maintain monetary stability and relatively low inflation.

Other macroeconomic objectives of the program are to keep the external current account deficit to sustainable levels and keep external debt low and sustainable. The current account deficit, excluding official transfers, is projected to continue to decline over the medium term and will be fully financed by external grants, foreign direct investment, and net public sector borrowing, which is projected to become positive again from 2001/02 onward and be limited to concessional loans.

The government's **fiscal targets** involve balancing the medium-term growth and poverty objectives against the short-term balance of payments constraints. In 2000/01, the budget deficit after grants is targeted to fall to 3.9 percent of GDP, with the decline accounted for by lower expenditures. In 2001/02, the budget deficit after grants is targeted to shrink further to 0.8 percent of GDP, mostly through revenue increase. From 2002/03 onward, the budget balance after grants will continue to improve, turning to a surplus by 2003/04. A number of fiscal reforms are being implemented to improve budgetary performance, strengthen the civil service, and increase efficiency and transparency in the public sector.

Structural reforms in the program include tax reform and tax administration, expenditure control and rationalization, public sector reform, financial sector reform, privatization, and statistics strengthening. Particularly important will be efforts to reduce the scale of government to facilitate private sector development.

The program aims to have a positive impact on **poverty reduction** through economic growth, employment generation, and an increased emphasis on the social sectors in the budget. In 2001/02, the program targets an increase in the share of health and primary education in total current spending, and budgets for rural development projects through the Lesotho Fund for Community Development. In addition to universal free primary education, which is being phased in over several years, the government is trying to provide free emergency hospital care to some terminally ill AIDs patients.

Lesotho joined the IMF on July 25, 1968. Its quota[2] is SDR 34.90 million (about US$45), and its outstanding use of IMF credit currently totals SDR 7.9 million (about US$10 million).

[2] A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Table 3. Lesotho: Selected Economic and Financial Indicators, 1997/98-2003/04 1/

	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
			Act.	Prog.	Prog.	Prog.	Prog.
	(Annual percentage change, unless otherwise specified)						
National income and prices							
Real GDP	4.6	-3.6	2.1	2.4	2.8	4.0	4.0
Real GNP	3.4	-6.6	1.1	0.7	1.7	4.2	3.3
Consumer price index (end of period)	7.3	8.9	6.3	6.0	5.7	4.9	4.9
Nominal GDP (in millions of maloti)	4,764.2	5,078.8	5,730.9	6,197.1	6,762.4	7,352.2	7,968.8
Nominal GNP (in millions of maloti)	6,305.4	6,488.9	7,246.5	7,706.4	8,318.6	9,070.7	9,779.6
External sector 2/							
Exports, f.o.b.	8.7	19.5	4.3	25.2	15.1	10.3	9.7
Imports, f.o.b.	8.4	-5.6	8.1	1.9	6.6	8.8	7.2
Net labor income	11.4	-7.7	8.8	0.3	0.6	5.5	4.5
Real effective exchange rate 3/	-2.9	-12.6	0.7	...	...	...	...
Government budget							
Revenue (excluding grants)	10.4	-3.3	6.4	8.3	14.9	7.9	8.7
Total expenditure and net lending	14.1	4.1	38.3	-12.3	8.4	6.9	5.6
Current expenditure	25.0	31.8	19.3	3.7	2.2	6.2	5.6
Capital expenditure and net lending	-0.6	-42.9	-3.2	15.5	35.4	9.3	5.5
Money and credit 4/ 5/							
Net foreign assets	61.9	22.1	-8.2	-10.7	20.2	14.6	14.8
Net domestic assets	-44.6	-10.3	6.5	10.1	-11.4	-6.9	-7.2
Credit to the government	-38.5	10.8	56.2	29.5	-1.4	-5.8	-12.4
Credit to the rest of the economy	-0.6	10.3	-4.0	0.2	7.4	7.7	7.2
Broad money	17.3	11.8	-1.7	-0.6	8.8	7.7	7.6
Velocity (GDP/average broad money)	4.1	3.7	4.3	4.6	4.5	4.6	4.6
	(In percent of GDP, unless otherwise specified)						
Investment and saving							
Investment	52.2	36.8	27.7	26.3	24.4	25.9	26.8
Public	18.2	9.8	8.4	8.9	9.8	9.9	10.2
Private	6.6	5.1	6.6	7.4	8.1	9.4	10.2
LHWP	27.4	21.9	12.8	10.0	6.6	6.5	6.4
Gross national savings (including remittances)	21.3	11.8	5.3	7.9	10.6	11.6	12.8
Public	16.2	4.5	-0.1	2.4	7.1	7.7	8.6
Private	5.0	7.2	5.4	5.4	3.5	3.9	4.2

Government budget							
Revenue	47.2	42.8	40.4	40.4	42.6	42.2	42.4
Total grants	3.8	2.4	2.3	3.4	4.1	4.1	4.1
Total expenditure and net lending	49.2	48.0	61.6	47.7	47.4	46.6	45.4
Overall balance (before grants)	-2.0	-5.2	-18.5	-7.3	-4.8	-4.4	-3.0
Overall balance (after grants)	1.8	-2.9	-16.2	-3.9	-0.8	-0.2	1.0
Primary balance (excluding grants)	-0.1	-2.7	-15.3	-3.1	-1.7	-1.4	-0.3
Government domestic debt	4.6	4.4	13.6	13.4	12.0	9.5	5.7
External sector							
Current account balance (excluding official transfers)	-50.7	-40.7	-36.0	-33.1	-31.4	-30.8	-30.3
Current account balance (including official transfers)	-31.0	-25.0	-22.4	-18.4	-13.9	-14.3	-14.0
Stock of external debt	69.4	84.8	76.7	67.2	63.6	61.1	59.2
Debt-service ratio 6/	4.0	6.6	8.1	14.7	8.8	8.3	7.6
	(In millions of U.S. dollars, unless otherwise specified)						
Overall balance of payments	153.6	63.6	-52.0	-22.8	37.3	26.5	27.0
Gross official reserves (end of period)	606.3	552.9	471.1	358.9	382.7	403.1	429.4
Gross official reserves (in months of imports of goods and services)	8.7	7.9	7.7	6.3	6.3	6.3	6.3

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

1/ Fiscal year beginning in April.

2/ In maloti.

3/ Based on partner country data (excluding South Africa).

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

5/ Monetary data for the period 1997/98-1998/99 are very provisional as the Lesotho Bank published no regular accounts for the period from December 1996 to September 1998.

6/ In percent of exports of goods, services, and income.