

Lesotho: Fourth Review Under the Poverty Reduction and Growth Facility Arrangement and Request for Waiver of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Lesotho

In the context of the fourth review under the Poverty Reduction and Growth Facility arrangement and request for waiver of performance criteria, the following documents have been released and are included in this package:

- the staff report for the fourth review under the Poverty Reduction and Growth Facility arrangement and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **April 13, 2003**, with the officials of Lesotho on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on May 22, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Press Release summarizing the **views of the Executive Board as expressed during its June 16, 2003 discussion** of the staff report that completed the request and/or review.
- a statement by the Executive Director for Lesotho.

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

Joint Staff Assessment of the Poverty Reduction Strategy Paper Progress Report
Letter of Intent sent to the IMF by the authorities of Lesotho*
Memorandum of Economic and Financial Policies by the authorities of Lesotho*
Poverty Reduction Strategy Paper Progress Report
Technical Memorandum of Understanding*

*May also be included in Staff Report

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

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LESOTHO

Fourth Review Under the Poverty Reduction and Growth Facility Arrangement and Request for Waiver of Performance Criteria

Prepared by the African Department

(In consultation with the Legal, Policy Development and Review, Statistics, and Finance Departments)

Approved by Michael Nowak and Liam P. Ebrill

May 22, 2003

- The Executive Board approved a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for SDR 24.5 million (70 percent of quota) on March 9, 2001. The third and fourth disbursements of SDR 3.5 million each took place on March 26, 2002 and September 30, 2002, respectively.
- Discussions for the fourth review under the PRGF were held in Maseru during December, 4-17, 2002 and February 17-21, 2003, and in Washington during April 9-13. Participants included Minister of Finance and Development Planning, T. Thahane; Governor of the Central Bank of Lesotho, E. M. Matekane; and officials of the government and central bank, and commercial bank representatives. The mission was briefed by the poverty reduction strategy paper (PRSP) coordinating committee and met with local donor representatives.
- The mission team comprised Mr. Green (head-AFR), Mr. Halikias (PDR), Ms. Medina Cas (AFR), Mr. Gershenson (FIN), and Mr. Surti (EP-AFR).
- Economic growth picked up to 4¼ percent in 2002/03, benefiting from the rapid expansion of clothing exports and related construction activities. The regional food crisis affected 40 percent of the population, but its impact was mitigated by donor support. The government also provided inputs to farmers, and this initiative caused several quantitative performance criteria in September 2002 and March 2003 to be breached. The government made considerable progress with the structural program and is addressing two performance criteria that were not observed. Agreement was reached on quantitative performance criteria for June and December 2003 and on structural targets through December 2003.

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I. INTRODUCTION

1. **Discussions for the fourth review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Maseru during December 4-17, 2002 and February 17-21, 2003, and in Washington during April 9-13, 2003.** Participants included Minister of Finance and Development Planning, T. Thahane; Governor of the Central Bank of Lesotho, E. M. Matekane; and officials of the government and central bank, and commercial bank representatives. Discussions were not concluded until the April 2003 meetings because of a change in Lesotho's budget preparation cycle. To avoid this problem in the future, the program test dates and mission schedule have been shifted by three months.
2. **In the attached letter of intent and memorandum on economic and financial policies (MEFP) (Appendix I, Attachment I), Finance Minister Thahane reviews performance under the program through March 2003 and describes objectives and policies through March 2004.** The authorities are requesting waivers for the missed performance criteria that pertain to this fourth review, that is one quantitative performance criterion for September 2002 and one structural performance criterion for December 2002.¹

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

3. **The key objectives of the program are to raise economic activity and boost employment in order to reduce poverty.** Thus, the program aims to restore and sustain macroeconomic stability by limiting the government's access to domestic financing and maintaining the pegged exchange rate regime by setting a floor on net international reserves and a ceiling on net domestic financing. Structural measures are designed to strengthen fiscal policy implementation through improved tax administration and public expenditure control, and to bolster the investment climate through the financial sector reforms.
4. **Lesotho broadly observed its performance targets during the first three program reviews.** However, recent spending pressures, partly related to the food emergency, caused several quantitative performance criteria to be exceeded. The government took steps to offset overspending during the 2002/03 fiscal year (April-March) and is working to put in place budgetary saving in the period ahead. Structural objectives have been generally observed during all of the reviews, and the government has moved quickly to address those that were not completed on time.

¹ Other performance criteria were also not observed through end-March 2003. Waivers are not required because these objectives were tied to the fifth review. New criteria for the fifth review are established in this report.

A. Recent Developments

5. **As many as 900,000 people (40 percent of the population) could be affected by the regional food shortage before the harvest is completed in June 2003.** The government distributed food early in the crisis, but most food assistance since August 2002 has been provided by donors through the World Food Program (WFP; Table 1).² Prospects for the 2003 harvest are unclear because of mixed weather conditions across the country and questions about the effectiveness of the government's agricultural support program.

6. **The economic consequences of HIV/AIDS are beginning to emerge.** The rural areas have been especially hard hit, and a vicious cycle of AIDS and famine is developing. Farmers are falling sick with AIDS and are less able to feed themselves or their families, and the resulting drop in nutrition is making them more susceptible to illnesses.

7. **Lesotho's economy has held up well, given adverse local weather conditions and the regional food situation (Table 2).** Economic growth is estimated to have risen to over 4 percent in 2002, from 3½ percent the year before, because of a surge in clothing exports to the United States under the African Growth and Opportunity Act (AGOA), related construction activities, and strengthened confidence in economic policies following the May 2002 elections. Consumer price inflation picked up in 2002 to an annual rate of 11¼ percent in December, mainly reflecting inflation conditions in South Africa, but also a larger weight assigned to the food component in Lesotho's price index. Thus, Lesotho's real effective exchange rate appreciated as food prices increased in 2001 and early 2002, but then depreciated as food price increases moderated in the second half of 2002. These fluctuations do not appear to have dampened foreign interest in investment opportunities in Lesotho, because the currency remains internationally competitive (Figure 1).

8. **Fiscal policy in 2002/03, as measured by the domestic balance, was more expansionary than anticipated by about 2 percent of GDP (Tables 3 and 4).** The main cause of this fiscal slippage was agricultural support to farmers, equivalent to about 1½ percent of GDP; this cost was not included in the original program but was understandable in the circumstances. Tax revenue was somewhat higher than programmed, as a shortfall in income tax was more than made up by larger sales tax collections.

9. **Lesotho's current account deficit is estimated to have worsened in 2002/03, relative to projections, reflecting the larger-than-projected fiscal imbalance (Table 5).** However, the external deficit improved to near 11 percent of GDP from over 13 percent in 2001/02 because of the sharp rise in clothing exports to the United States under the AGOA.

²A technical consequence of the flow of most aid through the WFP is that data for 2002/03 show that grants and food relief spending were nearly 5 percent of GDP below program estimates.

There were also indications that miners' remittances from South Africa stabilized during 2002 in response to an increase in world gold prices.

10. **Domestic credit to the government was in line with program objectives through December 2002, but then expanded sharply in the March quarter (Tables 6 and 7).** The central bank was successful in offsetting the drawdown in government deposits for most of the financial year through the sale of treasury bills and repurchase operations at yields closely following those in South Africa. The central bank did not meet its objective for end-March 2003 because of technical reasons, but it was able to return to the desired path in April. Gross official reserves declined to 4.3 months of imports in March 2003, below target, reflecting the expansion in domestic credit, but then rebounded in April.³ Credit to the private sector grew marginally during 2002, but, with the loan-to-deposit ratio at the commercial banks at around 15 percent, financial intermediation remains a problem.

11. **The High Court of Lesotho has taken steps to address corruption.** In May 2002, the former chief executive of the Lesotho Highlands Development Authority was sentenced to 18 years in prison for accepting payments from international construction companies. In October 2002, one of these companies was fined approximately US\$2½ million; actions against other companies are pending. The government is also investigating public sector corruption and has begun to prosecute offenders. The loss of public funds appears to be limited.

B. The PRGF Review

12. **Several quantitative performance criteria were not observed (Table 8).** The performance criterion on the ceiling on domestic financing requirement of the government for end-September 2002 was exceeded, mostly because of overruns in current expenditure on goods and services, excluding famine relief. Key sources of the overspending through September were monthly vehicle lease costs and the initial stage of the government's agricultural support program, which provided farmers with crop inputs, including plowing, seeds, and fertilizer.⁴ The ceiling on domestic financing was also exceeded in March 2003, again owing to spending overruns. In addition to support to farmers and vehicle leases,

³ The reserve-to-imports ratio also declined because the appreciation of the rand against the U.S. dollar reduced reserves in rand terms. Lesotho's imports, which mainly come from South Africa, were mostly unaffected by this valuation effect.

⁴ In addition, an accounting reclassification moved Fund disbursements from external financing to domestic financing in Ministry of Finance accounts. This shift added about M 47 million to the domestic financing requirement in September 2002. Had the reclassification been in place before the performance criterion was set, the target would have been missed by only M 12 million, or 0.2 percent of GDP.

spending on college scholarships exceeded expectations, largely due to an effort to expand university education opportunities. Revenue exceeded the program objective, mainly reflecting temporary electricity generation receipts. The performance criteria for end-March 2003 relating to the floor on net international reserves and the ceiling on net domestic assets were not observed because, as noted above, the central bank did not fully sterilize the monetary impact of the deficit for technical reasons.⁵

13. **The government took steps to improve the quality of spending and avoid overruns.** To bring vehicle lease costs under control, the government appointed a high-level task force to improve cost monitoring, dissemination of such cost information by the vehicle lease coordinator, and compliance in spending ministries and to seek changes in the leasing contract that would give the government more flexibility. To fund the agricultural support, the government instructed ministries to reduce spending in nonpriority areas.⁶ To improve quality, the 2003 budget speech indicated that crisis-related agricultural support and the scholarship program would be reviewed. In addition, any famine-related support above that already subsumed in regular budget authorizations would be implemented through a supplementary budget that would also identify offsetting savings.

14. **Lesotho has made significant progress in strengthening tax administration and financial management (Table 9 and Box 1).** The Lesotho Revenue Authority (LRA) became operational in late December 2002 (a performance criterion), and early indications are that the new arrangement has already helped to increase collections. The government completed an action plan to strengthen financial management and began a study of an integrated financial management system (both performance criteria for end-October 2002). It also improved expenditure management and tracking in the Lesotho Treasury (a performance criterion for end-November 2002), in particular by strengthening the processing of payment vouchers and improving the accuracy of treasury records.

15. **The expected reorganization of the Treasury Department was postponed.** The original program envisaged the installation of a new top management structure of the Treasury Department in the Ministry of Finance by end-February 2003 (a performance criterion for the sixth disbursement), under the expectation that a new Accountant General would not be in place until July 2003. In the event, the Accountant General was appointed in November 2002, and he said that he would prefer to oversee the reorganization himself. An action plan is expected by end-June 2003.

⁵ It reflected a lack of clarity about how the program's adjuster related to famine relief should have been applied.

⁶ Spending authority equivalent to ½ of 1 percent of GDP was redirected to agricultural assistance. This came on top of cuts in travel and purchases of office equipment of about ½ of 1 percent of GDP in August 2002 in response to budget concerns at that time.

Box 1. Structural Measures

Status of structural measures

Structural reform in Lesotho has been generally successful, and most targets were met under the PRGF-supported program for the period July 2002–March 2003. The Lesotho Revenue Authority is now operational, and plans are being made to improve government financial management. The government has also made progress on a variety of fronts in the area of financial sector reform.

Coverage of structural conditionality in the current program

Structural measures are listed in Table 9 of the staff report and Table 2 of the memorandum on economic and financial policies. The most important include the following:

- Improving tax administration, including establishing a national revenue authority, is part of the program to boost tax revenue and to create a level playing field for all taxpayers. The value-added tax (VAT) is due to start on July 1, 2003 and measures will be introduced by the end of June 2003 to increase revenue by 1 percent of GDP.
- Strengthening expenditure management is a critical first step toward bringing down Lesotho's high level of government spending. Progress has been made in preparing plans to strengthen the Accountant General's office and replace the financial management system. Construction of the government's balance sheet as of March 31, 2002 was not completed, but progress was made in capturing more fully the government's financial assets and liabilities. The government did not appoint the top management of the treasury, but this was because a new Accountant General was appointed ahead of schedule and he is now reviewing the restructuring of the department.
- In the area of financial sector reform, the central bank has encouraged commercial banks to take claims to the new commercial court, and it plans to hold a commercial court workshop by July 31, 2003. The central bank has worked with the private sector to establish a credit bureau and begun to publish its macroeconomic projections on the Internet. The central bank is preparing a schedule by June 30, 2003 to improve its balance of payments data and also plans to complete the liberalization of the capital account by the same date.

Structural areas covered by World Bank lending and conditionality

Currently, there is no World Bank lending program in Lesotho. However, the World Bank is administering a privatization and utility sector reform project. Structural benchmarks in the Fund-supported program are intended to be complements to a potential future World Bank public sector project and help start the financial management component, with support from Ireland Aid and the United Kingdom's Department for International Development (DFID).

Other relevant structural initiatives not included in the current program

The authorities have already addressed the problem of their two insolvent banks and are working to establish a more effective legal system, especially pertaining to commercial law and property rights.

The Privatization Unit of the Ministry of Finance is working to privatize Lesotho's electric utility, and the telecommunications company has already been privatized.

16. **The Ministry of Finance achieved some success in clearing the backlog of unaudited government accounts, but a related performance criterion was not observed.** The government presented the 2001/02 accounts for audit in March 2003, the first time the accounts were turned over to the Auditor General since 1995/96. The accompanying report identified several limitations in the 2001/02 accounts and, more generally, in the government's recordkeeping, so that the final audit is likely to be qualified. These limitations included inadequate accounting systems and procedures, improper treatment of below-the-line accounts, and problems with assigning costs of the vehicle lease to responsible ministries. In addition, some government financial assets, such as bank balances and loans to parastatals and individuals, were not fully captured. Therefore, the end-December 2002 performance criterion to construct the government's balance sheet as of March 2002 was not completed. Measures to address these problems are outlined below.

III. THE 2003/04 PROGRAM

17. **Macroeconomic stability and improved living conditions for the people of Lesotho remain the fundamental objectives of economic policy.** To achieve these, the government's economic policies will need to address a worsening of the fiscal situation, a deterioration of the government's treasury systems and physical infrastructure since the civil unrest in 1998, and the spread of HIV/AIDS. The program attempts to solve these interrelated problems over the medium term by first rebuilding expenditure management tools, so that government spending can be made to better reflect policy objectives. The program assumes that these improvements, coupled with more efficient tax administration, would help bring the government's borrowing to levels consistent with sustainable debt.

18. **Near-term economic growth projections have been revised upward to 4½ percent in 2003/04, but, in the medium term, growth is likely to slow.** The clothing and textile sector will remain the main source of output growth in the near term. HIV/AIDS is assumed to reduce economic growth over the medium term by ½ of 1 percentage point. Consumer price inflation is projected to fall during 2003/04, reflecting the assumption that inflation in South Africa will moderate.

A. Fiscal Policy⁷

19. **Fiscal policies in 2003/04 will result in a primary deficit of more than 2 percent of GDP and an increase in domestic debt (table below).** The imbalance reflects the anticipated decline in revenue and the spending pressures outlined below, which can feasibly

⁷ The economic program closely follows the 2003/04 budget that was passed by parliament on March 28, 2003. The program figures incorporate revisions to tax revenue based on recent information and two payments for rand monetary compensation in the financial year because of a technical delay in the 2002/03 payment. Revenue and expenditure figures are also higher because they reflect the subjection of government purchases to the value-added tax (VAT).

be only partly offset by expenditure compression. However, the fiscal stance, as measured by a deficit in the domestic balance, would be roughly unchanged from the previous year, albeit expansionary compared with the original program. Any adverse impact on the domestic economy will be temporary because spending on local elections, which is budgeted at nearly 2 percent of GDP, accounts for a large share of the fiscal imbalance.

Medium-Term Fiscal Scenario, 2003/04-2008/09
(In percent of GDP)

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Revenue and grants	42.5	41.2	41.1	40.7	40.5	40.3
Primary spending 1/	44.9	42.0	41.6	41.2	40.8	40.4
Domestic interest payments	1.6	1.5	1.5	1.5	1.6	1.6
Overall balance						
Primary 1/	-2.2	-0.9	-0.5	-0.5	-0.4	-0.1
Total	-3.8	-2.4	-2.0	-2.0	-2.0	-1.7
Domestic debt	14.8	15.4	18.0	20.8	22.7	22.1
Memo:						
Real growth	4.2	4.4	3.9	3.8	3.9	4.0
Real interest rate	3.1	2.7	4.2	2.8	3.3	2.8

1/ Excludes domestic interest payments.

20. **Resources available to the government are projected to decline in 2003/04.** Customs and excise tax receipts from SACU will fall by about 2¾ percent of GDP because of technical factors,⁸ and budget support grants are expected to decline by ½ of 1 percent of GDP relative to the original program because of a likely shift of a grant disbursement into the 2004/05 financial year. Offsetting factors amounting to ½ of 1 percent of GDP are: (i) a

⁸ The Southern African Customs Union (SACU) collects customs and excise taxes on behalf of Lesotho, Botswana, Namibia, South Africa, and Swaziland. SACU then redistributes these funds. Under the current formula, payments to countries are predetermined, based on economic variables with lags of two years. The 2003/04 payment to Lesotho fell because of a sharp decline in the payment linked to data revisions and, also, slow growth in the import data reported to the SACU secretariat.

5 percent gain in domestic tax collections related to the LRA efficiency gains; and (ii) two annual payments under the rand monetary compensation arrangement. Recognizing the severe limitations that would follow from this net decline in resources, the budget speech indicated that measures to raise revenue by 1 percent of GDP would be introduced (a performance criterion for end-June 2003). Projected collections would also rise by about 1½ percent of GDP when the VAT is applied to government purchases, but this would not expand available resources.⁹

21. The program includes some new spending on education and governance measures. Local government elections, planned for December 2003, will increase outlays by an estimated 2 percent of GDP, and the expansion of the National Assembly from 80 to 120 members in May 2003 will further increase administrative expenses. The expansion of free primary education is also very expensive, as is the government's scholarship program. Finally, there are costs associated with improving the government's financial management system, but these should help identify budget savings and better match policies with spending programs in the future. To offset these increases, wages paid by government were increased by only 4 percent and nonessential spending was curbed.

22. Lesotho's primary deficit would only be reduced sufficiently to stabilize government debt in the medium term. The base scenario assumes that total revenues would fall by about 2 percentage points of GDP over the next five years, mainly reflecting reductions in tariff rates and lower customs revenue (see table above). Therefore, to bring the deficits into the range needed to stabilize the domestic debt ratio, spending would need to be lowered by 4 to 5 percentage points of GDP. With this level of budget savings, domestic debt would stabilize at 22 percent of GDP by 2008/09, compared with 12½ percent recorded at end-March 2003.

23. If the primary deficit is not reduced, Lesotho would face adverse debt dynamics (table below). Such an outcome would cause debt-service payments to rise, leaving fewer resources available for priority programs. In this case, the primary deficit would remain in the 3 to 3½ percent range over the medium term and domestic debt would rise to 39 percent of GDP. This rise in debt could occur if the government were unable to find the budgetary savings assumed in the base-case scenario, or if customs revenue were to fall more quickly than assumed. The situation would be worsened if interest rates rose because investors perceived an increase in the risk of holding Lesotho government debt. This, in turn, would crowd out domestic investment.

⁹ The VAT will be applied to government purchases, whereas in the past, they were exempt from the sales tax. The rise in related revenue, however, will be offset by higher spending.

Debt Dynamics Scenario, 2003/04-2008-09
(In percent of GDP)

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Revenue and grants	41.5	41.2	41.1	40.7	40.5	40.3
Primary spending 1/	44.9	44.0	43.8	43.7	43.7	43.7
Domestic interest payments	1.6	1.9	2.4	2.6	3.1	3.0
Overall balance						
Primary 1/	-3.2	-2.8	-2.7	-3.0	-3.2	-3.4
Total	-4.9	-4.7	-5.1	-5.6	-6.3	-6.4
Domestic debt	15.5	21.2	26.3	32.0	36.0	39.2
Memo:						
Real growth	4.2	4.4	3.9	3.8	3.9	4.0
Real interest rates	5.1	4.7	6.2	4.8	5.3	4.8

1/ Excludes domestic interest payments.

24. **During the discussions, the mission recommended further budget savings to lessen the risk of unsustainable debt dynamics.** The authorities agreed that savings measures would be desirable and pointed to their intention to enact revenue measures amounting to 1 percent of GDP and the difficult decisions already taken to curb spending in 2003/04. Moreover, the costs associated with local elections in 2003 would be temporary, although the new positions created would have ongoing cost implications. They explained the lack of timely expenditure information and audited accounts had hampered attempts to identify budget savings without risking social objectives. Therefore, the budget deficit projected for 2003/04 was larger than desired, but it would be reduced in future years when management systems are stronger.

B. Budget Reform

25. **Structural measures supporting fiscal policies will remain focused on improving financial management and tax administration.** Priority areas for the next six months have been modified to reflect the deficiencies highlighted when the 2001/02 accounts were prepared for audit (see paras. 31-38 of the MEFP). They include measures to strengthen recordkeeping at spending ministries and the Ministry of Finance and steps to make government accounts more complete. In addition, the government will submit for audit its 2002/03 accounts and a report on below-the-line accounts (performance criteria for end-September 2003). Beyond these immediate tasks, the government will seek to implement the main financial management aspects of the Lesotho Public Sector Improvement and Reform Program, which was put on hold at end-2001 because of financing concerns. The government is receiving donor support for this exercise.

C. Monetary Policy and International Reserves

26. **The main objectives of monetary policy are to maintain the loti's peg to the South African rand and preserve an adequate level of international reserves.** Accordingly, the central bank will continue to use its indirect instruments—the sale of treasury bills and repurchase agreements—to sterilize most of the expansion of domestic credit caused by the use of government deposits at the central bank to finance the budget deficit. However, reserves are projected to decline by \$20 million when restrictions on foreign currency deposits are eased in July 2003. This is assumed to be a onetime outflow from the central bank and, therefore, would be accommodated. International reserves would remain at a comfortable level of around four months of imports.

IV. PRSP

27. **Completion of the poverty reduction strategy paper (PRSP) has been postponed until mid-2003, and it is expected to be delivered to the World Bank and Fund no later than November 2003.** The government's PRSP preparation status report (December 2002) indicates that an initial draft of the PRSP had been completed in November 2002, but more work was needed before the paper could be presented to the cabinet.¹⁰ Completion of the PRSP was also delayed as a result of the decision to merge the secretariats of the PRSP and Vision 2020, a community-based planning instrument similar to the PRSP. Despite the delay, a number of the PRSP's initial conclusions are reflected in the 2003/04 budget and economic program.

V. EXTERNAL FINANCING

28. **The external financing requirements in the baseline scenario remain large** (Table 10). However, these gaps should be filled by the concessional financing anticipated, including Fund disbursements, and there are no financing gaps. Debt-service payments to the Fund are projected to decline from 1.5 percent of exports of goods and services in 2001/02 to 0.3 percent in 2008/09 (Table 11). Lesotho's reserve position should remain strong and its payment risks to the Fund are small. The schedule of Fund disbursements has been shifted by three months so that future reviews are better aligned with Lesotho's budget cycle (Table 12).

VI. PRGF ARRANGEMENT MONITORING

29. **Quantitative and structural performance criteria and benchmarks are set out in Tables 1 and 2 of the MEFP.** The sixth disbursement will be based on end-June 2003 test dates and the structural performance criteria indicated in Table 2 of the MEFP. The

¹⁰ See "Joint Staff Assessment of the PRSP Preparation Status Report," EBD/03/42.

quantitative performance criteria for end-December 2003 would be conditions for the seventh disbursement.

VII. STAFF APPRAISAL

30. **Economic growth in 2002 outperformed expectations under the program.** This was largely due to performance in the manufacturing and construction sectors, which have been boosted by the surge in textile exports to the United States under AGOA and related plant and infrastructure construction. However, medium-term growth prospects are clouded by the economic consequences of HIV/AIDS. Consumer price inflation is expected to decline during 2003, in line with South Africa's.

31. **Local weather conditions and the regional food situation could affect 40 percent of the population before the 2003 harvest is completed in June.** The government of Lesotho provided food to the most needy in July and August 2002, when donor shipments began to arrive. The staff welcomes the generous level of humanitarian support that averted a disaster and helped the government conserve its limited resources.

32. **After the last program review, the government greatly expanded its agricultural support program by providing fully subsidized plowing, seed, and fertilizer to farmers.** The cost was high, about 1½ percent of GDP, but understandable in the circumstances. Nevertheless, concerns over the program's costs remain, and the staff endorses the government's intention to review the program before further agricultural support is offered.

33. **Lesotho's economic program was broadly on track through December 2002, but large fiscal slippages emerged by end-March 2003.** The program ceiling for the government's domestic financing requirements for end-September 2002 and end-March 2003 were breached, with overspending on vehicles, scholarships, and assistance to farmers being the main causes. The central bank offset most of the monetary impact of the fiscal slippage, but the program ceiling on net domestic assets of the central bank and the floor on net foreign assets for end-March 2003 were nevertheless breached. The staff supports a waiver for the September performance criterion because of the temporary nature of the agricultural spending, the ongoing efforts to strengthen the management of vehicle costs, and the plans to review the scholarship program. A waiver is not needed for the end-March target because it pertained to the fifth review.

34. **Lesotho's primary deficit in 2003/04 of 2½ percent of GDP would result in an increase in domestic debt.** The imbalance partly reflects the anticipated decline in customs revenue and budget support grants of more than 3 percentage points of GDP. While unfortunate, this reduction in resources cannot be avoided, and the staff welcomes the authorities' commitment to take new revenue measures equivalent to 1 percent of GDP by July 1, 2003. The staff supports the government's conservative income tax and VAT revenue projections for 2003/04 because the LRA and VAT are new institutions. It urges the authorities to dedicate all above-budget collections to reducing the deficit.

35. **The government has indicated that it would not be feasible to reduce overall spending in 2003/04 below the levels presently budgeted.** Pressing demands, such as local elections and the need to rebuild infrastructure following the 1998 civil disruptions, have pushed up authorized spending, and while efforts to improve the current state of expenditure monitoring and control are underway, at this stage it is difficult to identify savings that do not jeopardize social programs. The staff accepts these arguments, while noting that it is critical to press ahead with measures to strengthen financial systems so that the savings assumed in the medium term can be achieved. Otherwise, Lesotho's fiscal position could become unsustainable.
36. **The staff endorses the government's strategy to improve its financial management systems.** Measures to bolster expenditure tracking and control are beginning to take hold, but, as the government recognizes, more needs to be done. The staff anticipates that in the months ahead improvements in these areas will allow the government to match clearly budget line items with policy objectives. Similarly, the staff welcomes the efforts to build a public consensus on the importance of sustainable fiscal policies.
37. **The launch of the LRA provides an excellent opportunity for Lesotho to improve tax collection effort.** The management team now in place should help provide a smooth transition to the new tax administration arrangement. The staff agrees that major changes in tax policy should await a study on the economic and budget implications of tax reform. However, it understands that the benefits of such a delay need to be weighed against immediate revenue needs.
38. **Monetary policy is largely dictated by Lesotho's membership in the Common Monetary Area and the exchange rate peg to the rand.** The monetary program seeks to consolidate Lesotho's reserve position. The staff supports continuation of the exchange rate system because the majority of Lesotho's trade is with South Africa; moreover, South Africa's macroeconomic policies have been prudent.
39. **Lesotho's data are adequate for program monitoring, but there is room for improvement.** Recently, monetary reports have become timelier, and there has been some improvement in the reconciliation of domestic financing figures from the Central Bank and the Ministry of Finance. However, weaknesses in the main data sectors need to be addressed, and the staff endorses the use of the General Data Dissemination System (GDDS) framework for this purpose.
40. **A key risk to the program is that government deficits will not be brought down to sustainable levels.** Such an outcome would cause debt-service payments to rise, leaving fewer resources available for priority programs. Interest rates could rise significantly above those in South Africa, thereby exacerbating the debt problem. The need to continue emergency famine relief and agricultural support in 2003/04 is a second risk to the program. Budget authority for these purposes was not included in the 2003/04 budget or economic program because the 2003 harvest outcome was unclear when the program was being

finalized. The situation will be reassessed at the next review and, if donor support is inadequate, could be addressed in a supplementary budget that would also identify offsetting measures.

41. **The staff welcomes the government's strong commitment to its economic program and recommends completion of the fourth review.** It supports a waiver for the nonobserved quantitative performance criterion because of the actions taken by government to reduce nonessential spending in 2002/03 and because of its commitment to implement sustainable fiscal policies in the medium term. It also supports a waiver for the structural performance criterion that was not observed because key elements of financial balance sheet for the government were completed, and the government is working to finish the task. Looking forward, it will be important for the government to implement the program strictly and make every effort to implement the envisaged budget savings.

Table 1. Lesotho: Food Relief Program and Assumptions, 2002/03 ^{1/}

	(In millions of maloti)					
	September 2002		December 2002		March 2003	
	Program	Actual	Program	Actual	Program	Estimate
Government outlays	124	11	256	21	373	23
<i>Of which</i>						
Subsidy for general population	29	2	58	4	87	4
Less: donor support to government	98	0	194	0	291	0
Donor support in kind	52	0	104	0	155	0
Financial commitments and pledges	46	0	90	0	136	0
Government net outlays	27	11	62	21	82	23
Memorandum item:						
Agricultural support	0	8	0	37	0	109

Source: Ministry of Finance.

1/ Fiscal year begins April.

Table 2 Lesotho: Selected Economic and Financial Indicators, 1999/2000-2008/09 ^{1/}

	1999/00	2000/01	2001/02		2002/03		2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
	Act	Act	Prog.	Act	Prog.	Est.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise specified)												
National income and prices												
Real GDP	0.5	1.9	2.9	3.6	4.0	4.2	4.2	4.4	3.9	3.8	3.9	4.0
Real GNP	-0.3	0.8	2.1	1.4	0.8	3.1	3.5	3.4	3.4	3.0	3.2	3.0
Consumer price index (average change)	7.1	6.2	7.8	11.3	5.6	9.2	9.4	7.8	5.3	5.2	4.7	4.7
Nominal GDP (in millions of maloti)	5,668.7	6,104.6	6,975.1	6,762.5	7,946.7	7,867.7	8,908.7	9,981.7	10,892.9	11,872.0	12,896.4	13,997.4
Nominal GNP (in millions of maloti)	7,183.0	7,652.2	8,619.1	8,296.9	9,394.6	9,551.6	10,743.0	11,921.2	12,946.6	14,001.4	15,106.2	16,234.0
External sector ^{2/}												
Exports, f.o.b.	-1.6	18.4	38.8	32.6	55.2	68.1	13.2	7.8	7.8	7.9	8.4	7.5
Imports, f.o.b.	1.9	-10.0	7.4	-7.7	26.2	32.2	19.8	5.2	5.1	5.5	6.7	4.8
Net labor income	2.5	-12.5	0.8	-22.8	-1.1	13.0	25.8	1.8	0.9	0.7	0.8	-0.2
Real effective exchange rate ^{3/}	0.5	-9.9	...	3.5	...	...	...	...	...	...	...	...
Government budget												
Revenue (excluding grants)	6.4	13.6	9.1	6.1	8.6	9.2	14.7	7.1	8.9	7.8	7.9	7.5
Total expenditure and net lending	38.3	-15.7	2.6	3.4	25.2	22.5	14.7	5.5	7.5	7.8	8.0	7.2
Current expenditure	19.3	2.2	3.5	-2.4	27.4	24.4	14.0	5.2	7.8	7.4	7.6	7.0
Capital expenditure and net lending ^{4/}	112.8	-55.2	-1.5	32.5	16.9	15.9	17.3	6.6	8.3	9.1	9.4	7.9
Money and credit ^{5/}												
Net foreign assets	-9.8	5.1	41.3	85.5	-38.1	-77.0	-17.0	7.6	18.0	20.8	20.4	14.2
Net domestic assets	7.7	1.1	-29.7	-68.5	46.7	80.1	23.0	1.8	-8.9	-11.6	-11.6	-5.3
Of which: credit to the government	57.9	20.9	-10.1	3.7	6.1	16.4	15.5	5.7	-1.4	-3.2	-3.2	0.4
Of which: credit to the rest of the economy	-4.6	0.7	1.3	-3.3	21.0	3.1	2.8	1.0	1.0	0.9	0.8	0.8
Broad money	-2.1	6.1	11.6	17.0	8.6	3.1	6.0	9.4	9.1	9.3	8.7	8.7
Velocity (GDP/average broad money)	3.3	3.4	3.6	3.4	3.6	3.6	3.9	4.1	4.1	4.1	4.1	4.1
(In percent of GDP, unless otherwise specified)												
Investment and saving ^{6/}												
Investment	46.9	41.7	32.3	39.6	35.6	35.9	37.2	35.9	36.0	36.3	36.3	36.3
Public	8.5	8.4	9.9	12.2	8.2	8.6	9.9	8.6	8.8	9.0	9.1	9.0
Private	26.2	20.0	15.6	20.4	20.9	20.8	21.2	21.6	22.0	22.4	22.8	23.2
Lesotho Highlands Water Project	12.3	10.7	6.8	7.0	6.4	6.5	6.1	5.7	5.2	4.8	4.4	4.1
Gross national savings (including remittances)	24.1	23.4	24.9	26.2	27.4	24.9	24.3	22.8	22.9	23.1	22.2	22.5
Public	2.2	6.3	9.4	9.8	7.3	5.5	5.7	6.7	7.0	7.0	7.1	7.4
Private	21.9	17.1	15.5	16.4	20.1	19.4	18.6	16.1	15.9	16.0	15.0	15.1
Government budget												
Revenue	40.8	43.0	41.1	41.2	37.9	38.7	39.2	37.5	37.4	37.0	36.7	36.5
Total grants	2.3	2.1	3.7	2.8	7.8	3.3	3.3	3.7	3.7	3.7	3.8	3.8
Total expenditure and net lending	61.6	46.6	42.6	43.4	47.7	45.8	46.3	43.6	43.1	42.7	42.4	41.9
Overall balance (before grants)	-18.7	-3.5	-1.5	-2.2	-9.8	-7.1	-7.1	-6.2	-5.8	-5.7	-5.7	-5.4
Overall balance (after grants)	-16.4	-1.5	2.2	0.6	-1.9	-3.8	-3.8	-2.4	-2.0	-2.0	-2.0	-1.7
Domestic balance	-2.7	2.4	1.5	2.0	2.2	-0.1	0.2	0.7	0.9	0.8	0.8	0.8
Primary balance	-13.2	2.8	5.0	3.6	0.9	-0.9	-1.0	0.1	0.4	0.3	0.3	0.5
Gross government domestic debt	15.4	14.1	15.9	17.3	16.2	11.8	14.8	15.4	18.0	20.8	22.7	22.1
External sector												
Current account balance (excluding official transfers)	-36.7	-33.3	-23.9	-30.1	-26.3	-25.5	-25.9	-25.5	-25.1	-24.9	-25.6	-25.2
Current account balance (including official transfers)	-22.8	-18.3	-7.4	-13.4	-8.2	-11.0	-12.9	-13.2	-13.1	-13.2	-14.2	-13.9
Stock of public external debt	68.2	65.6	72.7	75.9	69.7	66.1	50.1	47.1	44.9	42.7	41.0	39.3
Debt-service ratio ^{7/}	17.1	25.4	7.5	12.4	11.0	10.3	9.2	8.5	7.5	6.5	5.8	5.5
Net present value of total public external debt	...	44.6	48.5	61.4	57.7	55.6	40.1	36.6	33.7	30.8	28.0	25.0
(In millions of U.S. dollars, unless otherwise specified)												
Gross official reserves (end of period)	470.1	393.3	381.7	400.2	381.3	406.3	398.9	400.7	425.9	457.6	483.2	483.2
Gross official reserves (in months of imports of goods and services)	7.4	6.7	7.6	5.1	5.0	4.3	4.0	3.8	3.8	3.8	3.8	3.8

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

1/ Fiscal year beginning in April.

2/ In U.S. dollars.

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

4/ Category affected by special factors including M 575 million of net lending to restructure the banks in 1999/2000.

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

6/ Historical investment and savings data were corrected for an error.

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

Table 3. Lesotho: Central Government Operations, Annual, 2000/01-2006/07 1/

	2000/01		2001/02		2002/03		2003/04	2004/05	2005/06	2006/07
	Prog.	Act.	Prog.	Act.	Prog.	Est.	Prog.	Proj.	Proj.	Proj.
(In millions of maloti)										
Revenue	2,505.8	2,626.6	2,864.9	2,787.8	3,011.0	3,044.9	3,491.9	3,741.2	4,073.2	4,388.9
Tax revenue	1,892.8	1,941.9	2,389.2	2,378.0	2,589.1	2,575.7	2,920.6	3,207.3	3,503.8	3,781.4
Customs revenue	1,128.2	1,126.1	1,438.2	1,438.2	1,470.0	1,470.0	1,421.7	1,561.1	1,669.7	1,785.8
Noncustoms tax revenue	766.6	815.8	951.0	939.8	1,119.1	1,105.7	1,498.9	1,646.3	1,834.1	1,995.6
New tax revenue measures	...	...	...	...	...	...	89.3	...	...	...
Income taxes	436.0	468.8	579.1	579.5	705.0	663.3	782.3	920.3	1,029.6	1,123.7
Sales tax / value-added tax (VAT)	270.0	279.8	306.5	302.0	323.6	343.7	529.7	623.2	697.1	759.7
Petrol levy	56.0	62.0	52.0	50.9	82.3	86.3	86.3	90.1	93.6	97.2
Other tax revenues	4.6	5.2	13.4	7.4	8.2	12.4	11.3	12.7	13.8	15.1
Nontax revenue	613.0	684.7	475.7	409.8	421.9	469.2	571.3	533.9	569.4	607.5
Grants	208.8	125.6	237.6	188.8	622.6	259.7	295.8	373.1	406.3	442.0
Of which: famine relief	...	...	...	...	291.0	0.0	0.0	...	...	...
Total expenditure and net lending	2,958.0	2,842.3	2,972.4	2,937.9	3,786.7	3,500.3	4,128.9	4,356.2	4,700.4	5,065.8
Current expenditure	2,409.8	2,370.0	2,464.8	2,312.3	3,055.2	2,875.4	3,278.5	3,449.3	3,718.1	3,994.2
Of which: total famine relief	...	...	...	...	373.0	23.0	0.0	...	...	...
Current expenditure excl. famine & agric. support	...	...	...	...	2,682.2	2,742.2	...	...	...	...
Wages and salaries	925.0	921.8	984.7	992.4	1,076.3	1,082.9	1,126.3	1,249.3	1,349.9	1,456.4
Interest payments	257.7	259.4	198.9	203.3	224.0	222.4	255.2	252.2	263.6	267.2
External	142.7	148.3	118.0	126.0	126.0	112.2	113.3	102.7	97.3	90.2
Domestic	115.0	111.1	80.9	77.3	98.0	110.2	141.9	149.5	166.3	177.0
Other expenditure	1,221.1	1,188.8	1,281.2	1,116.6	1,754.9	1,570.1	1,897.0	1,947.8	2,104.6	2,270.6
Excl. famine & agricultural support	...	...	...	...	1,381.9	1,436.9	...	...	...	...
Goods and services	1,006.0	911.4	940.8	720.3	1,202.8	1,074.4	1,273.6	1,256.3	1,357.4	1,464.5
Of which: Lesotho Revenue Authority	1.0	...	20.0	...	30.0	30.0	53.0	...	...	...
Of which: famine relief	...	...	...	...	286.0	19.0	0.0	...	...	...
Of which: agricultural support	...	...	...	...	...	110.2	0.0	...	...	...
Transfers and subsidies	215.1	277.4	340.4	396.3	552.1	495.7	623.4	691.5	747.1	806.1
Of which: famine relief subsidy	...	...	...	...	87.0	4.0	0.0	...	...	...
Capital expenditure	554.2	515.3	627.6	745.6	750.2	758.9	867.4	906.9	982.3	1,071.7
Domestically funded	280.0	275.0	337.0	373.1	300.8	322.5	341.0	244.5	266.8	290.8
Externally funded	274.2	240.3	290.6	372.5	449.4	436.4	526.4	583.8	629.7	687.4
Grant funded	159.8	125.6	161.2	166.8	245.6	199.3	266.1	298.1	325.4	354.6
Loan funded	114.4	114.7	129.4	205.7	203.8	237.1	260.3	285.7	304.3	332.8
Net lending 2/	0.0	-43.0	-120.0	-120.0	-18.7	-34.0	-17.0	0.0	0.0	0.0
Overall balance before grants	-452.2	-215.7	-107.5	-150.1	-775.7	-555.4	-637.0	-615.0	-627.2	-676.9
Excluding exceptional factors 3/	-478.3	-241.8	-322.2	-364.8	-775.7	-580.4	-623.0	...	...	...
Overall balance after grants	-243.4	-90.1	150.1	38.7	-153.1	-295.7	-341.2	-241.9	-220.9	-234.9
Excluding exceptional factors 3/	-269.5	-116.2	-64.6	-176.0	-153.1	-320.7	-327.2	...	...	...
Domestic balance 4/	-35.3	146.8	86.4	133.7	172.7	-8.8	16.7	71.5	99.8	100.7
Total financing 5/	243.4	90.1	-150.1	-38.7	153.1	295.7	341.2	241.5	220.9	234.9
External financing	-238.4	-257.1	-22.9	-54.3	23.1	8.1	0.1	33.4	46.6	73.2
Loan drawings	149.4	114.7	213.7	205.7	296.8	237.1	260.3	285.7	304.3	332.8
Amortization	-387.8	-371.8	-236.6	-260.0	-273.7	-229.0	-260.2	-252.3	-257.7	-259.6
Domestic financing	481.8	390.2	-127.2	15.6	130.0	287.3	341.1	208.5	174.2	161.7
Bank	501.8	366.9	...	67.3	...	349.0	...	...	...	...
Nonbank	-20.0	23.3	...	-51.7	...	-61.7	...	...	...	...
Residual	0.0	-43.0	0.0	0.0	0.0	0.3	0.0	0.0	0.0	0.0

Table 3. Lesotho: Central Government Operations, Annual, 2000/01-2006/07 (concluded) 1/

	2000/01		2001/02		2002/03		2003/04	2004/05	2005/06	2006/07
	Prog.	Act.	Prog.	Act.	Prog.	Est.	Prog.	Proj.	Proj.	Proj.
	(In percent of GDP, unless otherwise indicated)									
Revenue	40.4	43.0	41.1	41.2	37.9	36.7	39.2	37.5	37.4	37.0
Customs revenue	18.2	18.4	20.5	21.3	18.5	18.7	16.0	15.6	15.3	15.0
Noncustoms tax revenue	12.4	13.4	13.6	13.9	14.1	14.1	16.8	16.5	16.8	16.8
Nontax revenue	9.9	11.2	6.8	6.1	5.3	6.0	6.4	5.3	5.2	5.1
Grants	3.4	2.1	3.7	2.8	7.8	3.3	3.3	3.7	3.7	3.7
Total expenditure and net lending	47.7	46.6	42.6	43.4	47.7	45.8	46.3	43.6	43.1	42.7
Current expenditure	38.8	38.8	35.3	34.2	38.4	36.5	36.8	34.6	34.1	33.6
<i>Of which: famine relief & agric. support</i>	...	...	...	...	4.7	1.7	0.0	...	...	...
Current expenditure excl. famine & agric. support	...	...	...	...	33.8	34.9	36.8	...	...	...
Wages and salaries	14.9	15.1	14.1	14.7	13.5	13.8	12.6	12.5	12.4	12.3
Interest payments	4.2	4.2	2.9	3.0	2.8	2.8	2.9	2.5	2.4	2.3
External	2.3	2.4	1.7	1.9	1.6	1.4	1.3	1.0	0.9	0.8
Domestic	1.9	1.8	1.2	1.1	1.2	1.4	1.6	1.5	1.5	1.5
Other expenditure	19.7	19.5	18.4	16.5	22.1	20.0	21.3	19.5	19.3	19.1
Goods and services	16.2	14.9	13.5	10.7	15.1	13.7	14.3	12.6	12.5	12.3
Transfers and subsidies	3.5	4.5	4.9	5.9	6.9	6.3	7.0	6.9	6.9	6.8
Capital expenditure	8.9	8.4	9.0	11.0	9.4	9.6	9.7	9.1	9.0	9.0
Net lending 2/	0.0	-0.7	-1.7	-1.8	-0.2	-0.4	-0.2	0.0	0.0	0.0
Overall balance before grants	-7.3	-3.5	-1.5	-2.2	-9.8	-7.1	-7.1	-6.2	-5.8	-5.7
Excluding exceptional factors 3/	-7.7	-4.0	-4.6	-5.4	-9.8	-7.4	...	...	...	...
Overall balance after grants	-3.9	-1.5	2.2	0.6	-1.9	-3.8	-3.8	-2.4	-2.0	-2.0
Excluding exceptional factors 3/	-4.3	-1.9	-0.9	-2.6	-1.9	-4.1	...	...	...	...
Domestic balance 4/	-0.6	2.4	1.2	2.0	2.2	-0.1	0.2	0.7	0.5	0.8
Total financing 5/	3.9	1.5	-2.2	-0.6	1.9	3.8	3.8	2.4	2.0	2.0
Financing abroad	-3.8	-4.2	-0.3	-0.8	0.3	0.1	0.0	0.3	0.4	0.5
Domestic financing	7.8	6.4	-1.8	0.2	1.6	3.7	3.8	2.1	1.6	1.4
Memorandum items										
GNP at current prices (in millions of maloti)	7,706.4	7,652.2	8,619.1	8,296.9	9,395.4	9,551.6	10,743.0	11,921.2	12,946.6	14,001.4
GDP at current prices (in millions of maloti)	6,197.1	6,104.6	6,975.1	6,762.5	7,946.7	7,867.7	8,908.7	9,981.7	10,893.9	11,872.0

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

1/ Fiscal year from April to March.

2/ Net lending in 2001/02 consisted of a negative M 120 million from the redemption of the Lesotho Bank treasury bills.

In 2002/03, it consists of M 9 million of loan repayments to the government from parastatals and M 25 million

in revenue from the recovery of nonperforming loans from the old Lesotho Bank.

3/ In 2000/01, exceptional factors include one-off expenditure of M 98.9 million in payments of arrears to the South African Customs Union, and revenue of M 85 million in dividend payments from Lesotho Flour Mills and privatization revenues of M 40 million from the sale of the vehicle pool. In 2001/02, exceptional funds were received for the amortization of M 120 million of the Lesotho Bank treasury bills, an unbudgeted M 83 million from Muela electricity company transferred to government as revenue for the sale of electricity, and M 11.7 million from the sale of assets from Lesotho Flour Mills. In 2002/03, they consist of M 25 million in funds received from the amortization of Lesotho Bank treasury bills.

4/ Domestic balance excludes grants, foreign-financed capital spending, and foreign interest payments, and it excludes exceptional factors. In 2002/03, it also excludes current spending for the famine.

5/ In the new (revised) program period from Q3 2002/03, IMF disbursements are now included under domestic financing. In the previous past program figures, IMF disbursements were included in external financing, in line with Ministry of Finance practice. The Ministry now includes IMF disbursements under domestic financing, consistent with the Central Bank of Lesotho's accounting. Domestic financing is unchanged in the historical actual data as these figures are derived from the central bank's monetary survey. Estimates of external and total financing have been reduced in the historical actual data, as has the government's deficit and current spending on other goods and services because these items are derived as residuals.

Table 4. Lesotho: Central Government Operations, Quarterly, 2002/03-2003/04 1/

	2002/03 (Cumulative)							2003/04 (Cumulative)				
	Q1		Q2		Q3		Q4		Q1	Q2	Q3	Q4
	Act.	Prog.	Act.	Prog.	Act.	Prog.	Est.	Prog.	Prog.	Prog.	Prog.	
	(In millions of maloti)											
Revenue	718.2	1,484.2	1,489.1	2,184.5	2,250.5	3,011.0	3,044.9	796.2	1,684.9	2,541.0	3,491.9	
Tax revenue	562.9	1,246.6	1,217.7	1,875.4	1,878.1	2,589.1	2,575.7	637.9	1,415.5	2,121.1	2,920.6	
Customs revenue	367.5	735.0	735.0	1,102.5	1,102.5	1,470.0	1,470.0	355.4	710.9	1,066.3	1,421.7	
Noncustoms tax revenue	195.4	511.6	482.7	772.9	775.6	1,119.1	1,105.7	282.5	704.7	1,054.8	1,498.9	
New tax revenue measures	...	...	...	...	...	...	...	0.0	29.8	59.5	89.5
Income taxes	96.8	306.0	275.9	463.0	448.3	705.0	663.3	162.7	391.5	551.3	782.3	
Sales tax / value-added tax (VAT)	75.3	161.8	159.0	242.7	255.7	323.6	343.7	95.6	235.5	371.5	529.7	
Petrol levy	21.8	39.7	43.2	61.0	64.8	82.3	86.3	21.2	43.4	65.1	86.3	
Other tax revenues	1.5	4.1	4.6	6.2	8.8	8.2	12.4	3.0	4.7	7.4	11.3	
Nontax revenue	155.3	237.6	271.4	309.2	372.4	421.9	469.2	158.3	269.4	419.9	571.3	
Grants	90.1	202.9	133.8	422.3	189.9	622.6	259.7	39.9	147.7	204.7	295.8	
Of which: famine relief	0.0	97.0	0.0	194.0	0.0	291.0	0.0	0.0	0.0	0.0	0.0	
Total expenditure and net lending	887.7	1,851.6	1,810.9	2,826.7	2,642.5	3,786.7	3,600.3	839.7	2,004.8	3,014.1	4,128.9	
Current expenditure	709.6	1,536.8	1,463.3	2,292.1	2,098.1	3,055.2	2,875.4	671.9	1,628.5	2,376.6	3,278.5	
Of which: famine relief	0.0	124.0	11.0	256.0	21.0	373.0	23.0	0.0	0.0	0.0	0.0	
Current expenditure excl. famine & agric. support	708.9	1,412.8	1,444.6	2,036.1	2,039.4	2,682.2	2,742.2	671.9	1,628.5	2,376.6	3,278.5	
Wages and salaries	268.0	538.2	540.5	807.2	812.9	1,076.3	1,082.9	273.4	561.2	844.7	1,126.3	
Interest payments	43.6	113.2	109.1	166.1	163.7	224.0	222.4	46.5	104.5	187.0	255.2	
External	16.9	63.8	56.8	92.4	82.8	126.0	112.2	16.3	37.3	82.8	113.3	
Domestic	26.7	49.4	52.3	73.7	80.9	98.0	110.2	30.2	67.2	104.2	141.9	
Other expenditure	398.0	885.4	813.7	1,318.8	1,121.5	1,754.9	1,570.1	352.0	962.8	1,344.9	1,897.0	
Goods and services	300.0	625.4	583.8	914.4	771.5	1,202.8	1,074.4	221.4	666.4	869.9	1,273.6	
Of which: famine relief	20.0	95.0	9.0	198.0	17.0	286.0	19.0	0.0	0.0	0.0	0.0	
Of which: agricultural support	0.7	...	7.7	...	37.7	...	110.2	0.0	0.0	0.0	0.0	
Transfers and subsidies	98.0	260.0	229.9	404.4	350.0	552.1	495.7	130.6	296.4	475.0	623.4	
Of which: famine relief subsidy	0.0	29.0	2.0	58.0	4.0	87.0	4.0	0.0	0.0	0.0	0.0	
Capital expenditure	182.6	324.2	353.6	548.8	550.4	750.2	758.9	167.8	376.3	637.5	867.4	
Domestically funded	66.2	141.5	141.1	224.6	221.4	300.8	322.5	80.7	167.6	255.4	341.0	
Externally funded	116.4	182.7	212.5	324.2	329.0	449.4	436.4	87.1	208.7	382.1	526.4	
Grant funded	33.4	49.9	76.4	142.3	129.5	245.6	199.3	39.9	118.0	175.0	266.1	
Loan funded	83.0	132.8	136.1	181.9	199.5	203.8	237.1	47.2	90.7	207.1	260.3	
Net lending 2/	-4.5	-9.4	-6.0	-14.2	-6.0	-18.7	-34.0	0.0	0.0	0.0	-17.0	
Overall balance before grants	-169.5	-367.4	-321.8	-642.2	-392.0	-775.7	-555.4	-43.5	-319.9	-473.1	-637.0	
Overall balance after grants	-79.4	-164.5	-188.0	-219.9	-202.1	-153.1	-295.7	-3.6	-172.2	-268.4	-341.2	
Domestic balance 3/	-35.5	3.2	-22.8	30.4	99.5	172.7	-8.8	35.6	-98.2	-32.5	16.7	
Total financing 4/	79.4	164.5	188.0	219.9	202.1	153.1	295.7	3.6	172.2	268.4	341.2	
External financing	28.9	39.5	19.9	7.2	6.4	23.1	8.1	-3.6	-20.3	-0.7	0.1	
Loan drawings	83.0	179.3	136.1	228.4	199.5	296.8	237.1	47.2	90.7	207.1	260.3	
Amortization	-54.1	-139.8	-116.2	-221.2	-193.1	-273.7	-229.0	-50.8	-111.0	-207.8	-260.2	
Domestic financing	41.2	125.0	167.7	212.7	194.8	130.0	287.3	7.2	192.5	269.1	341.1	
Excluding net lending	45.7	134.4	173.7	226.9	200.8	148.7	321.3	7.2	192.5	269.1	358.1	
Bank	28.9	...	169.0	...	189.5	...	349.0	...	...	...	...
Nonbank	12.3	...	-1.3	...	5.3	...	-61.7	...	...	...	...
Residual	9.3	0.0	0.4	0.0	0.9	0.0	0.3	0.0	0.0	0.0	0.0	

Table 4. Lesotho: Central Government Operations, Quarterly, 2002/03-2003/04 (concluded) 1/

	2002/03 (Cumulative)							2003/04 (Cumulative)				
	Q1		Q2		Q3		Q4	Q1		Q2	Q3	Q4
	Act.	Prog.	Act.	Prog.	Act.	Prog.	Est.	Prog.	Prog.	Prog.	Prog.	
	(in percent of GDP, unless otherwise indicated)											
Revenue	9.1	18.7	18.9	27.5	28.6	37.9	38.7	8.9	18.9	28.5	39.2	
Customs revenue	4.7	9.2	9.3	13.9	14.0	18.5	18.7	4.0	8.6	12.0	16.0	
Noncustoms tax revenue	2.5	6.4	6.1	9.7	9.9	14.1	14.1	3.2	7.9	11.8	16.8	
Nontax revenue	2.0	3.0	3.4	3.5	4.7	5.3	6.0	1.8	3.0	4.7	6.4	
Grants	1.1	2.6	1.7	5.3	2.4	7.8	3.3	0.4	1.7	2.3	3.3	
Total expenditure and net lending	11.3	23.3	23.0	35.6	33.6	47.7	45.8	9.4	22.5	33.8	46.3	
Current expenditure	9.0	19.3	18.6	28.8	26.7	38.4	36.5	7.5	18.3	26.7	36.8	
<i>Of which: total famine relief</i>	0.0	1.6	0.1	3.2	0.3	4.7	0.3	0.0	0.0	0.0	0.0	
Current expenditure excl. famine & agric. support	9.0	17.8	18.4	25.6	25.9	33.8	34.9	7.5	18.3	26.7	36.8	
Wages and salaries	3.4	6.8	6.9	10.2	10.3	13.5	13.8	3.1	6.3	9.5	12.6	
Interest payments	0.6	1.4	1.4	2.1	2.1	2.8	2.8	0.5	1.2	2.1	2.9	
Other expenditure	5.1	11.1	10.3	16.6	14.3	22.1	20.6	4.0	10.8	15.1	21.3	
Goods and services	5.8	7.9	7.4	11.5	9.8	13.1	13.7	2.5	7.5	9.8	14.3	
Transfers and subsidies	1.2	3.3	2.9	5.1	4.4	6.9	6.3	1.5	3.3	5.3	7.0	
Capital expenditure	2.3	4.1	4.5	6.9	7.0	9.4	9.6	1.9	4.2	7.2	9.7	
Net lending	-0.1	-0.1	-0.1	-0.2	-0.1	-0.2	-0.4	0.0	0.0	0.0	-0.2	
Overall balance before grants	-2.2	-4.6	-4.1	-8.1	-5.0	-9.8	-7.1	-0.5	-3.6	-5.3	-7.1	
Overall balance after grants	-1.0	-2.1	-2.4	-2.8	-2.6	-1.9	-3.8	0.0	-1.9	-3.0	-3.8	
Domestic balance 3/	-0.5	0.0	-0.3	0.4	1.3	2.2	-0.1	0.4	-1.1	-0.4	0.2	
External financing	0.4	0.5	0.3	0.1	0.1	0.3	0.1	0.0	-0.2	0.0	0.0	
Domestic financing	0.5	1.6	2.1	2.7	2.5	1.6	3.7	0.1	2.2	3.0	3.8	
Memorandum items:												
GNP at current prices (in millions of maloti)	9,551.6	9,395.4	9,551.6	9,395.4	9,551.6	9,395.4	9,551.6	10,743.0	10,743.0	10,743.0	10,743.0	
GDP at current prices (in millions of maloti)	7,867.7	7,946.7	7,867.7	7,946.7	7,867.7	7,946.7	7,867.7	8,908.7	8,908.7	8,908.7	8,908.7	

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

1/ Fiscal year from April to March.

2/ Net lending in 2001/02 was the repayment to the government of M 120 million in Lesotho Bank treasury bills that were issued for its recapitalization two years earlier. In 2002/03, it consists of M 18.7 million of loan repayments to the government from parastatals.

3/ Domestic balance excludes grants, foreign-financed capital spending, and foreign interest payments, and it excludes exceptional factors. In 2002/03, it also excludes current spending for the famine.

4/ In the new (revised) program period beginning in the third quarter of 2002/03, IMF disbursements are now included under domestic financing. In the past program figures, IMF disbursements were included in external financing, in line with Ministry of Finance practice. The ministry now includes IMF disbursements under domestic financing, consistent with the Central Bank of Lesotho's accounting. Domestic financing is unchanged in the historical actual data as these figures are derived from the central bank's monetary survey. Estimates of external and total financing have been reduced in the historical actual data, as has the government's deficit and current spending on other goods and services, because these items are derived as residuals.

Table 5. Lesotho: Balance of Payments, 1999/2000 - 2007/08 1/
(In millions of U.S. dollars)

	1999/00	2000/01	2001/02		2002/03		2003/04	2004/05	2005/06	2006/07	2007/08
			Prog.	Act.	Prog.	Est.					
Trade balance	-608.0	-493.8	-353.6	-365.7	-315.8	-377.4	-485.2	-496.1	-504.6	-517.0	-539.0
Exports, f.o.b.	188.4	223.1	241.8	295.7	421.7	497.1	562.6	606.4	653.8	705.5	765.1
Imports, f.o.b.	-796.4	-716.9	-595.4	-661.4	-737.5	-874.5	-1,047.8	-1,102.6	-1,158.5	-1,222.5	-1,304.0
Services (net)	-3.5	2.2	-4.6	-12.2	-15.1	-21.5	-31.3	-42.1	-53.9	-62.6	-78.3
Receipts	43.8	46.9	34.1	35.8	41.6	37.6	49.0	50.8	53.0	59.9	62.8
<i>Of which: water royalties (and power sales)</i>	13.0	12.3	10.2	10.6	15.8	11.8	23.3	24.7	26.4	32.8	35.0
Payments	-47.4	-44.8	-38.7	-48.0	-56.7	-59.1	-80.3	-93.0	-106.8	-122.5	-141.1
Income (net)	245.7	211.4	176.6	160.9	134.3	180.2	227.2	231.4	237.7	241.3	245.6
Labor income (net)	244.7	214.0	171.0	165.3	145.3	186.8	235.0	239.3	241.6	243.2	245.2
Receipts	278.2	240.8	197.3	189.0	176.9	209.5	259.7	261.5	262.8	265.0	268.0
<i>Of which: miners' wages</i>	224.0	191.2	155.0	148.6	137.4	162.9	199.7	198.8	197.3	196.5	196.1
Payments	-33.5	-26.7	-26.3	-23.7	-31.6	-22.6	-24.7	-22.2	-21.3	-21.8	-22.8
Investment income (net)	1.0	-2.6	5.6	-4.3	-11.1	-6.6	-7.8	-7.9	-3.9	-1.9	0.5
Receipts	44.1	34.0	33.7	23.5	17.5	24.0	21.9	21.1	24.1	25.3	27.0
Payments	-43.1	-36.6	-28.1	-27.8	-28.4	-30.6	-29.7	-29.0	-28.0	-27.2	-26.5
<i>Of which: interest on debt</i>	-17.4	-21.0	-12.8	-13.5	-15.2	-16.9	-13.2	-12.4	-11.3	-10.2	-9.2
Unrequited transfers	155.9	127.4	126.5	122.2	136.5	125.9	147.2	150.1	155.0	161.4	168.8
Official	153.9	125.0	124.1	118.8	133.1	122.2	143.5	146.4	151.2	157.5	164.8
Southern African Customs Union nonduty receipts	135.7	109.4	109.8	113.7	96.8	111.8	125.2	132.4	137.4	143.8	150.9
Rand compensation	10.1	9.0	7.5	0.0	5.5	4.7	11.3	6.8	6.5	6.2	6.3
Other	8.1	6.6	6.8	5.0	30.8	5.6	7.0	7.2	7.3	7.4	7.5
<i>Of which: famine support</i>	...	...	...	...	26.8	0.0	0.0	0.0	0.0	0.0	0.0
Private	2.1	2.4	2.4	3.4	3.4	3.7	3.7	3.8	3.8	3.9	4.0
Current account (including official transfers)	-209.9	-152.8	-55.1	-94.8	-60.1	-92.7	-142.1	-156.7	-165.8	-177.0	-202.9
Current account (excluding LHWP) 2/	-135.3	-103.8	-9.4	-48.7	-27.8	-55.4	-121.0	-148.9	-162.5	-174.6	-200.5
Capital and financial account	186.1	121.2	55.1	123.4	60.2	92.7	142.1	156.7	165.8	177.0	202.8
Capital account (transfers received)	101.6	37.3	17.3	29.3	31.1	31.0	40.2	44.5	43.8	40.2	42.8
<i>Of which: LHWP 2/</i>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2
Financial account	84.5	83.9	37.8	94.0	29.1	61.7	101.9	112.2	122.1	136.9	160.0
Direct investment 3/	33.9	31.5	106.2	30.0	36.2	42.6	60.5	58.5	58.8	59.7	60.9
Other investment	-31.3	-24.3	-81.6	70.9	-27.8	25.2	34.0	55.5	88.5	108.8	124.7
Assets	-30.7	1.7	5.8	6.9	-11.7	-26.0	27.2	20.2	13.3	14.1	12.0
Liabilities	-0.7	-26.0	-87.5	63.9	-16.1	51.2	6.8	35.3	75.1	94.7	112.7
Loans	4.6	-16.0	-22.0	62.4	3.1	89.6	19.5	27.0	67.5	86.3	103.0
Public and publicly guaranteed	-12.7	-30.3	-2.1	7.6	7.0	1.2	8.6	12.1	13.8	17.1	21.9
Disbursements	15.0	21.0	24.9	29.4	32.9	31.6	40.0	42.2	43.7	46.5	50.3
Repayments	-27.7	-51.3	-27.0	-21.8	-25.8	-30.4	-31.5	-30.1	-29.8	-29.4	-28.4
LHDA (water transfer) loans, net 4/	17.5	14.7	54.9	54.9	67.8	78.2	59.1	51.4	127.1	24.5	25.4
Private (net)	-0.2	-0.4	-74.8	-0.2	-71.6	10.2	-48.2	-36.5	-73.4	44.7	55.7
Other liabilities	-5.3	-10.0	-10.5	1.6	-19.2	-38.4	-12.6	8.2	7.6	8.5	9.8
CBL liabilities	-2.0	-5.4	-6.9	2.6	-21.7	-32.8	-12.6	7.3	6.7	7.7	9.0
Commercial banks' liabilities	-3.3	-4.7	-3.6	-1.1	2.4	-5.6	0.0	1.0	0.9	0.8	0.8
Change in reserve assets 5/	82.0	76.8	13.3	-6.9	20.7	-6.1	7.4	-1.8	-25.2	-31.7	-25.6
Errors and omissions	23.8	31.6	0.0	-28.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Financial year is April-March.

2/ Lesotho Highlands Water Project.

3/ Direct investment has been revised lower owing to reclassification of some flows in the financial account.

4/ Lesotho Highlands Development Authority

5/ Transaction-based data, a minus sign indicates an increase in reserves.

Table 6. Lesotho: Central Bank Balance Sheet, March 2001-March 2005

	Act. March 2001	Act. June 2001	Act. Sep. 2001	Act. Dec. 2001	Act. Mar. 2002	Act. June 2002	Prog. Sep. 2002	Act. Sep. 2002	Prog. Dec. 2002	Act. Dec. 2002	Prog. March 2003	Est. March 2003	Rev. June 2003	Prog. Sep. 2003	Rev. Dec. 2003	Prog. March 2004	Proj. March 2005
(In millions of maloti)																	
Net foreign assets	3,074.9	3,176.3	3,539.5	4,616.8	4,474.6	3,940.4	3,690.1	3,857.1	3,612.3	3,201.1	3,612.3	2,900.3	2,900.3	2,741.9	2,741.9	2,741.9	3,045.6
Foreign assets	3,470.5	3,568.9	4,007.6	5,126.6	5,006.8	4,461.5	4,362.5	4,536.4	4,280.7	3,847.8	4,313.4	3,530.6	3,568.0	3,439.2	3,438.5	3,472.2	3,773.7
Foreign liabilities	395.6	392.6	468.1	509.9	532.2	521.1	672.4	679.3	668.4	646.7	701.1	630.3	667.7	697.4	696.6	730.4	728.1
Net domestic assets	-2,530.4	-2,514.2	-3,288.4	-4,333.8	-4,199.9	-3,680.1	-3,427.0	-3,565.7	-3,346.4	-2,872.6	-3,341.0	-2,583.9	-2,579.3	-2,416.1	-2,411.4	-2,406.3	-2,686.3
Net claims on government	-1,066.5	-1,081.7	-1,164.5	-1,255.7	-1,297.0	-1,240.8	-1,151.1	-1,097.6	-1,069.7	-1,066.0	-1,165.7	-781.4	-1,007.0	-840.7	-832.6	-824.1	-842.9
Claims on government	108.8	124.4	143.0	246.6	231.8	192.0	194.1	225.1	196.2	191.3	200.2	194.8	197.7	200.6	203.5	206.6	226.1
Government deposits	-1,175.4	-1,206.0	-1,307.5	-1,502.4	-1,528.8	-1,432.9	-1,345.2	-1,322.8	-1,265.8	-1,257.3	-1,365.9	-976.2	-1,204.7	-1,041.2	-1,036.1	-1,030.7	-1,069.0
Official entities' deposits	-191.7	-185.0	-184.8	-195.3	-205.9	-202.5	-204.6	-178.2	-206.8	-151.3	-211.1	-153.5	-155.8	-158.1	-160.4	-162.9	-178.2
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	0.0	0.0	0.0	0.0
Net claims on private sector	5.8	3.6	3.3	2.8	2.6	2.7	2.7	2.7	2.7	2.8	2.7	2.4	2.5	2.5	2.5	2.6	2.8
Other items (net)	-1,278.1	-1,251.2	-1,942.4	-2,885.5	-2,699.6	2,239.4	-2,074.0	-2,292.6	-2,072.7	-1,658.0	-1,966.9	-1,651.4	-1,418.9	-1,419.9	-1,420.9	-1,422.0	-1,668.0
Other assets	71.9	86.3	73.8	99.2	127.4	100.3	101.4	114.8	102.4	141.5	104.6	143.6	145.7	147.8	150.0	152.3	166.6
Other liabilities	-53.8	-86.2	-348.3	-127.8	-260.7	0.9	0.9	-26.0	0.9	-27.7	0.9	-27.7	-27.7	-27.7	-27.7	-27.7	-50.0
Capital account	-1,296.2	-1,251.2	-1,667.9	-2,856.9	-2,566.3	2,340.6	2,176.2	2,381.4	2,176.0	-1,771.8	-2,072.3	-1,767.3	-1,536.9	-1,540.0	-1,543.2	-1,546.5	-1,784.7
Reserve money	544.5	662.0	251.1	283.0	274.6	260.3	263.1	291.4	265.9	328.5	271.4	316.4	321.0	325.7	330.5	335.5	359.3
Maloti outside banks	142.6	140.3	139.9	147.1	164.1	168.3	170.1	181.3	171.9	179.7	175.5	167.9	170.4	172.9	175.4	178.1	194.9
Currency in commercial banks	17.7	23.3	26.0	40.4	32.1	30.0	30.3	27.9	30.6	43.4	31.2	44.0	44.7	45.3	46.0	46.7	51.1
Commercial banks deposits	384.3	498.4	85.2	95.5	78.4	62.0	62.7	82.2	63.4	105.4	64.7	104.4	105.9	107.5	109.1	110.7	113.2
(In units indicated)																	
Memorandum items:																	
Net foreign assets (in U.S. dollars)	383.7	393.9	393.2	380.7	393.0	384.4	360.0	365.0	352.4	370.5	352.4	377.1	377.1	357.1	357.1	357.1	355.1
Gross int'l reserves (in percent of currency in circulation)	2,211.0	2,318.3	2,604.1	3,167.0	2,777.0	2,396.1	2,326.4	2,261.3	2,209.1	1,937.7	2,227.8	1,764.9	1,759.5	1,665.4	1,610.9	1,633.8	1,673.1
Gross int'l reserves (in percent of M1)	275.4	269.2	298.4	360.6	322.5	274.2	266.2	282.7	252.8	241.6	254.9	270.1	219.5	207.7	204.7	203.8	202.6
Gross int'l reserves (in percent of M2)	173.0	173.2	192.7	233.9	213.6	181.5	176.2	187.5	167.4	160.6	168.8	146.3	145.8	138.0	136.0	135.4	134.6
Gross int'l reserves (in months of imports)	6.7	5.2	5.2	4.9	5.1	4.2	5.8	4.1	5.7	4.3	5.0	4.3	4.4	4.2	4.2	4.0	3.8

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

Table 7 Lesotho: Money Survey, March 2001-March 2005

	Act. March 2001	Act. Sep 2001	Prog. Mar. 2002	Act. Mar. 2002	Prog. June 2002	Act. June 2002	Prog. Sep. 2002	Act. Sep. 2002	Prog. Dec 2002	Act. Dec. 2002	Prog. March 2003	Est. March 2003	Rev. Prog. June 2003	Prev. Prog. Sep 2003	Rev. Prog. Dec. 2003	Rev. Prog. March 2004	Prog. March 2005
(In millions of maloti)																	
Net foreign assets	3,670.0	4,148.1	4,422.2	5,229.0	4,418.3	4,755.2	4,505.6	4,605.4	4,428.5	3,884.1	4,436.6	3,586.2	3,356.4	3,339.5	3,273.5	3,212.4	3,389.6
Central bank	3,074.9	3,539.5	3,752.7	4,474.6	3,745.3	3,940.4	3,690.1	3,857.1	3,612.3	3,201.1	3,612.3	2,900.3	2,900.3	2,741.9	2,741.9	2,741.9	3,045.6
Commercial banks	595.1	608.6	669.5	754.4	673.0	814.8	815.5	748.3	816.2	683.0	824.3	686.0	456.1	597.6	531.7	470.5	344.0
Net domestic assets	-1,847.6	-2,257.4	-2,388.9	-3,095.9	-2,360.4	-2,533.3	-2,260.1	-2,418.0	-2,159.2	-1,715.9	-2,120.8	-1,386.4	-1,124.3	-1,074.8	-975.7	-879.8	-837.8
Domestic credit	424.1	201.6	264.3	432.3	434.3	473.6	855.0	664.9	958.0	691.9	1,011.0	848.3	870.3	1,070.6	1,162.5	1,250.5	1,407.7
Claims on central government (net)	-579.2	-766.4	-762.7	-511.0	-633.1	-482.1	-386.1	-342.1	-298.4	-321.5	-381.0	-162.0	-154.7	30.5	107.1	179.1	311.8
Central bank	-1,066.5	-1,164.5	-1,401.2	-1,297.0	-1,279.8	-1,240.8	-1,151.1	-1,097.6	-1,069.7	-1,066.0	-1,165.7	-781.4	-1,007.0	-840.7	-832.6	-824.1	-842.9
Commercial banks	487.3	398.1	638.6	786.0	646.7	758.7	765.0	755.6	771.3	744.5	784.7	619.4	852.3	871.2	939.7	1,003.2	1,154.7
Claims on the rest of the economy	1,003.3	968.0	1,027.0	943.3	1,067.4	955.8	1,241.1	1,006.9	1,256.4	1,013.4	1,392.0	1,010.2	1,025.1	1,040.1	1,055.4	1,071.5	1,095.9
Other items (net)	-2,271.8	-2,459.0	-2,653.3	-3,528.2	-2,794.7	-3,007.0	-3,115.1	-3,082.9	-3,117.2	-2,407.8	-3,131.8	-2,234.6	-1,994.7	-2,145.4	-2,138.3	-2,130.4	-2,345.5
Money and quasi money (M2)	1,822.4	1,890.7	2,033.3	2,133.1	2,057.9	2,221.9	2,245.5	2,187.4	2,269.3	2,168.2	2,315.8	2,199.8	2,232.0	2,264.7	2,297.8	2,332.5	2,551.8
Money	1,144.7	1,221.3	1,324.3	1,413.2	1,340.3	1,471.0	1,486.6	1,450.5	1,502.3	1,440.9	1,533.0	1,461.9	1,483.3	1,504.9	1,526.9	1,549.9	1,695.2
Of which: currency outside dep. mon. banks	142.6	139.9	165.9	164.1	167.9	168.3	170.1	181.3	171.9	179.7	175.5	182.3	185.0	187.7	190.5	193.4	211.6
demand deposits	802.5	886.2	950.5	1,032.4	962.0	1,089.4	1,101.0	1,080.2	1,112.8	1,099.2	1,135.7	1,115.3	1,131.7	1,148.3	1,165.2	1,182.9	1,294.6
Quasi money	677.7	669.4	709.0	719.9	717.6	750.9	758.9	736.9	767.0	727.2	782.8	737.9	748.8	759.8	770.9	782.6	856.5
Of which: time and savings deposits	677.7	669.4	709.0	719.9	717.6	750.9	758.9	736.9	767.0	727.2	782.8	737.9	748.8	759.8	770.9	782.6	856.5
(Annual change in percent of beginning-of-year M2, unless otherwise specified)																	
Net foreign assets	5.1	27.8	41.3	85.5	37.3	55.3	18.9	24.2	-44.4	-71.8	-38.1	-77.0	-63.0	-57.9	-28.2	-17.0	7.6
Central bank	4.1	22.9	37.2	76.8	30.3	40.7	8.0	16.8	-50.4	-71.0	-41.4	-73.8	-46.8	-51.0	-21.2	-7.2	13.0
Commercial banks	0.9	4.9	4.1	8.7	7.0	14.6	10.9	7.4	6.0	-0.7	3.3	-3.2	-16.1	-6.9	-7.0	-9.8	-5.4
Net domestic assets	1.1	-13.7	-29.7	-68.5	-27.7	-37.0	-0.1	-8.5	58.3	80.6	46.7	80.1	63.4	61.4	34.1	23.0	1.8
Claims on central government (net)	20.9	19.2	-10.1	3.7	5.3	13.3	20.1	22.4	16.5	15.4	6.1	16.4	14.7	17.0	19.8	15.5	5.7
Claims on the rest of the economy	0.7	0.7	1.3	-3.3	5.2	-0.7	14.4	2.1	13.5	1.3	21.0	3.1	3.1	1.5	1.9	2.8	1.0
Claims on the rest of the econ. (yrlly change)	1.2	1.3	2.4	-6.0	10.1	-1.4	28.2	4.0	27.2	2.6	47.6	7.1	7.2	3.3	4.1	6.1	2.3
Other items (net)	-20.5	-33.7	-20.9	68.9	-38.3	-49.6	-34.7	-33.0	28.3	63.9	19.5	60.6	45.6	42.9	12.4	4.7	-4.9
Money and quasi money (M2)	6.1	14.0	11.6	17.0	9.6	18.3	18.8	15.7	13.9	8.8	8.6	3.1	0.5	3.5	6.0	6.0	9.4
Quasi money (yearly change)	-6.5	-4.0	4.6	6.2	7.2	12.2	13.4	10.1	9.5	3.8	8.7	2.5	-0.3	3.1	6.0	6.1	9.4
Memorandum item:																	
Money multiplier (M2/reserve money)	3.3	7.5	8.0	7.8	8.0	8.5	8.5	7.5	8.5	6.6	8.5	7.0	7.0	7.0	7.0	7.0	7.1

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

Table 8. Lesotho: Quantitative Benchmarks and Performance Criteria,
September 2002 - March 2003

	2002				2003	
	Sep. 1/		Dec.		Mar. 1/	
	Prog.	Act.	Prog.	Act.	Prog.	Est.
(In millions of maloti)						
Ceiling on the domestic financing requirement of the central government 2/	109	168	172	195	46	287
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-3,443	-3,478	-3,387	-3,370	-3,400	-3,251
(In millions of U.S. dollars)						
Floor on the stock of net international reserves of the Central Bank of Lesotho 3/	362	368	357	361	359	348
Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector (cumulative from end-November 2000) 4/ 5/ 6/						
Maturity of less than one year 7/	0	0	0	0	0	0
Maturity of one year or more	0	0	0	0	0	0
Ceiling on the stock of external payments arrears 6/	0	0	0	0	0	0

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

1/ Performance criteria.

2/ Cumulative from end-March 2002.

3/ At program exchange rates.

4/ This performance criterion applies not only to debt as defined in point no. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received.

A loan is concessional if its grant element is at least 35 percent, calculated using a discount rate based on the ten-year average of OECD commercial interest reference rates (CIRRs) for loans of maturity of greater than 15 years; for loans of maturity of 15 years or less, the discount rate is based on the six-month average of OECD CIRRs. To both the ten-year and six-month averages, the same margin for differing repayment periods would be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

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

6/ Continuous performance criterion.

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

Table 9. Lesotho: Structural Benchmarks and Performance Criteria, September 2002–March 2003

Action	Implementation Date	Status
A. Lesotho Revenue Authority, value-added tax and supporting measures	December 31, 2002	Done.
1. LRA becomes operational.*	March 1, 2003	Done.
2. Recommence VAT registration drive and visits to traders.		
B. Financial management		
1. Construct the government's balance sheet as of March 31, 2002 comprising all government accounts and below-the-line financial assets and liabilities.*	December 31, 2002	Not done.
2. Begin the recruitment process for an Accountant General.	September 30, 2002	Done.
3. Complete a timed action plan to strengthen financial management based on the recommendations of the IMF and European Union technical assistance reports.*	October 31, 2002	Done.
4. Begin phase one of the study of an integrated financial management system for government. This will entail identifying requirements, evaluating current resources, and making recommendations on closing the resource gap.*	October 31, 2002	Done.
5. Improve expenditure management and tracking through the following: (i) Implement the routine practice by which all payments are backed by a payment voucher. All vouchers are to be batched and sent to Treasury for processing on the days designated by Treasury for each ministry. (ii) Banks will continue to make payments only on instruction from Treasury. (iii) The Debt Office will continue to preauthorize payment orders under signature of the Accountant General.*	November 30, 2002	Done.
6. Put in place top management of the Treasury Department, including acting Accountant General and his/her expert advisor and at least two Deputy Accountants General. Recruit and have in place technical experts to assist deputies.**	February 28, 2003	Not done.
C. Other measures		
1. Work with the private sector to establish a credit bureau.	January 31, 2003	Done.
2. Begin to publish Central Bank of Lesotho macroeconomic projections.	January 31, 2003	Done.

* Performance criterion for the fifth disbursement.

** Performance criterion for the sixth disbursement.

Table 10. Lesotho: External Financing Requirements and Sources, 1999/2000-2008/09
(in millions of U.S. dollars)

	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
				Est.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
Gross financing requirements	-313.0	-257.5	-243.5	-247.0	-358.1	-370.8	-444.9	-350.4	-365.5	-370.3
External current account deficit (excl. off. transfers)	-363.8	-277.8	-213.5	-214.9	-285.6	-303.1	-317.0	-334.4	-367.6	-385.2
Debt amortization	-25.4	-51.1	-18.6	-22.7	-78.1	-65.8	-102.5	17.3	30.6	17.9
Medium- and long-term debt 1/	-25.4	-51.1	-18.6	-22.7	-78.1	-65.8	-102.5	17.3	30.6	17.9
Public sector	-21.9	-46.0	-17.3	-27.1	-29.7	-29.9	-29.7	-27.8	-25.3	-25.3
Commercial banks	-3.3	-4.7	-1.1	-5.6	0.0	1.0	0.9	0.8	0.8	0.7
Corporate private sector	-0.2	-0.4	-0.2	10.0	-48.4	-36.8	-73.7	44.3	55.5	42.5
Short-term debt 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayment of arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross reserves accumulation	82.0	76.8	-6.9	-6.1	7.4	-1.8	-25.2	-31.7	-25.6	0.0
IMF repurchases and repayments	-5.8	-5.3	-4.4	-3.3	-1.7	-0.2	-0.2	-1.6	-3.0	-3.0
Available financing	313.0	257.5	243.5	247.0	358.1	370.8	444.9	350.4	365.5	370.3
Foreign direct investment (net)	33.9	31.5	30.0	42.6	60.5	58.5	58.8	59.7	60.9	61.7
Debt financing from private creditors	0.0	0.0	0.0	0.2	0.2	0.3	0.3	0.3	0.3	1.3
Medium- and long-term financing	0.0	0.0	0.0	0.2	0.2	0.3	0.3	0.3	0.3	1.3
To commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
To corporate private sector	0.0	0.0	0.0	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Short-term financing (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Official 3/	203.3	169.6	157.1	162.2	220.0	215.6	224.1	235.3	248.7	261.8
External grants (net)	175.0	143.7	135.2	143.5	176.5	181.9	188.9	197.6	207.6	218.7
Of which: South African Customs Union nonduty receipt: balance of payments support 4/	135.7	109.4	113.7	111.8	125.2	132.4	137.4	143.8	150.9	158.9
Multilateral creditors	11.5	22.8	21.8	18.4	42.0	33.1	34.8	37.7	41.1	43.1
Bilateral creditors	10.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: balance of payments financing 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0	2.0
Commercial creditors	6.1	3.1	0.1	0.3	1.5	0.6	0.4	0.0	0.0	0.0
Other public sector	98.0	33.3	67.8	87.9	66.4	60.3	133.2	24.5	25.4	24.1
External grants	80.5	18.6	12.9	9.6	7.3	8.9	6.1	0.0	0.0	0.0
External loans - Nongovernment guaranteed	17.5	14.7	54.9	78.2	59.1	51.4	127.1	24.5	25.4	24.1
IMF	0.0	4.6	8.7	4.5	9.6	4.8	0.0	0.0	0.0	0.0
Accumulation of arrears (exceptional)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	23.8	31.6	-28.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other net financial flows	-46.0	-13.1	8.5	-50.4	1.5	31.2	28.5	30.6	30.2	21.4
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Excluding the IMF.

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

3/ Includes both loans and grants.

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

Table 11. Lesotho. Indicators of Financial Obligations to the Fund, 2000/01-2008/09

	Act.	Act.	Bst.	Proj.					
	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Debt service to the Fund									
In millions of U.S. dollars	5.2	4.9	3.5	1.7	0.2	0.2	1.6	3.0	3.0
In millions of SDRs	4.1	3.6	2.6	1.3	0.1	0.1	1.2	2.2	2.2
In percent of exports of goods and nonfactor services	1.9	1.5	0.7	0.3	0.0	0.0	0.2	0.4	0.3
In percent of debt service of nonfinancial public sector	7.3	12.1	10.1	3.7	0.4	0.4	4.1	8.1	8.3
In percent of gross international reserves	1.1	1.2	0.9	0.4	0.0	0.0	0.4	0.6	0.5
Gross Fund financing									
In millions of U.S. dollars	4.4	9.6	4.8	9.6	4.8	0.0	0.0	0.0	0.0
In millions of SDRs	3.5	7.0	3.5	7.0	3.5	0.0	0.0	0.0	0.0
In percent of Lesotho's financing needs ^{1/}	1.7	3.9	1.9	2.7	1.3	0.0	0.0	0.0	0.0
Fund credit outstanding									
In millions of U.S. dollars	13.2	19.3	20.7	28.8	33.6	33.6	32.1	29.3	26.4
In millions of SDRs	10.5	14.1	15.1	21.0	24.5	24.5	23.5	21.4	19.3
In percent of quota	29.9	40.3	43.4	60.2	70.2	70.2	67.2	61.2	55.2
In percent of exports of goods and nonfactor services	4.9	5.8	3.9	4.7	5.1	4.8	4.2	3.5	3.0
In percent of total debt outstanding	2.4	3.6	3.9	5.2	6.0	5.9	5.6	5.0	4.4
Memorandum item:									
U.S. dollar/SDR exchange rate	1.26	1.37	1.37	1.37	1.37	1.37	1.37	1.37	1.37

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

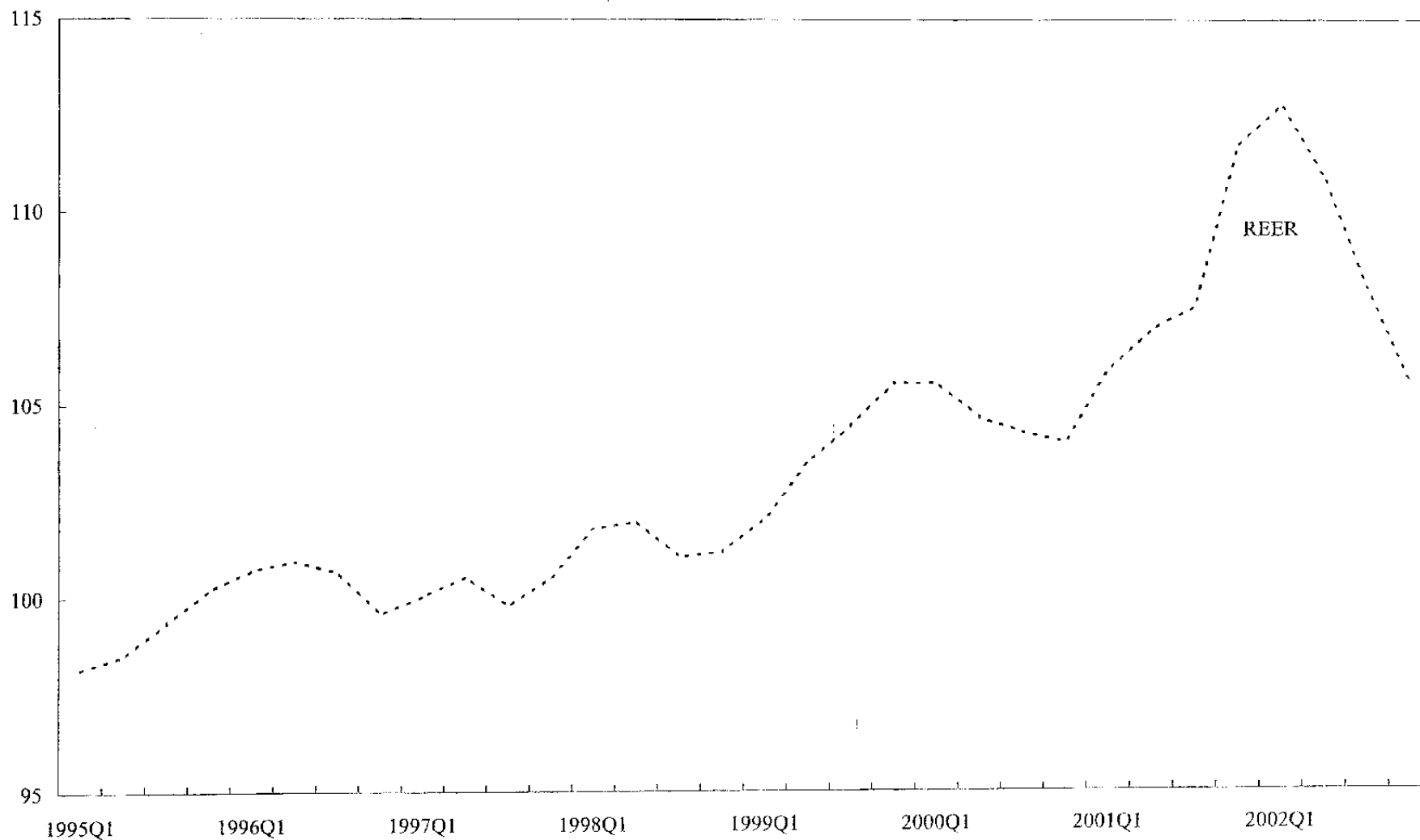
^{1/} Gross financing needs are defined as the sum of the current account deficit before grants, amortization of medium- and long-term debt, repayment to the Fund, reduction in payments arrears, and targeted accumulation of gross assets of the banking system.

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

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

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

Figure 1. Lesotho: Real Effective Exchange Rate 1/
(Index, 1997Q1=100)



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

May 15, 2003

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

Dear Mr. Köhler:

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

The attached memorandum on economic and financial policies reviews performance under the program and updates the government's economic objectives and policies for the period through March 2004. The memorandum also outlines the Government's action plan for the financial year 2003/04. The Government has prepared and submitted to the IMF and the World Bank a second preparation status report on the poverty reduction strategy paper, and is preparing a full PRSP.

Government requests a waiver for the nonobservance of the quantitative performance criterion on the ceiling on the domestic financing requirement for end-September 2002. It was not observed mainly because of spending overruns on vehicle leases and famine-related support to farmers.

Government also requests a waiver for the structural performance criterion related to the construction of government's balance sheet as of end-March 2002. It was completed on time, but Government did not consider this first draft to be of sufficient quality. The task is now largely completed.

In collaboration with Fund staff, Government will review progress in implementing the program every six months. The fifth review is scheduled to be completed no later than November 30, 2003, and the sixth review no later than May 31, 2004.

Sincerely yours,

/s/

Timothy Thahane
Minister of Finance and
Development Planning

LESOTHO

MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES

I. INTRODUCTION

1. This memorandum updates the Government of Lesotho's memorandum on economic and financial policies (MEFP) dated September 5, 2002. It reviews performance through March 2003 and outlines the economic program for the period April 2003- March 2004.
2. Medium-term economic objectives center on poverty reduction through employment creation in the private sector, universal primary education and enhanced education quality at all levels, expanded access to health care, containing the spread of HIV infections and supporting AIDS sufferers and their families, improved efficiency, accountability, and transparency in government services, wider provision of public infrastructure, and improved Government procurement.
3. As in other countries, Lesotho's economic program supported by the IMF is based on several numeric, or quantitative targets such as a maximum level of government borrowing and a minimum level of international reserves. There are also objectives related to improvements in the economy's structure, for example establishment of the Lesotho Revenue Authority (LRA) and improvements in Treasury management. These targets are evaluated every six months and if met, or if deviations from target are explained by unforeseen circumstances such as unexpected demands for famine relief and if corrective actions have been taken, the program is considered to be meeting objectives.
4. Most program objectives were achieved for the period under review. Completion of the review was delayed by about three months to better align the program review dates with Lesotho's annual budget cycle.

II. RECENT DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

5. Economic performance over the past two years has been bolstered by sustainable economic policies and free and fair parliamentary elections in May 2002. These developments have raised confidence in the economy and have begun to attract foreign direct investment. Access to international textile and clothing markets, particularly under the U.S. African Growth Opportunity Act (AGOA), has allowed the manufacturing sector to add more than 10,000 jobs over the past 12 months, making this sector the largest employer in the economy. In addition, higher gold prices and the depreciation of the South African rand during 2001 has stabilized the downward trend in Basotho employed in South African mines. As a result, economic growth was 3.4 percent in 2001 and is estimated to have risen to 4.2 percent in 2002.

6. However, over the past 18 months, Lesotho and its neighboring countries have been buffeted by unusual weather conditions and other adverse factors affecting crop yields. Many Basotho were unable to grow enough food for their families, while at the same time a doubling of the regional price of maize since early 2001 greatly worsened the situation. In response to this emergency, Government and international donors have put in place a food assistance program to provide aid to more than 40 percent of Lesotho's population by June 2003, when the next summer crops are harvested. Reduced nutrition in rural areas may have worsened the HIV/AIDS crisis.

A. Food Emergency

7. Government declared a food emergency in April 2002. At that time, it was estimated that 900,000 Basotho would face severe food shortages because of poor crop production and sharply higher import prices for staples such as maize. Government then developed a plan that would provide free food to the most affected, including the elderly, young children, and the sick. In addition, the plan included a food-for-work program to assist able-bodied unemployed and a 20 percent subsidy for unsifted maize meal. To fund the program, M23 million was initially identified, compared with a cost estimate of M 373 million (US\$45 million), and it was assumed that the international community would come forward to assist with most of the remaining cost. In the event, Government provided food to the most affected in June-July 2002, exhausting much of the funds that were first identified. Donor assistance, organized through the World Food Program (WFP), began to flow in early August and the WFP became the main distributor of free food in the most affected districts. Since August, Government has subsidized unsifted maize meal.

8. Food assistance needs mounted in December-January as more families exhausted their own resources in the months before the harvest. In response, the WFP increased its support, widening coverage to eight of Lesotho's ten districts, and providing food to those 55 years and older (from 65 years). The cost of famine relief to Government in 2002/03 is now expected to be much less than initial estimates mainly because donors have provided assistance directly to those in need. As a result, Government's contribution to food aid is now expected to be M 23 million, including about M 4 million for subsidizing unsifted maize meal.

9. Government also responded to the emerging crisis by subsidizing inputs for the summer and winter 2003 crops. Plowing, seed, and fertilizer were being provided to farmers at no cost, with an expectation that they would repay 50 percent of the cost when the crops are harvested. However, shortages of seed and fertilizer in the region slowed the process. In past years, Government had subsidized up to 30 percent of inputs, but decided that greater intervention was needed in the current serious situation. To finance this effort, Government instructed ministries to reduce their spending and transfer unspent votes to the Ministry of Agriculture and committed a further M 150 million from government deposits. As of end-February, approximately M 34 million had been revoted. Current estimates, however,

indicate that a total amount of about M 110 million will be spent. Thus, Government now expects that famine relief plus support to agriculture will total M 109 million in the 2002/03 financial year.

10. Government's famine relief and agricultural support programs will end as planned in August 2003. Government will review the situation then, but anticipates that any food shortfalls after the 2003 harvest will again be met through generous donor assistance. In view of the budgetary constraints facing Lesotho, Government expects that the Ministry of Agriculture will provide ongoing services to farmers and meet any emergency needs within its budget allocation, and will draw on lessons learned during 2002/03 to improve the response to emergency food situations. Restructuring of this ministry will also be completed within this budget so that it can address Lesotho's trend decline in agricultural production and ensure that Basotho are getting value for money in this area.

B. HIV/AIDS

11. Government recognizes that HIV/AIDS has become a driving social and economic force. According to UNAIDS estimates, Lesotho faces an infection rate of 30 percent of the adult population, and about 20 percent of children under five are orphans. While foremost a human tragedy, the impact on Lesotho's economy could be especially severe because of the country's mainly rural population. The disease creates a vicious cycle in which farmers are unable to tend their crops because of illness while the resulting lack of food makes them more susceptible to disease.

12. The HIV/AIDS tragedy will not be solved overnight or by the Basotho alone. H.M. King Letsie III and Government at the highest levels are leading the battle on HIV/AIDS that includes prevention and support to those living with the virus and to orphans. In 2002/03, Government directed Ministries to allocate 2 percent of their budgets to HIV/AIDS and also set up the Lesotho AIDS Prevention and Control Authority (LAPCA). The Executive Director's Office of LAPCA functions directly under the Prime Minister's Office, with an eye towards enabling it to conduct its operations with minimal administrative delays. More needs to be done, however, including strengthening coordination of HIV/AIDS programs within government and with the donor community. In this direction, Government has organized a conference of SADC heads of state to formulate a regional response to the HIV/AIDS scourge.

C. Performance under the Program

13. Government was unable to observe some of its quantitative benchmarks for September and December 2002 and March 2003, but did observe most of the structural benchmarks through February 2003. As outlined below, overspending, some of which was related to unplanned agricultural support, caused overshooting of the targets for domestic

financing of the government. The targets for net foreign and domestic assets of the central bank were not met in March 2003 when the Central Bank did not fully offset the monetary impact of the deficit.

Quantitative targets

14. The end-September 2002 and end-March 2003 quantitative performance criteria on domestic financing of the government were exceeded because of above budget spending in several areas including, vehicle leases, pensions and scholarships, agricultural support, and spending that has not yet been classified.¹ Pension costs were initially underestimated because the impact of the large number of government officers leaving service in July-August 2002 was not anticipated when the budget was approved. In response to the overall overspending, Government initiated a high-level study of the vehicle lease and its implementation, reduced spending on international travel and special purchases, and pushed ahead with efforts to improve expenditure monitoring. In addition, Government launched reviews of the main scholarship program and agricultural support, which by March, had added around M 70 million to spending, taking into account nearly M 35 million in reduced expenditures elsewhere. In view of these actions, Government requests a waiver of the September 2002 performance criterion on domestic financing.

15. Government revenue collections were mostly in line with program objectives for 2002/03. Overall revenue was slightly above target due to higher than anticipated nontax income, while income tax collections were below target because of ongoing staff shortages, particularly at higher levels, uncertainty in the transition to the LRA, and the closure or downsizing of several large businesses, particularly those associated with the Lesotho Highlands Water Project. Initial budget projections for tax collections may also have been too high. Grants were far below expectations because the majority of donor support for famine relief was channeled through the WFP and therefore not captured in Government accounts as originally envisaged. Spending on famine relief was correspondingly lower. Government income through March 2003 was near program estimates, but there was a shortfall in budget support grants because the European Union grant was delayed.

16. The Central Bank fully sterilized the liquidity impact of the fiscal slippages through December 2002 and, in consequence, both the monetary and international reserve targets were met. However, for technical reasons, the Central Bank did not fully sterilize the liquidity impact at the end of the financial year, and these targets were missed by a narrow margin in March 2003.

¹ Owing to the shortcomings in the government's accounting system, which are currently being addressed, domestic financing for program purposes is monitored through the monetary accounts. Therefore, it is difficult to identify specific areas of overspending.

Structural measures

17. Government has made good progress in fulfilling the structural performance criteria for the fifth disbursement, but two criteria were missed. In particular, the LRA (a performance criterion for end 2002) was made operational in December, and its new tax commissioners and staff are pressing ahead to apply tax law fairly and justly. There has also been considerable progress in strengthening treasury management. A new Accountant General was appointed in December, well ahead of schedule. Expenditure management and tracking have been improved, and the backlog of unpaid vouchers has been cleared, nearly all payments are backed by vouchers, and voucher and tracking information are entered into computerized systems with little or no delay (a performance criterion for end-November). Government recognizes, however, that reporting accuracy could be improved. These improvements and the action plan already completed (a performance criterion for end-October) will lay the basis for further management reforms outlined below.

18. Lesotho has had recent success in reducing corruption and fraud. In 2002, the High Court imposed significant penalties on a foreign company found guilty of bribing former officials of the Lesotho Highlands Water project, who were found guilty and sentenced to jail. Government has also uncovered several schemes to misappropriate public funds. Government sees its anticorruption as a central aspect of improving financial management and promoting foreign investment.

19. There has been notable progress in modernizing the financial sector. The Central Bank of Lesotho now publishes its macroeconomic forecasts (a benchmark for end-January 2003) in an effort to raise the public's awareness in these issues. The bank also made progress in promoting a private sector credit bureau (a benchmark for end-January 2003), and has identified the next steps Government can take to bring this source of credit information to Lesotho. Finally, the Bank has completed plans to allow foreign currency deposits, a move that will facilitate business operations and help attract foreign investors.

20. Government retained a private accounting firm to prepare the 2001/02 accounts for audit and to construct a balance sheet or "statement of affairs" listing all government financial assets and liabilities as of end-March 2002 (a performance criterion for end-December 2002). However, Government was not satisfied with the coverage and accuracy of the work and asked for a second, more comprehensive report, which was completed in February 2003. This second report presented the 2001/02 accounts, including some qualifying notes, and listed many financial assets and liabilities. In their qualifying notes, the report's authors observed that loans to parastatals, some accounts held by spending ministries, and the balances of a number of below the line accounts were not captured. In consequence, an accurate listing of financial assets and liabilities for March 2002 was not completed. However, in restarting the audit process and identifying areas for further work, the report went a long way toward the objective of greater transparency and accountability in

government accounts. In addition, Government has already started to correct some of the shortcomings that became apparent in this process (see below). Government therefore requests a waiver for this performance criterion.

21. Restructuring the top management of the Treasury Department (a performance criterion for February 28, 2003 and the sixth disbursement) has been delayed. At the time this performance criterion was written, Government did not expect to have a new Accountant General in place until at least June 2003, and in the meantime it wanted to push ahead with restructuring of the Treasury. Because the position of Accountant General was filled well ahead of plan, it is now preferable to allow the new Accountant General time to restructure the department himself, perhaps within six months. Government will request a waiver of this performance criterion during the sixth review.

III. THE ECONOMIC PROGRAM FOR APRIL 2003–MARCH 2004

22. The 2003/04 budget aims at providing a starting point for sustainable fiscal policies that will allow Lesotho to address the urgent policies of poverty reduction. Monetary policies will seek to maintain the pegged exchange rate arrangement. Supporting structural measures will center on improving Treasury management, tax administration, and financial intermediation.

A. The 2003/04 Budget

23. The 2003/04 budget, which was approved by parliament on March 28, is based on priorities emerging from the consultative process and emphasizes service to the public. These priorities include: education and health; building a network of roads to link the country internally and externally, development of tourism; access to clean water, sanitation, electricity, telephones, and credit; development of agro-industries, protection of the environment through controlled grazing, deforestation, and construction of gullies to stop soil erosion.

24. Government recognizes that the medium-term fiscal strategy must achieve a sustainable budget deficit. To do otherwise could create conditions for a financial crisis in the future and lead to a debt level that has crippled several other countries in Africa. It would also deplete resources that may be needed in the future to fight HIV/AIDS, cushion against another drought situation, or help adjust to possible declines in SACU revenue. Thus, Government aims for a deficit of under 4 percent of GDP in 2003/04, with medium-term deficits declining to the neighborhood of 2 percent of GDP. Government is aware that this adjustment depends critically on instituting better revenue collection measures; stringent financial discipline; and a concerted improvement in financial management.

25. Formulating the 2003/04 budget within this strategy involved many difficult decisions mainly because of a drop in the SACU customs transfer. This transfer was determined in late 2002 and shows a decline in Lesotho's allocation for technical reasons that were unrelated to policy. Nevertheless, Government has decided to act as if the decline foreshadows

diminishing future transfers as the new SACU agreement comes into effect and as tariffs and other trade barriers are reduced. Nontax revenue is also projected to fall, but this reflects unusually high flows in the previous year including dividend payments from the central bank and payments from electrical generation at the Muella power station. Income taxes are expected to rise as the LRA begins operation and pushes up tax efficiency. Indirect tax collections (the VAT) are expected to increase based on recent improvements in border collections, but also the fact that VAT base will be broader than that of the sales tax. On the basis of current commitments, donor grants are expected to fall in real terms.

26. Government recognizes that tax collections will need to be raised by the equivalent of about 1 percent of GDP in 2003/04, above what can be expected by LRA efficiency gains. Specific measures are currently under review and will be presented to Cabinet and then Parliament in due course.

27. The outlook for financial resources dictates that spending in 2003/04 will be extremely tight. Capital spending funded by Government will be held slightly above 2002/03 levels, with the result that most new projects will be postponed. Purchases of goods and services other than for famine relief and agricultural support will rise on account of M 140 million allocated for local elections that will be held on December 2003. On the other hand, transfers and subsidies will rise owing to the Lesotho College of Education and the Lerotoli Technical Institute becoming autonomous, the establishment of the LRA, and higher student scholarships. Government anticipates that savings and efficiency gains, including those offered by better financial management and reporting, will allow government spending to be held within the framework without jeopardizing services to the public.

28. Within these constraints, Government has emphasized health and education. The resources devoted to overall social services are budgeted to rise by almost 15 percent, with much of this for the ongoing expansion of free primary education. Moreover, Government will be looking at ways of providing education more efficiently, for example by addressing administrative and staffing issues at the National Manpower Development Secretariat (NMDS), which oversees scholarships. The budget for defense has been lowered as a percent of GDP.

29. Government's need for financing will be significant, between M 320 and M 350 million in 2003/04. The budget framework assumes that this amount will be met almost entirely through domestic sources, with only almost no new net external financing available. Domestic financing of this magnitude would be feasible in the short run through a drawdown in government deposits at the central bank and some increase in government debt. However, there are costs to such an operation, including a greater burden on monetary policy and higher interest costs on treasury bills. Government feels that these costs are justified in the current circumstances of pressing need to rebuild public institutions and infrastructure that were neglected since the 1998 political unrest. Government recognizes that debt would become unsustainable unless fiscal savings are put in place in the medium term.

B. Supporting structural measures

30. Structural measures over the next several months will center on strengthening existing procedures and systems in the Treasury Department, developing the LRA, and introducing the VAT. These efforts, outlined below, have three objectives: (i) making Government accounts more transparent; (ii) reducing the possibility of spending beyond what has been authorized by Parliament; and (iii) improving revenue administration. Overall, reforms will allow Government to deliver services efficiently, ensure that all funds are used for the intended purpose, and collect taxes fairly.

31. Near-term reforms in the Treasury will address operational issues. To improve the accuracy of government records, Government will work to ensure that all transactions in bank accounts are entered into the Treasury general ledger and that all cash books are reconciled with bank balances monthly. Diplomatic mission accounts will be submitted to the Treasury timely and immediately captured in the general ledger. It will also move to enforce existing regulations and reassign financial responsibility for each ministry to the Principal Secretaries by emphasizing their roles as Chief Financial Officers.

32. Looking ahead, the Ministry of Finance is currently formulating plans to modernize Treasury operations. These will be based on the recommendations of earlier expert reports and the private sector experience of the newly appointed Accountant General. Areas under review are:

- restructuring of the Treasury top management structure, including new posts for deputy accountants general;
- a strengthened internal audit function in the Treasury;
- a review of computer staffing and reporting responsibilities and hardware and software;
- measures to strengthen the accounting cadre in Government.

Specific plans and an implementation timetable have been delayed to allow the Accountant General time to become acquainted with the department, and a new plan is expected by June 2003.

33. Government remains committed to making its books accessible to Parliament and the public. To this end, it has submitted the 2001/02 accounts for audit and will prepare the 2002/03 accounts for audit by September 30, 2003. A report on below-the-line accounts will also be submitted for audit. Government has also begun to address the accounting and administrative weaknesses that were identified in its report to the Auditor General on the 2001/02 accounts. Already, Principle Secretaries have been reminded of their responsibilities in keeping accurate accounts. Government is also working to bring into its accounting system loans to parastatals, bank accounts of some spending ministries that are not captured in the

system, and below-the-line accounts. Furthermore, Government is pursuing means of completing accounts from 1995/96, while recognizing that the audits of past years' accounts are likely to be qualified because of incomplete records and the use of below-the-line accounts. Nevertheless, Government will make all results public and strive to improve the quality of government financial information in the future.

34. Initiatives in the revenue area will build on the successful launch of the LRA in December 2002. Already the LRA has contributed to better tax compliance, and further improvements can be expected as the new organization gains experience. The next major hurdle in this area will be implementation of a Value Added Tax (VAT) on July 1, 2003. For efficiency, Government is considering harmonizing the VAT system with that in South Africa and coordinate collections and refunds with the South African Revenue System (SARS).

35. Government purchases will be subject to VAT when it is implemented. This will increase government spending by an estimated M 80 million in 2003/04, but also raise tax collections by the same amount. While there is clearly no direct impact of this arrangement from a deficit point of view, Government anticipates significant benefits. First, tax avoidance will be reduced. Under the current sales tax arrangement that exempts government purchases, some producers incorrectly claim exemptions for sales to government that in fact go to private consumers. This will not be possible under the VAT arrangement. Second, Government will face the same prices as others in the economy, thereby leveling the playing field.

36. Government does not envisage further significant changes in tax policy at this time. Rather, Government has developed terms of reference for a study of tax policies, including the impact of taxes on competitiveness within the region. Government will also prepare estimates of the budgetary implications of tax exemptions before they are granted. When complete, the studies will provide policymakers with a roadmap for updating Lesotho's tax system.

37. Government is taking steps to improve civil service efficiency including the training of human resource officers and the introduction of performance appraisals for some civil servants. In addition, Government is working with donors on a far-reaching plan to improve the public sector. Without measures that will reduce the cost of civil service, Government may be forced to freeze wages or otherwise slow their inflation adjustments.

C. Financial Market Development

38. One of the main impediments to faster economic growth in Lesotho is the lack of financial intermediation. The Central Bank of Lesotho, in conjunction with Government, is addressing institutional and structural weaknesses that hinder private credit growth through several channels. For example, it is assisting the private sector in developing a credit bureau that would provide payment histories and other information to creditors. Draft regulations for

the bureau have been given to the Ministry of Trade, Industry, Cooperatives and Marketing, which governs licenses in this area. The Central Bank is also working with the legal professionals to make Lesotho's commercial court operate more efficiently. A credit bureau and a smooth-running commercial court would encourage lending by reducing risk and lowering the cost of recovering bad loans.

39. The Central Bank of Lesotho is committed to gradual liberalization of capital controls with a view toward better alignment of Lesotho's exchange controls with those of other countries in the Common Monetary Area. In the near term, it is likely that residents will be allowed to open foreign currency bank accounts to facilitate transactions, especially for the business community. Looking ahead, the Central Bank has prepared a blueprint for liberalization and is incorporating suggestions made by the IMF, in particular concerning the sequencing of reforms.

40. The Central Bank will be active in several other areas. First, it will complete a blueprint for modernizing the national payments system so that banking will be more efficient and services will be available to more people. Second, the Bank will review regulations pertaining to the insurance industry. Third, it will seek to bolster balance of payments data and analysis. Better data will be necessary to monitor developments as capital controls are relaxed, and also improve policy analysis. In this connection, the Central Bank plans to collect more information on foreign exchange exposure and also foreign direct investment.

D. The PRSP

41. The poverty reduction strategy paper (PRSP) is now scheduled for final publication no later than November 2003. To date, village consultations throughout the country have been completed. These have led to an early draft of the PRSP that identified agriculture, housing, roads, water, employment, trade, and industry as the main areas needing government intervention.

42. Government has decided to merge the PRSP and National Vision 2020 Secretariats. A progress report was submitted to the IMF and World Bank in January 2003.

IV. PROGRAM MONITORING

43. Quantitative and structural performance criteria and benchmarks are set out in Tables 1 and 2 of the MEFP. The sixth disbursement will be based on end-June test dates, with the exception of the quantitative performance criteria for end-December 2003, which would be conditions for the seventh disbursement.

44. The Government of Lesotho will keep the IMF informed of the progress in the implementation of the program. In particular, the government will continue to send to the IMF fiscal and monetary data on a monthly basis, as well as balance of payments and health

and education spending data at least on a quarterly basis. It will send domestic debt (by holder and instrument), external debt data on a monthly basis and information on monthly treasury bill auctions. A calendar for the provision of data appears in the Technical Memorandum of Understanding.

45. Government recognizes that there have been delays in providing data in the recent past. It is making every effort to rectify this situation.

46. During the program period, the government does not intend to (a) impose or intensify any restrictions on payments and transfers for current international transactions; (b) introduce or modify multiple currency practices; (c) conclude bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement; or (d) impose or intensify any restrictions on imports for balance of payments reasons.

Table 1. Lesotho: Quantitative Benchmarks and Performance Criteria,
June 2003 - December 2003

	2003			
	June 1/ Prog.	Rev. Prog.	Sep. Rev. Prog.	Dec. 1/ Rev. Prog.
	(In millions of maloti)			
Ceiling on the domestic financing requirement of the central government 2/	10	7	193	269
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-3,335	-2,579	-2,416	-2,411
	(In millions of U.S. dollars)			
Floor on the stock of net international reserves of the Central Bank of Lesotho 3/	352	377	357	357
Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector (cumulative from end-November 2000) 4/ 5/ 6/				
Maturity of less than one year 7/	0	0	0	0
Maturity of one year or more	0	0	0	0
Ceiling on the stock of external payments arrears 6/	0	0	0	0

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

1/ Performance criteria.

2/ June, September and December 2003 are cumulative from end-March 2003.

3/ At program exchange rates.

4/ This performance criterion applies not only to debt as defined in point no. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received.

A loan is concessional if its grant element is at least 35 percent, calculated using a discount rate based on the ten-year average of OECD commercial interest reference rates (CIRRs) for loans of maturity of greater than 15 years; for loans of maturity of 15 years or less, the discount rate is based on the six-month average of OECD CIRRs. To both the ten-year and six-month averages, the same margin for differing repayment periods would be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

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

6/ Continuous performance criterion.

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

Table 2. Lesotho: Structural Benchmarks and Performance Criteria, June 2003-December 2003

	Action	Implementation Date
A.	Lesotho Revenue Authority, VAT, and Supporting measures	
	1. Put into effect VAT.*	July, 2003
	2. Put into effect measures to raise revenue by the equivalent of 1 percent of GDP.*	June 30, 2003
	3. Begin a study on the costing of all income tax, VAT, and customs exemptions.	June 30, 2003
B.	Financial Management	
	1. Transactions in bank accounts, including diplomatic missions, will be entered into the Treasury ledger system. Initiate practice of reconciling all cash balances with bank balances monthly.*	August 31, 2003
	2. Enhance Status of Funds reports to include revenue collections and projections of spending and revenue through the end of the financial year.	September 30, 2003
	3. Prepare a timed action plan for Treasury reform including a restructured top management, a strengthened internal audit function, and a review of Treasury computer arrangements.	June 30, 2003
	4. Strengthen financial control at the ministry level by enforcing existing regulations and reemphasizing the financial oversight role and responsibilities of the Principal Secretaries, Chief Accounting Officers, and Financial Controllers. Strengthen Inspectorate and increase number of inspections.	September 30, 2003
	5. Strengthen the accounting cadre in Government by reviewing minimum qualifications for accounting positions and the salary structure.	September 30, 2003
	6. Complete Government's 2002/03 accounts and present to Auditor General.*	September 30, 2003
	7. Submit for audit a report on below-the-line accounts.*	September 30, 2003
	8. Integrate into the Treasury accounting system loans to parastatals and ministry accounts that are not being captured by the system and report such integration to the Fund.*	August 31, 2003
	9. Appoint a Contract Representative for Imperial Fleet contract.*	July 31, 2003
	10. Complete a study on the needs for future famine relief and agricultural support programs.	July 31, 2003
	Action	Implementation Date
C.	Financial Sector	
	1. Prepare a schedule for improving balance of payment data collection.	June 30, 2003
	2. Complete the revision to the insurance legislation.	December 31, 2003
	3. Complete the first stage of capital account liberalization.	June 30, 2003
	4. Hold commercial court workshops.	July 31, 2003
	5. Complete vision planning paper for national payments systems.	August 31, 2003

* Performance criterion for the sixth disbursement.

INTERNATIONAL MONETARY FUND

GOVERNMENT OF LESOTHO

Technical Memorandum of Understanding

May 15, 2003

1. This memorandum sets forth the understandings between the Government of Lesotho and the IMF staff regarding the definitions of the quantitative performance criteria and benchmarks for the three-year arrangement supported under the Poverty Reduction and Growth Facility (PRGF), as well as the respective reporting requirements. These performance criteria and benchmarks are reported in Table 1 of the government's Memorandum on Economic and Financial Policies (MEFP).

2. The test dates during the financial year April 2003-March 2004 will be end-June 2003, end-September 2003 and end-December 2003. The end-June 2003 and end-December 2003 targets will constitute quantitative performance criteria, and the end-September 2003 target will be a quantitative benchmark. In addition, the ceilings on the stock of external payments arrears and new nonconcessional external debt are continuous performance criteria. The fourth review under the program is scheduled for completion by June 16, 2003. End-June 2004 performance criteria for the financial year April 2004-March 2005, will be set at the fifth review.

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

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

¹ Program cross exchange rates: South African rand per U.S. dollar: 7.920; U.S. dollar per pound sterling: 1.580; U.S. dollar per SDR: 1.374; U.S. dollar per Euro: 1.090; Swiss franc per U.S. dollar: 1.354; Swedish krona per U.S. dollar: 8.505; Botswanan pula per U.S. dollar: 5.153. Program loti per U.S. dollar exchange rate: 7.920.

4. **Adjustment clause:** The program target for the NIR of the Central Bank of Lesotho in any quarter will be adjusted upward by the amount of any advance receipts from the Southern Africa Customs Union (SACU) in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter. It will be adjusted for accounting practice changes implemented by the Central Bank of Lesotho that are recommended by the IMF's Statistics Department or are made in response to the IMF safeguard report.

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

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

6. **Definition:** The net domestic assets (NDA) of the Central Bank of Lesotho are defined as the difference between reserve money (currency in circulation plus total bank deposits at the central bank) and 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. Foreign assets and liabilities at the end of each quarter will be calculated in U.S. dollars using the agreed cross exchange rates stipulated in paragraph 3 converted into maloti using the U.S. dollar–loti exchange rate (also stipulated in paragraph 3). 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 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 nonbank sector. It will be calculated as the cumulative change from end-March 2002 in fiscal year 2002/03 and as the cumulative change from end-March 2003

in fiscal year 2003/04, 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. Changes in government liabilities stemming from the issue or retirement of treasury bills and bonds due to the recapitalization of the Old Lesotho Bank 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. External debt service, amortization, disbursements and external grants will be calculated at program exchange rates.

10. **Adjustment clause:** The program assumes that customs revenue from the SACU revenue pool will be received as follows: M367.5 million in each quarter in fiscal year 2002/03, and M355.4 million in each quarter in fiscal year 2003/04. The program target for the domestic financing requirement of the central government in any quarter will be adjusted downward by the amount of any excess of customs revenue received over the programmed amount in that quarter, where this excess constitutes advance receipts of amounts that would otherwise have been received in a subsequent quarter.

11. **Adjustment clause:** The program assumes total European Union budget support grants of M0 in the first quarter of 2003/04, M29.7 million in the second quarter of 2003/04 and M0 million in the third quarter of fiscal year 2003/04. The program target for net domestic requirement of the central government will be adjusted downward (upward) by the amount of any early (late) payment of EU budget support grants.

12. **Adjustment clause:** The program assumes rand monetary compensation revenues of M44 million in the first quarter of 2003/04, M0 million in the second quarter of 2003/4 and M0 million in the third quarter of fiscal year 2003/04. The program target for net domestic requirement of the central government will be adjusted downward (upward) by the amount of any early (late) payment of rand monetary compensation.

13. **Supporting material:** The Central Bank of Lesotho will provide the monetary survey and other monthly monetary statistics, as well as a table showing the details of all government financing operations from the nonbank public, on a monthly basis and within 30 days of the end of the month. The outstanding balances in the privatization account or accounts, and in the SACU revenue pool account mentioned in paragraph 9, as well as details of any monetary operations with treasury bills, including the changes in government deposits stemming from such operations will be separately identified as memorandum items in the monetary survey. The Central Bank will also provide a table showing the details of government debt by type and holder. The Ministry of Finance will provide detailed monthly budget operations and tax arrears reports.

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

14. **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 and loans under the PRGF arrangement will be excluded from this performance criterion. The performance criterion will be evaluated on a continuous basis as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from end-November 2000.

15. **Adjustment clause:** None.

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

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

17. **Definition:** The public sector comprises the central government, the Central Bank of Lesotho, and all enterprises with majority state ownership. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received. Included in this performance criterion are all current liabilities that are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and that require the public sector (obligor) to make one or more payments in the form of assets (including currency) at some future point(s) in time to discharge principal and/or interest liabilities incurred under

the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits, and leases) will be subject to the ceiling. Treasury bills issued for the purposes of monetary policy operations will also be excluded. Normal short-term import credits, will be excluded from this performance criterion. The performance criterion will be evaluated on a continuous basis as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from end-March 2001.

18. **Adjustment clause:** None.

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

F. Ceiling on the Stock of External Payments Arrears

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

21. **Adjustment clause:** None.

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

LESOTHO: FUND RELATIONS
As of March 31, 2003

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

II. General Resources Account:	<u>SDR million</u>	<u>Percent Quota</u>
Quota	34.90	100.0
Fund holdings of currency	31.36	89.9
Reserve position in Fund	3.54	10.1
III. SDR Department:	<u>SDR million</u>	<u>Percent Allocation</u>
Net cumulative allocation	3.74	100.0
Holdings	0.44	11.7
IV. Outstanding Purchases and Loans:	<u>SDR million</u>	<u>Percent Quota</u>
ESAF/PRGF arrangements	15.13	43.4

V. Financial Arrangements:

<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>
PRGF	03/09/2001	3/08/2004	24.50	14.0
Stand-by	09/23/1996	9/22/1997	7.17	0.0
Stand-by	07/31/1995	7/30/1996	7.17	0.0

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

	<u>Forthcoming</u>				
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	0.8	0.4	0.0	0.4	1.8
Charges/Interest	0.1	0.1	0.1	0.1	0.1
Total	0.9	0.5	0.1	0.5	1.9

VII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, Central Bank of Lesotho (CBL) is subject to a full Stage One safeguards assessment with respect to the PRGF Fund arrangement approved on March 09, 2001, which is scheduled to expire on March 08, 2004.

An off-site safeguards assessment of the CBL was completed on July 02, 2001. The assessment concluded that an on-site assessment was not necessary at this juncture, but identified certain weaknesses and made appropriate recommendations, as reported in EBS/01/115.

VIII. Exchange Arrangements:

Lesotho's currency, the loti (plural maloti), continues to be pegged at par to the South African rand. For the 12-month period ended January 2003, the nominal effective exchange rate appreciated by 0.4 percent and the real effective exchange rate depreciated by 3.3 percent. The Central Bank of Lesotho (CBL) deals with commercial banks mainly in South African rand. As of March 31, 2003, the rand (maloti) rate per U.S. dollar was M7.95.

IX. Article IV Consultation:

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

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

X. Technical Assistance:

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

XI. Resident Representatives:

None.

LESOTHO: IMF-WORLD BANK RELATIONS

IMF-World Bank collaboration in the PRSP Process

1. The IMF and World Bank staff maintained a collaborative relationship in supporting the ongoing Poverty Reduction Strategy Paper (PRSP) process. In February 2001, the staff teams prepared a joint staff assessment of the I-PRSP which was cleared by the Bank's Board and presented to the IMF Board together with the PRGF program report. Similarly, a joint staff assessment of the PRSP progress report was prepared in March 2002. The I-PRSP outlines the Government's medium-term economic strategy that will serve as the basis for developing a poverty reduction strategy. It emphasizes economic growth and poverty reduction in the context of macroeconomic stability and contains the following elements: export-led economic growth driven by private sector development, prudent fiscal management, cautious monetary policy, strengthened capacity for national economic management, and increased efficiency and accessibility to quality social services. The I-PRSP however, remains weak with respect to sectoral policies and programs for the medium and longer term. It lists ongoing sectoral programs in trade, state enterprise reform, telecommunications, power, water, agriculture, and the social sectors without defining follow-up medium term measures and policies in these areas.
2. The IMF has taken the lead in assisting Lesotho in maintaining fiscal discipline which is the main macroeconomic problem affecting the economy, through a PRGF. The IMF and Bank teams have been in close contact and discussed structural measures and conditionality, most of which have fiscal implications.
3. The World Bank is supporting the Government with the PRSP process by providing technical assistance to the PRSP Secretariat and its Technical Working Group (TWG). The leading cause of poverty in Lesotho is rising unemployment and underemployment caused by a series of structural changes which began in the early 1990s with the decline of mining in South Africa. The latter employed a third of the male Basotho labor force in the 1980s. With the return of retrenched Basotho miners, the pressure on agriculture has increased and unemployment has risen in the rural areas. Additionally, other structural changes are underway: traditionally, a significant proportion of the Basotho labor force was absorbed on neighboring South African farms. However, with rising unemployment among unskilled South Africans, job prospects for Basotho workers have depleted. In the late 1990s, the unemployment problem was exacerbated by slow economic growth with the exception of the small garment sub-sector (which employs only 6 percent of the labor force), and the winding down of construction activity on the Lesotho Highlands Water Project (as it nears completion in 2007). Given the absence of a productive natural resource base and a vibrant local private sector, there are few employment opportunities for Basotho workers. The Bank is undertaking a Growth and Employment Options study which will examine in a comprehensive modeling framework the trade-off between growth, employment and poverty reduction of alternative policy options. It will also evaluate the fiscal cost of these options. Since the Government is presently re-thinking its poverty reduction stance and is poised to consider various options, more information about its policy options should lead to informed

decision making and an optimal prioritization of its medium and longer term poverty reduction agenda.

4. Within 3-4 months after the completion of the PRSP, the Bank will prepare its Country Assistance Strategy (CAS) for Lesotho. The content of the CAS will closely support the Government's priorities identified in the PRSP.

Financial Relations with the World Bank Group

5. The attached table summarizes the World Bank's lending operations. As of March 31, 2003, IDA had approved 29 credits amounting to US\$332.6 million, of which US\$240.9 million was disbursed; US\$56.4 million was canceled; and US\$40.4 million remains undisbursed. An IBRD loan of US\$110 million was approved for Phase IA of the Lesotho Highlands Water Project (LHWP) in July 1991; of which US\$68.9 million was disbursed and US\$41.1 million canceled. A second IBRD loan of \$45 million was approved in June 1998 for Phase IB of the Lesotho Highlands Water Project, of which US\$18.5 million has been disbursed and US\$17.5 million is undisbursed and the remainder US\$9.0 million was cancelled. The Bank Group's first operation in Lesotho was approved in February 1966. To date, the World Bank has financed six projects in education; five in roads and roads rehabilitation and maintenance; four in agriculture, three in industry, two in water supply (including highland water engineering), three in urban development, three in health, two in privatization and one in community development.

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

Contact: Vandana Chandra

Lesotho: World Bank Lending Operations
(As of March 31, 2003; in millions of U.S. dollars, unless otherwise indicated)

Sector	Disbursed Credits		Disbursing Credits and Loans				Total Approved Credit Loans (G)=(A)+(C)	Total Disbursed and Undisbursed (I)=(E)+(H)	Percent of Total Disbursed	Percent of Total Disbursed and Undisbursed	
	Original amount (A)	Disbursed 1/2/ (B)	Original amount (C)	Disbursed 2/ (D)	Undisbursed 2/ (E)	(F) = (D) + (E)					
Credits:											
Education	77.7	73.2	0.0	0.0	0.0	0.0	77.7	73.2	73.2	17.6	16.9
Transport 3/	84.4	62.7	0.0	0.0	0.0	0.0	84.4	62.7	62.7	15.1	14.5
Agricultural/land management and conservation	34.4	17.9	0.0	0.0	0.0	0.0	34.4	17.9	17.9	4.3	4.1
Industry	27.5	24.5	0.0	0.0	0.0	0.0	27.5	24.5	24.5	5.9	5.7
Water supply	6.0	5.1	0.0	0.0	0.0	0.0	6.0	5.1	5.1	1.2	1.2
Urban development	26.4	10.8	0.0	0.0	0.0	0.0	26.4	10.8	10.8	2.6	2.5
Health and population	22.1	17.6	0.0	0.0	0.0	0.0	22.1	17.6	17.6	4.2	4.1
Lesotho Highlands Water Project	9.8	10.4	0.0	0.0	0.0	0.0	9.8	10.4	10.4	2.5	2.4
Privatization	39.6	18.2	0.0	0.0	0.0	0.0	39.6	18.2	18.2	4.4	4.2
Social Protection	4.7	0.6	0.0	0.0	0.0	0.0	4.7	0.6	0.6	0.1	0.1
Total	332.6	241.0	0.0	0.0	0.0	0.0	332.6	241.0	241.0	58.0	55.6
Loans											
Lesotho Highlands Water Project	155.0	87.4	155.0	87.4	17.5	104.9	310.0	174.7	192.3	42.0	44.4
Total credits and loans	487.6	328.4	155.0	87.4	17.5	104.9	642.6	415.7	433.3	100.0	100.0
Repayments		93.7		71.1				164.8			
Cancellation	106.5		-50.1				56.4				
Total obligation		234.6		16.3				250.9			

Source: IBRD.

1/ Original principal less cancellations.

2/ Reflects adjustment for exchange rate movements.

3/ Infrastructure Project and Road Rehabilitation and Maintenance Project.



Press Release No. 03/87
FOR IMMEDIATE RELEASE
June 17, 2003

International Monetary Fund
Washington, D.C. 20431 USA

**IMF Completes Review Under Lesotho's PRGF Arrangement and Approves
US\$4.98 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) has completed the fourth review of Lesotho's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. As a result, Lesotho will be able to draw up to SDR 3.5 million (about US\$4.98 million) under the arrangement immediately.

The Board also granted a waiver of nonobservance of the end-September 2002 performance criteria on the domestic financing requirement of the central bank and the end-December 2002 structural performance criterion on the construction of the government's balance sheet as of March 31, 2002.

Lesotho's three-year PRGF arrangement was approved on March 9, 2001 (see [Press Release No. 01/8](#)) in an amount equivalent to SDR 24.5 million (about US\$34.87 million). So far, Lesotho has drawn SDR 14.0 (about US\$19.93 million).

The PRGF is the IMF's most concessional facility for low income countries. 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 PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

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

"The economy of Lesotho continues to perform well under the PRGF-supported program, despite the stresses caused by a serious drought. Economic growth last year was stronger than expected, and inflation has fallen back. The foreign reserve position is sound, competitiveness has been maintained, and exports, in particular textile exports, are strong. The strong and quick

response of the authorities, hand in hand with considerable assistance from bilateral and multilateral donors, helped avert development of a full-blown food crisis in Lesotho last year. “Lesotho’s economic program has been generally on track, but fiscal slippages emerged in the first quarter of 2003, partly as a result of agricultural support spending related to the drought. Corrective measures are being taken to bring the budget back to a sustainable basis. Accordingly, the Fund grants the authorities’ request for a waiver of performance criteria related to domestic financing of the government, as well as that for construction of the government balance sheet. The authorities are firmly committed to securing a sound medium-term fiscal position, through increased revenues and a disciplined and targeted approach to expenditures. In that vein, the authorities aim to make rapid progress in bolstering spending systems so that budget items can be better matched with policy objectives, with a strong focus on social and poverty reduction programs.

“Considerable progress has been made in the area of tax administration. Establishment of the Lesotho Revenue Authority and the upcoming introduction of a value-added tax will bolster the efficiency and transparency of revenue collections and help to address budget pressures. In the period ahead, administration of the Treasury is to be strengthened.

“The preparation of the full PRSP for Lesotho is proceeding well, although with some delays caused by the extra time needed to coordinate carefully the planning processes that seek to improve living standards—including the government’s National Vision program—so that resulting policy recommendations are fully harmonized. The progress made so far in finalizing the PRSP provides a sound basis for support for Lesotho’s poverty reduction and social development efforts by the international community,” Mr. Sugisaki said.

**Statement by Ismaila Usman, Executive Director for Lesotho
June 16, 2003**

Introduction

My Lesotho authorities thank the staff for a very candid and balanced report and for their continuing support to the country. The authorities have remained broadly on track in implementing the program, with almost all of the performance criteria and structural benchmarks met with a few minor exceptions, for which waivers are requested. The authorities have, within the context of the program, implemented a wide range of structural reforms, which were aimed at laying the foundation for improved long-term economic and social conditions in the country. However, the progress with these endeavors has been negatively affected by the drought last year, which resulted in famine affecting almost 900,000 people. The authorities have acted pro-actively to address this dire situation, by declaring a state of famine in April 2002 in order to contain the calamity. Budgetary outlays were increased to provide famine relief to those affected, in addition to the very generous donor support.

Macroeconomic Performance under the Program

a. Growth Performance

Lesotho's GDP grew by more than 4 percent during 2002, compared with 3½ in the previous year, notwithstanding the severe drought conditions. The increased growth performance was mainly attributed to improved export performance as the authorities effectively seized the opportunity to enhance exports to the United States within the framework of the African Growth and Opportunity Act (AGOA). Increased exports contributed to the creation of more than 10,000 new job opportunities in the manufacturing sector over the past 12 months. It is expected that agricultural output will increase, as weather conditions improve. This very positive development illustrates the potential for enhanced growth for small economies when developed countries allow them greater access to their markets.

b. Fiscal Policy

Fiscal policy was implemented under very challenging conditions with the prevailing famine in the country, compelling the authorities to take a more expansionary fiscal stance. Agricultural support to farmers increased significantly, and expenditures were increased to address the widespread famine in the country. Spending overruns became necessary, but steps have now been taken to ensure that overruns do not occur again in the future. In addition to these measures, the authorities implemented the improved expenditure management tracking system in the Lesotho Treasury Department, to strengthen vigilance on expenditures.

In contrast to the overrun in expenditures, revenue performance was better than programmed. The authorities expect revenue collections to be more efficient in the future since the Lesotho

Revenue Authority (LRA) became fully operational in December 2002. Furthermore, the tax base will be broadened with the introduction on July 1, of the Value Added Tax (VAT) at a rate of 14 percent. Registration drive is currently underway. It is expected that the implementation of these measures would raise additional revenues equivalent to 1 percent of GDP.

The authorities are determined to maintain a sustainable debt situation, by reducing primary and overall deficit over the medium-term. Lesotho devotes a very small percentage of export earnings to servicing external debts, and do not intend to finance the 2003/04 fiscal deficit with new external financing.

c. Monetary and Exchange Rate Policy and Financial Market Developments

The Loti is pegged to the South African Rand. This policy continues to serve Lesotho well. Annual inflation increased to 11¼ in December 2002, reflecting inflationary trends in South Africa, but also higher domestic food prices. On average it remained below 10 percent over the last few years, and recent data indicates a steep decline in inflation from the high level in December 2002, to 7.2 percent in April 2003, mainly attributable to the sharp decline in food prices.

The Loti depreciated sharply towards the end of 2001 and the beginning of 2002, but has strengthened subsequently in tandem with the South African currency. Notwithstanding the recent appreciation however, Lesotho's exports remained strong, since the exchange rate is still competitive.

The authorities' continued efforts to develop and modernize the financial market, and the latest efforts aimed at improving the functioning of the financial markets, include the publication of macroeconomic forecasts, and promoting the establishment of a private credit bureau, in addition to the substantive progress made towards allowing foreign currency deposits in the domestic banking system. The authorities are confident that these measures will facilitate business operations and greater foreign investment in the economy.

Famine Conditions and Food Relief

Lesotho experienced food shortages as a result of adverse weather conditions, which severely impeded the production of crops. The severity of the situation with almost 900,000 people threatened by famine, compelled the authorities to provide free maize meal in the affected areas, introducing a food-for-work scheme to assist able-bodied unemployed, and subsidizing unsifted maize meal. The dire situation in Lesotho has been eased by the generous support from the donor community. The World Food Program assisted greatly in distributing the free food to most of the affected areas. My authorities are extremely grateful to donors for honoring their pledges, as a result of which the cost of famine relief to the Government in 2002/03 is expected to be much lower than originally estimated.

In addition to providing famine relief, the authorities also helped farmers by providing plowing facilities, seeds, and fertilizer. Resources for this effort were reallocated from

unspent transfers of other Ministries, and from increased expenditures. The authorities hope to end famine relief and agricultural support programs during the second half of this year, when the situation would have eased considerably, to reduce the expenditure pressure on the budget.

HIV/AIDS

The HIV/AIDS infection rate in Lesotho is very high and the economic consequences on the economy are considerable. The authorities are addressing this pandemic at the highest levels. All Ministries allocate 2 percent of their budgets to combat HIV/AIDS. The authorities, aware that the prevalence of the disease can only be addressed more comprehensively at a regional level, have organized a conference of SADC heads of states to formulate a regional response to the pandemic.

PRSP Process

My authorities have made good progress in formulating the PRSP with full participation of all the stakeholders, including the donors and civil society as attested by the IMF/World Bank Joint Staff assessment. The authorities are committed to completing the PRSP and submitting to the IMF and the World Bank by November 2003.

Governance Issues

The authorities have during the period under review demonstrated their commitment to addressing governance issues. In recent actions to root out corruption, some government officials were sentenced by the Lesotho High Court, while significant penalties were imposed on the foreign company involved.

Economic Program for the Period April 2003-March 2004

My Lesotho authorities are firmly committed to implementing the Fund supported program for the period ahead as outlined in the authorities' Memorandum on Economic and Financial Policies.

Policy actions include pursuing sound fiscal policies to ensure long-term debt sustainability. In this regard, efforts will be made to broaden the tax base by introducing VAT at a rate of 14 percent, and improving the efficiency of tax collection and administration through the Lesotho Revenue Authority (LRA). Steps are also being taken to strengthen the expenditure management systems, limiting wage increases to only 4 percent, and curbing nonessential expenditures during 2003/04. Social expenditures will, however, be increased by 15 percent, to address the long-term goal of reducing poverty.

As regards structural reforms, there will be enhanced efforts to strengthen the procedures and systems in the Treasury Department. These will include making government accounts more transparent, and implementing the Lesotho Public Sector Improvement and Reform Program,

which was put on hold at end- 2001 because of lack of resources. These efforts will now continue with donor resources for the project.

The authorities will continue to strengthen the financial sector, with reforms in this area aimed at strengthening the credit culture in Lesotho by establishment of a credit bureau and enhancing the operation of the Commercial Court. In addition, the authorities will align the exchange control regulations with those of other countries in the Common Monetary Area. The Central Bank's initiative to modernize the national payments system will also contribute to enhancing the efficiency of the banking system.

Conclusion

My Lesotho authorities remain fully committed to fulfill the program requirements during the next review period, and request that waivers be granted for the non-observance of minor deviations, largely related to the adverse weather conditions during 2002. They are immensely appreciative of the generous donor support in alleviating the famine threat in the country, and believe that a favorable conclusion of today's review will enable them to face with renewed confidence, the numerous challenges of economic development, poverty reduction and efforts to achieve the MDGs.