

**Lesotho: Third Review Under the Poverty Reduction and Growth Facility Arrangement and Request for Waivers of Performance Criteria—Staff Report and News Brief on the Executive Board Discussion**

In the context of the Third Review Under the Poverty Reduction and Growth Facility Arrangement and Request for Waivers of Performance Criteria, the following documents have been released and are included in this package:

- the staff report for the Third Review Under the Poverty Reduction and Growth Facility Arrangement and Request for Waivers of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on **July 2, 2002**, 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 September 5, 2002.** 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 News Brief summarizing the **views of the Executive Board as expressed during its September 20, 2002 discussion** of the staff report that completed the review.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Lesotho\*  
Memorandum of Economic and Financial Policies by the authorities of Lesotho\*  
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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INTERNATIONAL MONETARY FUND

LESOTHO

**Third Review Under the Poverty Reduction and Growth Facility Arrangement and  
Request for Waivers of Performance Criteria**

Prepared by the African Department

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

Approved by José Fajgenbaum and Liam P. Ebrill

September 5, 2002

- The Executive Board approved a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for SDR 24.5 million on March 9, 2001. The second and third disbursements of SDR 3.5 million each took place on July 27, 2001, and March 26, 2002, respectively.
- Discussions for the third review under the PRGF were held in Maseru during June 19-July 2, 2002. Participants included Assistant Minister of Finance and Development Planning, P. Lebesa; Governor of the Central Bank of Lesotho, E. M. Matekane; Principal Secretary, M. Mphutlane; officials of the government and central bank, and commercial bank representatives. The mission attended a meeting that was part of the Poverty Reduction Strategy Paper (PRSP) process and met with local donor representatives.
- The mission team comprised Mr. Green (head), Ms. Medina Cas, Mr. Walsh (all AFR), Mr. Hatanpaa (TRE), and Mr. Mitchell (PDR).
- Two performance criteria were not observed. The quantitative performance criterion on domestic financing was breached, almost entirely due to delayed external disbursements. The structural performance criterion on filling the position of Accountant General was not completed because the nominee was unable to accept the position. The authorities request waivers for these. Lesotho observed all remaining quantitative and structural performance criteria and completed most of the structural benchmarks. Looking ahead, agreement was reached on structural targets until March 2003 and emergency food relief spending has been incorporated into quantitative targets and the program.

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### **Executive Summary**

- Economic growth for 2001/02 and near-term prospects have been revised upward because of positive developments in clothing manufacturing and construction. The successful completion of elections in May 2002 should bolster credibility and help attract foreign direct investment. The pickup in inflation in 2002, to 12½ percent in May, mainly reflects temporary factors including a doubling of maize prices.
- The government has declared a state of famine that is affecting an estimated 900,000 people. The government's relief plan will cost an estimated US\$37 million, to which donors are expected to contribute about US\$29 million. The government will finance the shortfall by drawing down deposits at the central bank. It has decided against a request for augmented IMF assistance at this time.
- One quantitative performance criterion for end-March 2002, the ceiling on the government's domestic financing requirement, was not observed, almost entirely because of delays in external payments. The authorities have requested, and the staff supports, a waiver on this performance criterion.
- Domestic revenue collections fell below projections in June, and without the receipt of external payments delayed from May, the benchmark on domestic borrowing would have been exceeded. In response to underperformance in tax collections, the government has cut spending by M 45 million (½ percent of GDP) for the remainder of 2002/03 and it has taken measures to bolster spending controls.
- The Ministry of Finance has undertaken an ambitious strategy to strengthen financial management and tax administration. The Lesotho Revenue Authority (LRA) is to be introduced by end-December, and it should help stem current revenue leakages. A new Accountant General was not appointed by end-July 2002 (a performance criterion) because the nominee withdrew at the last minute. Nevertheless, the authorities are pushing ahead with treasury reform.
- The central bank is working with the private sector and the judiciary to improve financial intermediation. It has also completed a strategy paper on strengthening the financial sector.

## I. RECENT DEVELOPMENTS

1. **Elections took place on May 25, 2002, and, as expected, the ruling Lesotho Congress for Democracy retained its majority (Box 1).** Unlike the previous round in 1998, the recent elections were peaceful.

### **Box 1. May 25 Elections in Lesotho**

Elections for Lesotho's National Assembly were held on May 25, 2002. The previous elections, in 1998, were disputed by opposition parties because the Lesotho Congress for Democracy (LCD), won 79 of the 80 seats in the Assembly, despite winning a much lower percentage of the popular vote. Political unrest followed, and the situation was only stabilized after military intervention by South Africa and Botswana.

In the wake of this, Lesotho established an Independent Electoral Commission to oversee future elections and suggest government reforms. In addition to the 80 seats apportioned by constituency, the National Assembly now includes 40 seats to be apportioned according to proportional representation.

The May elections went smoothly and were pronounced free and fair by international observers. The LCD remained the majority party with 55 percent of the vote, and it won all but one constituency seat. The proportional representation seats were won by 9 parties.

The peaceful outcome of the elections and the lack of controversy surrounding the seating of the members of the Assembly have been met with wide praise domestically and abroad.

2. **The Government of Lesotho declared a state of famine in April 2002 (Box 2, and Section III.B of the MEFP).** High rainfall in October-November 2001 prohibited planting in many areas, and hail and frost during the growing season exacerbated crop shortfalls. These developments, together with the regional food shortage, caused the price of cereals to more than double. The World Food Program (WFP) estimates a shortfall of up to 85 percent of domestic demand for staple grains.

3. **The most notable macroeconomic developments since the last Board discussion in March 2002 are upward revisions to near-term growth and inflation.** The latest economic estimates show that GDP rose by 4 percent in 2001/02 (April-March), compared

### **Box 2. Famine in Lesotho**

Lesotho is currently in a state of famine. Despite a largely rural population, Lesotho generally imports roughly half its food, with the percentage of imported maize, the staple crop, slightly higher. Due to a growing season first delayed by rains, then abbreviated by early frost, yields for staple grains over the next year are expected to amount to between 15 and 20 percent of domestic demand, according to a May, 2002 World Food Program (WFP) survey. The survey found that about 440,000 would require emergency assistance.

The Government of Lesotho's Famine Steering Committee in June published a report on the crop situation as well as a three-part plan to protect food security. The first component of the plan is a full subsidy of unsifted maize meal to vulnerable elements of the population (namely the elderly, the disabled, child-headed households, and orphans) as well as the unemployed under a Food For Work program. Those at risk were estimated at 900,000, above the WFP survey because the government's analysis covered additional regions. Second, the government plans to provide a 20 to 30 percent subsidy to the wholesale price of unsifted maize meal sold throughout the country, with fixed wholesale and retail markups for sellers. Finally, the government plans a supplemental food program for children under five.

Detailed cost estimates prepared by the Famine Steering Committee put the cost of this program, including distribution and organizational costs, at M 373 million. The government had, as of the preparation of the Steering Committee report, set aside M 23 million, leaving an amount remaining to be funded of M 350 million.

The Government has written to donors asking for support for its program. At the time of the mission, some support had been pledged, but this was insufficient to underwrite the entire program. The donors with whom the mission team spoke indicated that their funds would be given to the World Food Program in support of its regional efforts to distribute food in Southern Africa. In mid-July, the United Nations issued an appeal for Southern Africa including a request for US\$41 million for Lesotho. This appeal also covered support for inputs for the next crop year and social areas affected by the food situation.

with nearly 3 percent in the program, reflecting strong performance of the construction and manufacturing sectors (Table 1). The 12-month rate of inflation in May 2002 reached 12.6 percent, due to higher food prices caused by the shortage of cereals and the pass through effects of the depreciation of the loti in 2001. Estimates of the current account deficit for 2001/02 are larger than under the program due to higher merchandise imports, lower labor and investment income, and lower transfers (Table 2). These developments offset a rise in

textile exports under the U.S. African Growth Opportunity Act (AGOA). The loti depreciated in real effective terms in 2001, but has appreciated since January 2002, owing to higher inflation in Lesotho than in South Africa, Lesotho's main trading partner (Figure 1).<sup>1</sup>

4. **Gross official reserves fell to 6.1 months of imports of goods and services at end-March, but net reserves still remained above the program floor** (Tables 3 and 4). Net domestic assets of the banking system were lower than programmed at end-March 2002 (Table 5). Total domestic credit grew, as an increase in bank lending to the central government more than offset a decline in credit to the private sector. The latter variable continued to reflect weak financial intermediation in Lesotho.

5. **Fiscal policy, as measured by the surplus in the domestic balance, was tight in 2001/02** (Tables 6 and 7). Current expenditure declined to 34 percent of GDP from just over 37 percent in 2000/01, reflecting efforts by the government to exercise tight control over expenditure and wages and a higher-than-expected level of nominal GDP. Capital spending rose by more than 2 percentage points of GDP, driven mostly by increases in Government of Lesotho-funded spending on roads and schools and by increases in loan-funded projects. Noncustoms tax collections increased by 0.5 percent of GDP, owing to efforts to improve tax compliance such as limiting eligibility of businesses to receive government contracts to those current on their taxes. Nontax revenue fell by 5 percentage points of GDP compared with collections in 2000/01, when the government received almost 2 percent of GDP in exceptional revenue. The drop is also explained by the temporary shortfall in rand monetary compensation transfer from South Africa and more permanent declines in interest payments on government deposits at the central bank and in administrative fees.

6. **Considerable progress has been made in preparing the full PRSP.** Successful community-level consultations took place from March to May 2002, and, at the time of the mission discussions, sector working groups had begun work on the strategies in their respective areas. A draft of the PRSP is expected to be submitted to cabinet in November 2002, in time to influence discussions on the 2002/03 budget.<sup>2</sup>

## II. REPORT ON DISCUSSIONS

7. **The key objectives of the program are to raise economic activity and boost employment in order to reduce poverty.** In the first year of the program, the authorities have been largely successful in restoring and sustaining macroeconomic stability by

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<sup>1</sup> This differential reflects the larger weight given to food in Lesotho's consumer price index basket.

<sup>2</sup> A progress report was submitted to the IMF and World Bank Executive Boards in January 2002.



limiting the government's access to domestic financing, placing a floor on international reserves of the central bank and a ceiling on its net domestic assets, and prohibiting non-concessional financing of the central government. Monetary policy has been consistent with the maintenance of the pegged exchange rate regime. Macroeconomic policies have been supported by structural measures designed to improve tax administration, public expenditure control, and the financial system.

8. **The macroeconomic environment and growth projections have improved since the last program review.** The staff's near-term growth projections have been raised, mainly reflecting recent developments in the textile sector, but also the expected benefits of improving confidence in the economy. The unusual weather patterns are expected to have a relatively small impact on GDP because of the sector's modest size in the economy. The average rate of consumer price inflation was revised down for 2002/03, but the quarterly pattern shows a rise in inflation in the first three quarters of the year due to higher grain prices, and then a sharp drop in the fourth quarter when grain prices are assumed to fall back to more normal levels. Projections of the current account deficit have worsened because of revisions to trade and foreign direct investment historical data.<sup>3</sup> The authorities broadly concurred with these projections. They stated that, in conjunction with the PRSP, a macroeconomic working group had been set up. The staff offered its assistance, in particular to work on key uncertainties, namely the impact of HIV/AIDS and medium-term balance of payment projections.

#### A. The PRGF Review

9. **Lesotho's economic program remained mostly on track through July 2002, although some slippages emerged** (Tables 3 and 8). The performance criterion on the domestic financing requirement of the government was missed by M 143 million, but this was almost entirely due to delays in two financing flows. Disbursement of the EU budget support grant (M 70 million) came after the end of the financial year because of procedural delays that did not reflect performance shortfalls by the government of Lesotho. Payment of the rand monetary compensation transfer (M 66 million) was late because of a need by South Africa to reconfirm the amount of rand currency in circulation in Lesotho. Had the EU grant and the rand monetary compensation been received as scheduled, the performance criterion would have been missed by only M 7 million, or 0.1 percent of GDP. This shortfall reflected weaker-than-projected tax collections that appear to have persisted into the first quarter of 2002/03.

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<sup>3</sup> A recent IMF technical assistance mission confirmed that there are deficiencies in the balance of payments data. The authorities are working to improve collection of these data, thereby increasing their reliability as an indicator of the external position and also the reliability of medium-term projections.

10. **Most structural measures were observed.** However, the government was not able to fill the position of Accountant General, a performance criterion for end-July, because the appointee withdrew his acceptance of the government's offer after a member of his family fell ill in late July. The authorities have already begun the search for a new Accountant General and are seeking donor support for it. In the interim, they are pressing ahead with already-planned measures to strengthen financial management. Also, two structural benchmarks were not completed. First, the central bank did not introduce guidelines for foreign exchange dealers because it was decided to link this effort to the liberalization of the capital account, which is currently in the planning stages. Second, plans to introduce performance-based pay were not finalized because of time lost during the election process. The authorities indicated that performance pay remains an important part of public sector reform. It would be reintroduced into the economic program in the near future, perhaps as part of the larger Public Sector Improvement and Reform Project (PSIRP) that was put on hold last year owing to funding difficulties.

11. **The government requests waivers for the two performance criteria that were not observed.** First, the nonobservance of both criteria was outside the control of government. Second, the government is taking adequate steps to keep the program on track. It is working to fill the position of Accountant General and is continuing with its financial management reform plans. As explained below, it is also addressing the underperformance in tax collections that began to emerge in late 2001/02 with spending reductions. Tax collections are expected to pick up once the Lesotho Revenue Authority becomes operational at the end of the calendar year.

#### **B. Revisions to the April 2002–March 2003 Fiscal Program<sup>4</sup>**

12. **The government met the June 2002 benchmark target for domestic financing, largely because the disbursements for EU budget support and the rand monetary compensation payment were shifted from the end of 2001/02 to the beginning of 2002/03.** Without these higher-than-anticipated inflows, the domestic financing benchmark for the quarter would have been exceeded by about M 60 million ( $\frac{3}{4}$  percent of GDP), or M 40 million excluding famine relief.<sup>5</sup> Thus, the authorities and staff agreed that additional measures were needed to maintain the thrust of the original program in terms of the domestic balance.

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<sup>4</sup> The original economic program for 2002/03 is fully consistent with the government's budget for the same period.

<sup>5</sup> The rand compensation and EU budget support received in the June quarter exceeded the amount programmed for that quarter by M 76 million. Actual domestic borrowing in June was M 17 million below the benchmark.

13. **On the basis of preliminary data for June 2002, tax revenue was M 25 million below target, and nontax revenue, excluding the rand monetary payment, was M 16 million below target.** The authorities explained that shortfalls in income and sales tax collections reflected problems arising from the transition to the Lesotho Revenue Authority, such as shortages of experienced staff and a lack of enforcement effort. Officials said that sales and income tax collections would likely rebound when the LRA became operational, but that the observed weakness in nontax revenue could be more long lasting. Projections for these most likely had been overestimated in the budget.

14. **Total domestic expenditure was estimated to be on target in the June quarter, despite the M 20 million spent on famine relief that was not in the original program.**<sup>6</sup> This estimate was based on preliminary data, in particular with regard to the breakdown of current and capital spending. Preliminary data for July point to an above-program domestic financing requirement that is perhaps related to spending rates that were above monthly projections. There are no indications at this time that budget allocations have been breached.

15. **The authorities decided that it would be prudent to reduce spending to address revenue shortfalls through June 2002 and potential above-target spending in July.** They first considered tax increases, but preferred to hold tax policies unchanged until a more general review of tax policy was completed, sometime in 2003. Spending cuts could be implemented quickly. Specifically, the authorities would lower nonfood spending by M 45 million in 2002/03 relative to the program and budget through reductions in two main areas, international travel and expenditure on government office equipment. In addition, the Minister of Finance and Development Planning had informed the cabinet that special spending requests that could not be covered by the contingency allocation in the budget would be denied. The staff welcomed the proposed spending cuts, in particular that they were not in poverty-related areas, but cautioned that further expenditure reduction might be necessary if revenue does not rebound following the LRA's introduction. It urged the authorities to be ready for further cuts in the absence of such a rebound by identifying government-funded development projects that could be postponed. It emphasized that holding nonfood relief expenditures within budget was critical for the success of the economic program.

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<sup>6</sup> Domestic expenditure is defined as total spending less externally financed capital expenditure and external interest payments. Loan-financed capital projects were M 76 million (1 percent of GDP) above program in the first quarter because of improved implementation and recording, while grant financed capital spending was M 40 million below target. Because both categories are externally financed, there is no impact on domestic financing. The need for domestic financing was above program because external amortization was M 26 million higher than expected.

16. **In addition to spending reductions, some revisions were made to current expenditure and tax collections in the 2002/03 program** (paragraph 16 MEFP).<sup>7</sup> Wages and salaries were revised down due to a government decision not to fill all vacancies. Spending on vehicle leasing was running above budget, so the government will implement measures to control these costs. Despite renewed efforts to bolster tax compliance, revenue estimates were revised down by M 43 million. In sum, the domestic balance would be slightly higher relative to program at around 2 percent of GDP, a tightening of the impact of fiscal policy relative to 2001/02.

17. **The authorities are pushing ahead with a package of structural measures aimed at improving tax administration and financial management** (Box 3 and Table 3 of the MEFP). They reported that the LRA Commissioner General was in place and he was already taking steps to stem collection losses, for example by bolstering supervision at border posts. The staff underscored the importance of completing the transition to the LRA as a means of restoring the morale of tax collection officers. They would also continue with the plan to clear unaudited accounts by establishing a new government balance sheet and reporting discrepancies with current government books to parliament. The first step in this process will be the construction of a new balance sheet as of March 31, 2002 (a performance criterion for December 31, 2002). This could be accomplished largely with existing staff and local accountants, with assistance from an expert with experience in this area.

18. **The authorities have revised plans to strengthen the Treasury department in view of the recent setback in filling the Accountant General position.** The authorities indicated that they would begin the recruitment process to fill the Accountant General position (a benchmark for end-September), but that filling the position could take some time.<sup>8</sup> In the interim, the Ministry of Finance will enhance its control over spending by reintroducing past procedures that ensured that payments were backed by payment vouchers, except in a limited number of exceptional cases (a performance criterion for end-November). It will also initiate a study to identify a suitable financial management system (a performance criterion for end-October), and put in place a new top management in the Treasury department (a performance criterion for end-February 2003 and a condition for the sixth disbursement). These actions are critical to meet the government's objective of good financial management, while bolstering spending control and monitoring capability in the near term.

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<sup>7</sup> Revisions also reflect a reclassification of some items from the other goods and services category to transfers and subsidies, and an upward revision in estimated pension costs to take into account those who will be made redundant with the upcoming LRA and the privatization of a technical college.

<sup>8</sup> The authorities did not want to set the filling of the Accountant General position as a new performance criterion because of the uncertainties involved with a new international search. They nevertheless recognized this task as key.

### **Box 3. 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 September 2001–March 2002. A Commissioner General for the Lesotho Revenue Authority is now in place, and plans are being made to improve government financial management. The government has also made wide 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 8 of the staff report and Table 3 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 Commissioner General was in place by end-July, and the LRA is expected to become operational on schedule, by end-2002.
- strengthening expenditure management is a critical first step in bringing down Lesotho's high level of government spending. Progress has been made in preparing action plans to strengthen the Accountant General's office and replace the financial management system. A plan to introduce performance-based pay for public sector employees has been delayed, but the Government is dedicated to the principle, and the post-election political environment may be more conducive.
- in the area of financial sector reform, the Central Bank has encouraged commercial banks to take claims to the new commercial court, though these efforts have yet to produce significant results. The government has established and publicized regulations for ancillary financial markets, and has developed an integrated strategy for improving financial intermediation in Lesotho. A final benchmark, introduction of regulatory guidelines for foreign exchange dealers has been postponed until the government decides whether it should be linked to future capital account liberalization.

#### **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 project and expects to begin a multiyear project to improve the private sector in 2002. Structural benchmarks in the IMF-supported program are intended to be complements to a 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 toward 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.

They will form the core of an overall action plan that was under development at the end of August 2002.

### **Food relief**

19. **The government estimates that as many as 900,000 people are at risk of famine** (Box 2). In April, the government began to distribute free maize meal in affected areas, and in June, it unveiled a relief plan to assist farmers and others who are severely affected. Total cost of the government's program developed by the Famine Relief Steering Committee was estimated at US\$37 million. After taking account of donors' pledges of almost 60,000 tons of grain and US\$13 million in financial support, the government anticipated it would need to contribute just over US\$8 million (M 82 million, or 1¼ percent of GDP) by drawing down its central bank deposits. Most of this would be used to purchase grain and medical supplies externally.

20. **The staff team observed that assistance appeared to be well targeted to the most vulnerable groups and, by design, could be implemented easily.** Moreover, it was time limited to the current crop year (April/March). In terms of financing, the team raised the possibility of augmenting access under the PRGF arrangement. Officials asked that the possibility of augmentation be left open should the need arise as a consequence of either higher costs or lower-than-anticipated donor support.<sup>9</sup> The staff team agreed, noting that, under current plans, the government's share of food support would amount to just over 1 percent of GDP. The impact on domestic financing and international reserves was unlikely to pose a problem, provided that other parts of the budget—particularly nonfood spending—remained on track. Demonstration of the government's firm commitment to sound fiscal policy would bolster credibility and perhaps offset the adverse consequences on credibility of higher domestic financing.

### **Monetary Policies**

21. **The main objective of monetary policy is to maintain the fixed exchange rate.** Net international reserves are programmed to decline by about US\$9 million from September to March 2003, in part in line with programmed famine support, but could fall more if food relief needs are greater than expected, or if donor support falls below assumed levels.<sup>10</sup> In

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<sup>9</sup> Quantitative targets for the government's domestic financing and net domestic assets and net international reserves of the central bank would be adjusted if actual donor support or program costs differ from assumptions. See section IV.

<sup>10</sup> Net domestic assets of the central bank exceeded the June benchmark by M 2 million, compared with a stock of M -3488 million.

order to achieve the international reserves objective, reserve money is targeted to remain below M 300 million in the near term. Treasury bill operations will also help absorb excess liquidity.

22. **The central bank made progress toward modernizing Lesotho's financial market.** Central Bank officials reported on their new strategy for financial market development that seeks to strengthen financial market operations (a performance criterion). They have established new regulations for ancillary financial institutions and written papers on the problems with financial intermediation and the way forward. Recently, the central bank worked with the private sector to increase commercial bank lending by holding a workshop on financial intermediation and encouraging banks to take delinquent accounts to the commercial court. It is also working to establish a credit bureau to allow firms to better assess the risks of private sector lending. Central bank officials and commercial bank representatives explained that these efforts have yet to prove effective, and that some problems remain, for example a lack of documentation on delinquent loans and a shortage of experienced commercial lawyers. The central bank also made progress in strengthening internal accounting and auditing as recommended the Stage-One Safeguards Assessment Report.

### C. Other Issues

23. **While improvements have been made, significant data problems still exist.** Specific areas of concern include the timeliness of monetary data, in particular, the calculation of net international reserves, reconciliation of domestic financing figures from the Central Bank of Lesotho and from the Ministry of Finance, and a lack of timely spending reports. In addition, a recent IMF technical assistance team found that balance of payments data could be improved considerably. The authorities indicated that they are committed to improving economic data.

24. **The PRSP process is moving ahead, but there is some concern that work on the related macroeconomic projections is lagging.** The authorities indicated that they would convene a working group on this topic, and that the Central Bank of Lesotho would look into publishing its macro forecast as a means of increasing public awareness of the outlook. The staff recommended that the conduct of poverty and social impact analyses of key actions by the government be considered as resources permit, for example following the completion of the PRSP.

### III. EXTERNAL FINANCING

25. **The external financing requirements in the baseline scenario remain large** (Table 9). However, there are no financing gaps after Fund disbursements, and concessional financing will meet most of Lesotho's needs. Debt-service payments to the Fund are projected to decline from 1.2 percent of exports of goods and services in 2001/02 to 0.2 percent in 2007/08 (Table 11).

#### IV. PRGF ARRANGEMENT MONITORING

26. **Quantitative and structural performance criteria and benchmarks are set out in Tables 2 and 3 of the MEFP.** These performance criteria will be conditions for the fifth disbursement, with the exception of a new top management structure for the Treasury department (a structural performance criterion for end-February 2003) and the quantitative targets for end-March 2003, which will be conditions for the sixth disbursement.

27. **The quantitative performance criteria for end-September have been modified to take account of recent developments, including the need for food relief.** In particular, the ceiling on domestic financing of the central government for end-September has been changed from M 63 million to M 125 million, owing to the government's contribution to food relief (M 27 million), higher capital spending (M 11 million), and a downward revision to tax collections (M 39 million).<sup>11</sup> Above-program receipts from the EU and for rand monetary compensation would act to lower domestic financing.

28. **To account for the uncertainties related to food relief, adjustment clauses have been introduced.** Specifically, the ceilings on domestic financing of the government, net international reserves, and net domestic assets of the central bank would be adjusted if the cost of food relief or donor support differ from the food relief program assumptions as specified in Table 1 of the MEFP.

#### V. STAFF APPRAISAL

29. **Economic growth in 2001/02 outperformed expectations under the program.** This has been largely due to the buoyant construction and manufacturing sectors, the latter boosted by the surge in textile exports to the United States under the AGOA treaty. Growth prospects have been revised upward, in part reflecting the success in the textile sector, but also the peaceful general elections in May 2002, which served to consolidate democracy and political stability, thereby bolstering confidence and investment.

30. **The government has declared a state of famine and has put in place a food relief program.** The effort is well targeted toward those in need and is time-limited to the current crop cycle. Donors have committed grain and some financial support, but as of end-July, the plan implied a cost to the government of just over 1 percent of GDP for 2002/03. In view of the emergency at hand, the government has adequate deposits at the central bank and the central bank has adequate international reserves for this purpose, provided spending in other

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<sup>11</sup> Due to an arithmetic error in Table 4 of the March 2002 staff report, the ceiling on domestic financing for September 2002 was incorrectly reported as M -64 million.



areas remains in control. The staff also notes that consideration could be given to augmenting Fund support for Lesotho if needed.

31. **Lesotho's fiscal position deteriorated in the June quarter, largely because of underperformance in revenue collections, but also because of famine relief.** It appears that tax collections fell below projections because of staff shortages and the transition to the Lesotho Revenue Authority (LRA) and are therefore temporary. As the authorities are already stepping up enforcement and pressing ahead with the LRA, tax collections are likely to recover later in the year. Nontax revenue also fell below projections, a situation which may be more permanent.

32. **To counteract problems on the revenue side of the budget, the authorities have instituted short-term spending cuts.** The staff considers this approach appropriate, and it agrees with the authorities' decision to leave tax policy unchanged pending implementation of the LRA and the completion of a more formal review of the tax system. Nevertheless, the staff recommends that the authorities be prepared for further expenditure reductions, if necessary, by reviewing government-funded capital projects. It urges the authorities to safeguard poverty-related spending if further cuts are needed.

33. **The staff endorses the government's strategy to address weaknesses in its financial management.** It includes much needed short-term measures to bolster spending control and tracking and also longer-term restructuring of the Treasury department. The staff urges the authorities to begin the search for a new Accountant General as soon as possible and to establish a high-level oversight committee to ensure that Treasury reforms proceed in the interim. The staff also endorses the plan to clear the backlog of unaudited government accounts by constructing a new government balance sheet and presenting discrepancies with respect to current government books to parliament.

34. **For 2002/03, domestic borrowing targets are now higher, but adjustments are mainly to accommodate higher current spending for the famine, slightly higher capital expenditure, and lower non-customs revenue.** Meeting the new targets will depend on adherence to spending levels approved by parliament, and strengthening spending control and tax collection as outlined above.

35. **Monetary policy is dictated by Lesotho's membership in the Common Monetary Area and the exchange rate peg to the rand.** The staff supports the continuation of this framework as it has served the country well by providing monetary stability and relatively low inflation. The staff welcomes the central bank's strategy for the development of financial markets, and its plans to establish a credit bureau by early 2003. The publication of the Central Bank of Lesotho's macroeconomic projections by January 2003 should also enhance policy transparency.

36. **Lesotho's data are adequate for program monitoring, but there is room for improvement.** Recently, the timeliness of data reports has improved, but there are some

problems in the reconciliation of domestic financing figures from the central bank and the ministry of finance. In addition, there are weaknesses in the balance of payments data that need to be addressed. The staff urges the Central Bank of Lesotho to finish implementing the recommendations contained in the Stage-One Safeguards Assessment Report.

37. **The staff welcomes the government's strong commitment to its economic program and recommends completion of the third review.** Two performance criteria were not observed: the ceiling on the domestic financing requirement of the government for March 2002 was exceeded largely because of a delayed EU grant disbursement and the late payment for rand monetary compensation. A new Accountant General was not appointed by the end of July because the candidate withdrew for personal reasons. As the nonobservance of these performance criteria was beyond the government's control, and as corrective actions have been taken, the staff supports waivers for the nonobservance of these performance criteria.

Table 1. Lesotho: Selected Economic and Financial Indicators 1/

	1999/00	2000/01	2001/02		2002/03		2003/04	2004/05	2005/06	2006/07	2007/08
	Act.	Act.	Prog.	Est.	Prog.	Rev. Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise specified)											
<b>National income and prices</b>											
Real GDP	2.4	3.5	2.9	4.0	2.8	4.0	4.3	3.9	3.9	3.8	3.9
Real GNP	1.4	1.6	2.1	2.0	1.3	0.9	4.6	3.9	3.5	3.1	3.2
Consumer price index (average change)	7.1	6.2	7.8	9.8	8.4	5.6	3.9	5.9	5.6	5.1	4.6
Nominal GDP (in millions of maloti)	5,733.3	6,393.7	6,975.1	7,067.7	7,733.0	7,946.7	8,865.0	9,561.8	10,470.0	11,448.6	12,470.3
Nominal GNP (in millions of maloti)	7,247.6	7,941.3	8,619.1	8,615.5	9,412.0	9,395.4	10,514.3	11,336.8	12,366.3	13,435.8	14,547.4
<b>External sector 2/</b>											
Exports, f.o.b.	4.3	40.6	38.8	79.6	15.6	55.2	10.2	8.9	8.7	8.6	10.1
Imports, f.o.b.	8.1	6.8	7.4	20.3	6.7	26.2	7.9	7.5	6.5	6.8	8.9
Net labor income	8.7	3.9	0.8	1.2	-1.0	-1.1	11.0	6.9	-3.0	1.9	33.4
Real effective exchange rate 3/	0.5	-9.9	...	3.5	...	...	...	...	...	...	...
<b>Government budget</b>											
Revenue (excluding grants)	6.4	13.6	9.1	6.1	5.9	8.0	15.8	17.4	8.5	8.3	7.7
Total expenditure and net lending	38.3	-14.1	2.6	4.4	10.8	25.2	3.5	6.6	4.5	6.2	6.8
Current expenditure	19.3	2.8	3.5	0.7	11.1	27.4	-2.6	6.0	6.9	7.5	7.2
Capital expenditure and net lending 7/	112.8	-51.2	-1.5	21.4	9.9	16.9	28.8	8.6	-3.0	1.9	5.4
<b>Money and credit 4/</b>											
Net foreign assets	-9.8	5.1	41.3	86.7	-11.1	-38.1	3.8	22.9	14.2	17.9	18.4
Net domestic assets	7.7	1.1	-29.7	-69.6	21.2	46.7	5.0	-13.5	-5.4	-9.0	-9.9
Credit to the government	57.9	20.9	-10.1	3.7	2.3	6.1	-5.7	-18.0	-20.6	-22.1	-23.0
Credit to the rest of the economy	-4.6	0.7	1.3	-3.3	10.2	21.0	13.6	4.4	28.9	20.6	6.3
Broad money	-2.1	6.1	11.6	17.0	10.1	8.6	8.8	9.4	8.8	8.9	8.5
Velocity (GDP/average broad money)	3.3	3.6	3.6	3.6	3.6	3.6	3.7	3.6	3.6	3.7	3.7
(In percent of GDP, unless otherwise specified)											
<b>Investment and saving 5/</b>											
Investment	43.0	36.3	32.3	38.8	32.5	35.6	37.1	38.0	37.0	36.7	36.4
Public	8.4	8.1	9.9	11.7	9.8	8.2	9.6	10.2	9.2	8.8	8.6
Private	22.5	20.0	15.6	20.5	16.1	20.9	21.4	21.9	22.4	22.8	23.3
Lesotho Highlands Water Project	12.1	10.2	6.8	6.7	6.6	6.4	6.1	6.0	5.5	5.0	4.6
Gross national savings (including remittances)	20.5	21.1	24.9	29.1	26.5	27.4	28.3	31.5	31.2	31.1	29.5
Public	2.2	5.8	9.4	8.2	9.3	7.3	10.1	14.2	14.6	14.7	14.7
Private	18.3	15.3	15.5	20.9	17.2	20.1	18.2	17.4	16.6	16.4	14.8
<b>Government budget</b>											
Revenue	40.3	41.1	41.1	39.4	39.5	37.9	39.3	42.8	42.4	42.0	41.5
Total grants	2.3	2.0	3.7	2.7	5.1	7.8	4.3	4.3	4.3	4.3	4.3
Total expenditure and net lending	61.6	45.3	42.6	42.8	45.4	47.7	44.2	43.7	41.7	40.5	39.7
Overall balance (before grants)	-18.5	-4.2	-1.5	-3.3	-5.9	-9.8	-4.9	-0.9	0.8	1.5	1.9
Overall balance (after grants)	-16.2	-2.3	2.2	-0.7	-0.8	-1.9	-0.5	3.5	5.1	5.9	6.2
Domestic balance	-2.7	1.4	1.5	0.0	1.7	2.2	3.4	7.4	7.6	7.6	7.6
Primary balance	-13.0	1.8	5.0	2.2	1.9	0.9	2.4	6.1	7.3	7.8	7.9
<b>Gross government domestic debt</b>	15.2	11.8	15.9	16.3	14.9	16.2	14.5	11.6	10.6	9.7	8.9
<b>External sector</b>											
Current account balance (excluding official transfers)	-35.1	-31.6	-23.9	-25.7	-21.3	-26.2	-24.2	-24.3	-23.3	-22.8	-23.7
Current account balance (including official transfers)	-22.6	-17.2	-7.4	-9.8	-6.0	-8.2	-8.8	-6.5	-5.8	-5.6	-7.0
Stock of public external debt	67.4	62.6	72.7	72.6	75.0	69.7	64.5	61.1	56.1	51.3	46.9
Debt-service ratio 6/	17.1	24.6	7.5	12.5	7.6	9.7	8.8	8.2	5.6	4.9	4.4
Net present value of total public external debt	...	42.6	48.5	58.7	49.4	57.7	51.2	46.7	41.6	37.0	35.0
(In millions of U.S. dollars, unless otherwise specified)											
Gross official reserves (end of period)	470.1	393.3	381.7	402.0	360.3	381.3	389.3	440.8	474.4	520.6	571.3
Gross official reserves (in months of imports of goods and services)	7.4	6.7	7.6	6.1	6.9	5.0	4.7	5.0	5.0	5.0	5.0

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

1/ Fiscal year beginning in April. Please note 2002/03 projections are tentative.

2/ In maloti.

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

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

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

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

7/ Category affected by special factors in 2000 and 2001. Growth should return to trend in 2003.

Table 2. Lesotho: Balance of Payments, 1998/99 - 2007/08 1/  
(In millions of U.S. dollars)

	1999/00	2000/01 Act.	2001/02		2002/03		2003/04 Proj.	2004/05 Proj.	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.
			Prog.	Est.	Prog.	Proj.					
Trade balance	-608.0	-493.0	-353.6	-353.8	-316.3	-315.8	-348.8	-368.3	-380.8	-395.9	-423.6
Exports, f.o.b.	188.4	223.1	241.8	307.6	248.8	421.7	489.1	532.7	579.2	629.1	692.7
Imports, f.o.b.	-796.4	-716.0	-595.4	-661.4	-565.1	-737.5	-837.9	-901.0	-960.0	-1,025.0	-1,116.3
Services (net)	-3.5	2.8	-4.6	-2.2	-4.1	-15.1	-24.8	-35.2	-46.4	-56.0	-71.7
Receipts	43.8	47.6	34.1	45.8	33.0	41.6	46.6	49.0	51.5	57.6	61.3
<i>Of which: water royalties (and power sales)</i>	13.0	12.3	10.2	18.5	9.8	15.8	18.4	20.2	22.2	27.7	30.2
Payments	-47.4	-44.8	-38.7	-48.0	-37.1	-56.7	-71.4	-84.2	-97.9	-113.6	-133.1
Income (net)	245.7	211.4	176.6	162.4	160.4	134.3	160.9	173.2	185.0	193.9	202.6
Labor income (net)	244.7	214.0	171.0	166.4	150.7	145.3	169.8	181.4	190.9	198.2	204.9
Receipts	278.2	240.8	197.3	188.1	181.7	176.9	195.2	202.7	209.6	216.1	223.0
<i>Of which: miners' wages</i>	224.0	191.2	155.0	147.7	141.2	137.4	149.9	153.9	157.2	160.0	162.9
Payments	-33.5	-26.7	-26.3	-21.7	-31.1	-31.6	-25.4	-21.3	-18.7	-17.9	-18.1
Investment income (net)	1.0	-2.6	5.6	-4.0	9.8	-11.1	-8.8	-8.3	-5.9	-4.3	-2.3
Receipts	44.1	34.0	33.7	23.5	35.1	17.3	17.4	18.0	20.0	21.5	23.4
Payments	-43.1	-36.6	-28.1	-27.5	-25.3	-28.4	-26.3	-26.3	-26.0	-25.8	-25.7
<i>Of which: interest on debt</i>	-17.4	-21.0	-12.8	-13.2	-11.3	-15.2	-11.8	-11.2	-10.3	-9.6	-8.9
Unrequited transfers	155.9	128.3	126.5	121.4	115.6	136.5	136.9	169.6	182.4	195.5	207.9
Official	153.9	125.8	124.1	118.0	113.2	133.1	133.2	165.8	178.6	191.6	203.8
Southern African Customs Union nonduty receipts	135.7	109.4	109.8	113.7	99.8	96.8	122.6	154.8	167.0	179.6	191.4
Rand compensation	10.1	9.0	7.5	0.0	7.0	5.5	6.1	6.4	6.7	6.9	7.2
Other	8.1	7.5	6.8	4.2	6.4	30.8	4.5	4.7	4.9	5.1	5.3
Famine Support						26.8					
Private	2.1	2.4	2.4	3.4	2.4	3.4	3.7	3.8	3.9	3.9	4.1
Current account (including official transfers)	-209.9	-150.5	-55.1	-72.3	-44.4	-60.1	-75.7	-60.7	-59.7	-62.5	-84.8
Current account (excluding LHWP) 2/	-135.3	-101.5	-9.4	-26.2	-21.1	-27.8	-59.1	-54.3	-57.0	-60.4	-82.7
Capital and financial account	186.1	121.2	55.1	111.5	44.5	60.2	75.7	60.7	59.7	62.5	84.8
Capital account (transfers received)	101.6	37.3	17.3	30.4	28.1	31.1	32.5	36.1	36.7	34.5	37.6
<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	81.1	16.3	29.1	43.2	24.6	23.0	28.0	47.2
Direct investment 3/	33.9	31.5	106.2	30.0	85.0	36.2	45.8	45.6	47.1	48.9	50.9
Other investment	-31.3	-24.3	-81.6	59.7	-90.1	-27.8	5.4	30.6	9.5	-25.3	46.9
Assets	-30.7	1.7	5.8	6.9	-4.1	-11.7	-3.6	-4.5	-4.3	-4.5	-4.4
Liabilities	-0.7	-26.0	-87.5	52.8	-85.9	-16.1	9.0	35.1	13.9	29.8	51.3
Loans	4.6	-16.0	-22.0	51.2	-13.6	3.1	12.0	34.8	13.6	28.2	47.9
Public and Public Guaranteed	-12.7	-30.3	-2.1	-3.5	7.6	7.0	23.8	18.5	10.6	7.0	6.5
Disbursements	15.0	21.0	24.9	23.5	34.3	32.9	47.8	43.5	35.3	31.3	31.2
Repayments	-27.7	-51.3	-27.0	-27.0	-26.7	-25.8	-24.1	-25.0	-24.7	-24.3	-24.7
LHDA (Water Transfer) Loans net	17.5	14.7	54.9	54.9	67.8	67.8	46.9	42.1	107.1	21.1	22.3
Private (net)	-0.2	-0.4	-74.8	-0.2	-89.0	-71.6	-58.7	-25.7	-104.1	0.2	19.1
Other liabilities	-5.3	-10.0	-10.5	1.6	-4.6	-19.2	-3.0	0.3	0.3	1.6	3.5
CBL liabilities	-2.0	-5.4	-6.9	2.6	-4.6	-21.7	-3.0	0.3	0.3	1.6	3.5
Commercial banks' liabilities	-3.3	-4.7	-3.6	-1.1	0.0	2.4	0.0	0.0	0.0	0.0	0.0
Change in reserve assets 4/	82.0	76.8	13.3	-8.7	21.4	20.7	-8.0	-51.5	-33.6	-46.2	-50.7
Errors and omissions	23.8	29.3	0.0	-39.2	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 due to reclassification of some flows in the financial account.

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

Table 3. Lesotho: Quantitative Benchmarks and Performance Criteria,  
December 2001 - June 2002

	2001		2002			
	Dec.		Mar. 1/		June	
	Prog.	Act.	Prog.	Act.	Prog.	Est.
(In millions of maloti)						
Ceiling on the domestic financing requirement of the central government 2/	124	30	-7	136	58	41
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-3631	-3565	-3,499	-3,756	-3488	-3486
(In millions of U.S. dollars)						
Floor on the stock of net international reserves of the Central Bank of Lesotho 3/	372	373	363	391	363	363
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 staff estimates.

1/ Performance criteria.

2/ December 2001 and March 2002 are cumulative from end-March 2001, and exclude net lending by the government. For March 2002, had the rand monetary compensation (M 66 million) and the EU budget support grant (M 70 million) been disbursed as programmed, actual domestic financing would have been M 0 million.

June 2002 is cumulative from end-March 2002. June program at M 58 million is consistent with the budget (see Table 7). However, Table 1 of the MEFP in the March 2002 Staff Report showed June program at M 7 million due to an arithmetic error in Table 4 of that report.

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 4. Lesotho: Central Bank Balance Sheet, March 2001-March 2004

	Prog. March 2001	Act. March 2001	Act. June 2001	Prog. Sep. 2001	Act. Sep. 2001	Act. Dec. 2001	Prog. March 2002	Act. Mar. 2002	Prog. June 2002	Act. June 2002	Prog. Sep. 2002	Rev.Prog. Sep. 2002	Rev.Prog. Dec. 2002	Rev.Prog. March 2003	Rev.Prog. June 2003	Proj. Sep. 2003	Proj. Dec. 2003	Proj. March 2004
(In millions of maloti)																		
Net foreign assets	2,830.1	3,074.9	3,176.3	2,540.6	3,539.5	4,616.8	3,752.7	4,494.9	3,745.3	3,940.4	3,747.9	3,690.1	3,612.3	3,612.3	3,612.3	3,645.6	3,635.2	3,663.0
Foreign assets	2,924.8	3,470.5	3,568.9	3,004.5	4,007.6	5,126.6	4,333.9	5,027.1	4,326.5	4,461.5	4,355.2	4,362.5	4,280.7	4,313.4	4,309.3	4,386.2	4,371.8	4,395.0
Foreign liabilities	94.6	395.6	392.6	463.9	468.1	509.9	581.2	532.2	581.2	521.1	607.3	672.4	668.3	701.1	697.0	740.6	736.5	731.9
Net domestic assets	-2,218.2	-2,530.4	-2,514.2	-1,937.4	-3,288.4	-4,333.8	-3,499.3	-4,220.3	-3,488.8	-3,680.1	-3,488.2	-3,427.0	-3,346.4	-3,341.0	-3,335.3	-3,362.9	-3,346.8	-3,367.6
Net claims on government	-982.0	-1,066.5	-1,081.7	-1,195.2	-1,164.5	-1,255.7	-1,401.2	-1,297.0	-1,279.8	-1,240.8	-1,363.9	-1,151.1	-1,069.7	-1,165.7	-1,169.3	-1,286.3	-1,229.1	-1,358.4
Claims on government	109.2	108.8	124.4	177.1	143.0	246.6	246.5	231.8	249.5	192.0	249.5	194.1	196.2	200.2	204.3	208.5	212.8	218.0
Government deposits	1,091.2	1,175.4	1,206.0	1,372.3	1,307.5	1,502.4	1,647.7	1,528.8	1,529.2	1,432.9	1,613.3	1,345.2	1,265.8	1,365.9	1,373.6	1,494.8	1,441.9	1,576.3
Official Entities' Deposits	0.0	191.7	185.0	200.0	184.8	195.3	197.6	205.9	200.0	202.5	202.5	204.6	206.8	211.1	215.4	219.8	224.4	229.8
Claims on commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net claims on private sector	0.0	5.8	3.6	0.0	3.3	2.8	3.0	2.6	3.0	2.7	3.0	2.7	2.7	2.7	2.7	2.8	2.8	2.8
Other items (net)	-1,236.2	-1,278.1	-1,251.2	-542.2	-1,942.4	-2,885.5	-1,903.4	-2,720.0	-2,012.0	-2,239.4	-1,924.9	-2,074.0	-2,072.7	-1,966.9	-1,953.4	-1,859.5	-1,896.1	-1,782.3
Other assets	148.1	71.9	86.3	88.3	73.8	99.2	147.8	107.1	7.8	100.3	62.9	101.4	102.4	104.6	106.7	108.9	111.1	113.8
Other liabilities	-1,280.7	-53.8	-86.2	657.2	-348.3	-127.8	-22.0	-261.2	-20.0	0.9	-20.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Capital account	-103.6	-1,296.2	-1,251.2	-1,287.8	-1,667.9	-2,856.9	-2,029.2	-2,565.9	-1,999.8	-2,340.6	-1,967.8	-2,176.2	-2,176.0	-2,072.3	-2,060.9	-1,969.3	-2,008.1	-1,897.0
Reserve money	611.9	544.5	662.0	603.2	251.1	283.0	253.4	274.6	256.5	260.3	259.6	263.1	265.9	271.4	277.0	282.7	288.5	295.4
Maloti outside banks	130.0	142.6	140.3	146.2	139.9	147.1	150.9	164.1	152.7	168.3	154.6	170.1	171.9	175.5	179.1	182.8	186.5	191.0
Currency in commercial banks	22.9	17.7	23.3	22.7	26.0	40.4	28.9	32.1	29.2	30.0	29.6	30.3	30.6	31.2	31.9	32.5	33.2	34.0
Commercial banks deposits	459.1	384.3	498.4	434.3	85.2	95.5	73.7	78.4	74.6	62.0	75.5	62.7	63.4	64.7	66.0	67.4	68.7	70.4
(In units indicated)																		
Memorandum items:																		
Net foreign assets (in U.S. dollars)	347.3	383.7	393.9	312.3	393.2	380.7	363.5	394.8	362.8	384.4	363.0	360.0	352.4	352.4	352.4	355.7	354.7	357.4
Gross int'l reserves (in percent of M1)	297.1	275.4	269.2	256.1	298.4	360.6	297.6	323.9	293.5	274.2	292.1	266.2	252.8	254.9	249.6	249.4	243.5	201.0
Gross int'l reserves (in months of imports)	5.7	6.7	6.1	5.9	6.1	5.8	7.6	6.1	7.6	5.9	7.6	5.8	5.7	5.0	5.0	5.1	5.1	4.7

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

Table 5. Lesotho: Monetary Survey, March 2001-March 2004

	Act. March 2001	Act. June 2001	Act. Sep. 2001	Act. Dec. 2001	Pog. Mar. 2002	Act. Mar. 2002	Prog. June 2002	Act. June 2002	Prog. Sep. 2002	Rev.Prog. Sep. 2002	Rev.Prog. Dec. 2002	Rev.Prog. March 2003	Rev.Prog. June 2003	Proj. Sep. 2003	Proj. Dec. 2003	Proj. March 2004
(In millions of Maloti)																
Net foreign assets	3,670.0	3,717.2	4,148.1	5,313.9	4,422.2	5,249.3	4,418.3	4,755.2	4,424.3	4,505.6	4,428.5	4,436.6	4,444.7	4,486.2	4,484.2	4,524.2
Central bank	3,074.9	3,176.3	3,539.5	4,616.8	3,752.7	4,494.9	3,745.3	3,940.4	3,747.9	3,690.1	3,612.3	3,612.3	3,612.3	3,645.6	3,635.2	3,663.0
Commercial banks	595.1	540.9	608.6	697.1	669.5	754.4	673.0	814.8	676.4	815.5	816.2	824.3	832.4	840.6	848.9	861.1
Net domestic assets	-1,847.6	-1,839.3	-2,257.4	-3,321.2	-2,388.9	-3,116.2	-2,360.4	-2,533.3	-2,341.5	-2,260.1	-2,159.2	-2,120.8	-2,081.4	-2,074.5	-2,023.1	-2,004.0
Domestic credit	424.1	236.6	201.6	359.2	264.3	432.3	434.3	473.6	404.2	855.0	958.0	1,011.0	1,065.0	1,086.7	1,153.1	1,193.4
Claims on central government (net)	-579.2	-732.5	-766.4	-628.1	-762.7	-511.0	-633.1	-482.1	-709.0	-386.1	-298.4	-381.0	-371.0	-474.1	-402.8	-514.0
Central bank	-1,066.5	-1,081.7	-1,164.5	-1,255.7	-1,401.2	-1,297.0	-1,279.8	-1,240.8	-1,363.9	-1,151.1	-1,069.7	-1,165.7	-1,169.3	-1,286.3	-1,229.1	-1,358.4
Commercial banks	487.3	349.2	398.1	627.6	638.6	786.0	646.7	758.7	654.8	765.0	771.3	784.7	798.3	812.2	826.3	844.4
Claims on the rest of the economy	1,003.3	969.1	968.0	987.4	1,027.0	943.3	1,067.4	955.8	1,113.2	1,241.1	1,256.4	1,392.0	1,436.0	1,560.8	1,555.8	1,707.3
Other items (net)	-2,271.8	-2,075.9	-2,459.0	-3,680.4	-2,653.3	-3,548.5	-2,794.7	-3,007.0	-2,745.7	-3,115.1	-3,117.2	-3,131.8	-3,146.4	-3,161.2	-3,176.1	-3,197.3
Money and quasi money (M2)	1,822.4	1,877.9	1,890.7	1,992.7	2,033.3	2,133.1	2,057.9	2,221.9	2,082.8	2,245.5	2,269.3	2,315.8	2,363.3	2,411.7	2,461.1	2,520.2
Money	1,144.7	1,208.6	1,221.3	1,292.3	1,324.3	1,413.2	1,340.3	1,471.0	1,356.5	1,486.6	1,502.3	1,533.0	1,564.4	1,596.3	1,629.0	1,668.0
Of which currency outside DMBs	142.6	140.3	139.9	147.1	165.9	164.1	167.9	168.3	170.0	170.1	171.9	175.5	179.1	182.8	186.5	191.0
Of which demand deposits	802.5	873.4	886.2	939.0	950.5	1,032.4	962.0	1,089.4	973.7	1,101.0	1,112.8	1,135.7	1,159.1	1,182.9	1,207.3	1,236.4
Quasi money	677.7	669.3	669.4	700.4	709.0	719.9	717.6	750.9	726.3	758.9	767.0	782.8	798.9	815.4	832.1	852.2
Of which time and savings deposits	677.7	669.3	669.4	700.4	709.0	719.9	717.6	750.9	726.3	758.9	767.0	782.8	798.9	815.4	832.1	852.2
(Annual change in percent of beginning-of-year M2, unless otherwise specified)																
Net foreign assets	5.1	16.6	27.8	101.6	41.3	86.7	37.3	55.3	14.6	18.9	-44.4	-38.1	-14.0	-0.9	2.5	3.8
Central bank	4.1	22.1	22.9	89.1	37.2	77.9	30.3	40.7	11.0	8.0	-50.4	-41.4	-14.8	-2.0	1.0	2.2
Commercial banks	0.9	-5.5	4.9	12.5	4.1	8.7	7.0	14.6	3.6	10.9	6.0	3.3	0.8	1.1	1.4	1.6
Net domestic assets	1.1	-5.0	-13.7	-84.5	-29.7	-69.6	-27.7	-37.0	-4.4	-0.1	58.3	46.7	20.3	8.3	6.0	5.0
Claims on central government (net)	20.9	-0.6	19.2	6.2	-10.1	3.7	5.3	13.3	3.0	20.1	16.5	6.1	5.0	-3.9	-4.6	-5.7
Claims on the rest of the economy	0.7	-0.9	0.7	1.5	1.3	-3.3	5.2	-0.7	7.7	14.4	13.5	21.0	21.6	14.2	13.2	13.6
Claims on the rest of the econ. (yrlly. change)	1.2	-1.5	1.3	2.6	2.4	-6.0	10.1	-1.4	15.0	28.2	27.2	47.6	50.2	25.8	23.8	22.6
Other items (net)	-20.5	-3.5	-33.7	-92.2	-20.9	-70.1	-38.3	-49.6	-15.1	-34.7	28.3	19.5	-6.3	-2.1	-2.6	-2.8
Money and quasi money (M2)	6.1	11.6	14.0	17.2	11.6	17.0	9.6	18.3	10.2	18.8	13.9	8.6	6.4	7.4	8.5	8.8
Quasi money (yearly change)	-6.5	-8.7	-4.0	5.3	4.6	6.2	7.2	12.2	8.5	13.4	9.5	8.7	6.4	7.4	8.5	8.9
Memorandum item:																
Money multiplier (M2/Reserve money)	3.3	2.8	7.5	7.0	8.0	7.8	8.0	8.5	8.0	8.5	8.5	8.5	8.5	8.5	8.5	8.5

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

Table 6. Lesotho: Central Government Operations, Annual, 1999/2000-2003/04 1/

	1999/00	2000/01		2001/02		2002/03		2003/04
	Act.	Prog.	Act.	Prog.	Act.	Prog.	Rev. Prog.	Proj.
	(In millions of maloti)							
Revenue	2,312.8	2,505.8	2,626.6	2,864.9	2,787.8	3,053.6	3,011.0	3,486.0
Tax revenue	1,888.8	1,892.8	1,941.9	2,389.2	2,378.0	2,619.0	2,589.1	3,068.2
Customs revenue	1,183.1	1,126.2	1,126.1	1,438.2	1,438.2	1,470.0	1,470.0	1,768.4
Noncustoms tax revenue	705.7	766.6	815.8	951.0	939.8	1,149.0	1,119.1	1,299.8
Income taxes	419.5	436.0	468.8	579.1	579.5	710.6	705.0	825.8
Sales tax / value-added tax (VAT)	238.0	270.0	279.8	306.5	302.0	353.6	323.6	379.0
Petrol levy	43.6	56.0	62.0	52.0	50.9	74.7	82.3	85.8
Other tax revenues	4.6	4.6	5.2	13.4	7.4	10.1	8.2	9.1
Nontax revenue	424.0	613.0	684.7	475.7	409.8	434.6	421.9	417.7
Grants	130.0	208.8	125.6	257.6	188.8	394.4	622.6	384.0
<i>Of which for famine relief</i>	...	...	...	...	...	...	291.0	...
Total expenditure and net lending	3,373.4	2,958.0	2,897.9	2,972.4	3,024.5	3,513.3	3,786.7	3,917.7
Current expenditure	2,318.5	2,403.8	2,382.6	2,464.8	2,398.9	2,728.9	3,055.2	2,975.4
<i>Of which: famine relief</i>	...	...	...	...	...	...	373.0	...
Wages and salaries	835.9	925.0	921.8	984.7	992.4	1,103.9	1,076.3	1,188.7
Interest payments	183.4	257.7	259.4	198.9	203.3	214.2	224.0	260.6
External	101.6	142.7	148.3	118.0	126.0	117.2	126.0	119.3
Domestic	81.8	115.0	111.1	80.9	77.3	97.0	98.0	141.3
<i>Of which: bank restructuring</i>	45.0	65.0	33.0	44.8	38.1	47.0	48.0	45.6
Other expenditure	1,299.2	1,221.1	1,201.4	1,281.2	1,203.2	1,410.8	1,754.9	1,526.2
Goods and services	1,028.8	1,006.0	924.0	940.8	806.9	968.1	1,202.8	1,012.5
<i>Of which: National Revenue authority</i>	...	1.0	n.a.	20.0	n.a.	32.0	30.0	0.0
Transfers and subsidies	270.4	215.1	277.4	340.4	396.3	442.7	552.1	513.7
Capital expenditure	479.9	554.2	515.3	627.6	745.6	803.9	750.2	942.3
Domestically funded	250.0	280.0	275.0	337.0	373.1	310.0	300.8	330.0
Externally funded	229.9	274.2	240.3	290.6	372.5	493.9	449.4	612.3
Grant funded	130.0	159.8	125.6	161.2	166.8	294.4	245.6	274.0
Loan funded	99.9	114.4	114.7	129.4	205.7	199.5	203.8	338.3
<i>Of which utility sector loans</i>	...	...	...	58.3	38.9	65.7	118.1	95.5
Net lending 2/	575.0	0.0	0.0	-120.0	-120.0	-19.5	-18.7	0.0
Overall balance before grants	-1,060.6	-452.2	-271.3	-107.5	-236.7	-459.7	-775.7	-431.7
Excluding exceptional factors 3/	-485.6	-478.3	-297.4	-322.2	-451.4	-479.2	-775.7	...
Overall balance after grants	-930.6	-243.4	-145.7	150.1	-47.9	-65.3	-153.1	-47.7
Excluding exceptional factors 3/	-355.6	-269.5	-171.8	-64.6	-262.6	-84.8	-153.1	...
Domestic balance 4/	-154.1	-35.3	91.2	86.4	47.1	131.9	172.7	299.8
Total financing	930.6	243.4	145.7	-150.1	47.9	65.3	153.1	47.7
External financing	-70.9	-238.4	-221.9	-22.9	32.0	18.1	23.1	180.7
Loan drawings	99.9	149.4	149.9	213.7	292.0	294.2	296.8	427.5
Amortization	-170.8	-387.8	-371.8	-236.6	-260.0	276.1	-273.7	-246.8
Domestic financing	1,048.0	481.8	390.2	-127.2	15.6	47.2	130.0	-132.9
Excluding net lending	473.0	481.8	390.2	-7.2	135.6	66.7	148.7	-132.9
Bank	1,025.3	501.8	366.9	...	67.3	...	...	...
Nonbank	22.7	-20.0	23.3	...	-51.7	...	...	...
Residual	-46.5	0.0	-22.6	0.0	0.3	0.0	0.0	0.0



Table 6. Lesotho: Central Government Operations, Annual, 1999/2000-2003/04 1/

	1999/00	2000/01		2001/02		2002/03		2003/04
	Act.	Prog.	Act.	Prog.	Act.	Prog.	Rev. Prog.	Proj.
(In percent of GDP, unless otherwise indicated)								
Revenue	40.3	40.4	41.1	41.1	39.4	39.5	37.9	39.3
Customs revenue	20.6	18.2	17.6	20.6	20.3	19.0	18.5	19.9
Noncustoms tax revenue	12.3	12.4	12.8	13.6	13.3	14.9	14.1	14.7
Nontax revenue	7.4	9.9	10.7	6.8	5.8	5.6	5.3	4.7
Grants	2.3	3.4	2.0	3.7	2.7	5.1	7.8	4.3
Total expenditure and net lending	58.8	47.7	45.3	42.6	42.8	45.4	47.7	44.2
Current expenditure	40.4	38.8	37.3	35.3	33.9	35.3	38.4	33.6
Wages and salaries	14.6	14.9	14.4	14.1	14.0	14.3	13.5	13.4
Interest payments	3.2	4.2	4.1	2.9	2.9	2.8	2.8	2.9
Other expenditure	22.7	19.7	18.8	18.4	17.0	18.2	22.1	17.2
Goods and services	17.9	16.2	14.5	13.5	11.4	12.5	15.1	11.4
Transfers and subsidies	4.7	3.5	4.3	4.9	5.6	5.7	6.9	5.8
Capital expenditure	8.4	8.9	8.1	9.0	10.5	10.4	9.4	10.6
Of which utility sector loan	...	...	...	0.8	0.6	0.8	1.5	1.1
Net lending 2/	10.0	0.0	0.0	-1.7	-1.7	-0.3	-0.2	0.0
Overall balance before grants	-18.5	-7.3	-4.2	-1.5	-3.3	-5.9	-9.8	-4.9
Excluding exceptional factors 3/	-8.5	-7.7	-4.7	-4.6	-6.4	-6.2	-9.8	...
Overall balance after grants	-16.2	-3.9	-2.3	2.2	-0.7	-0.8	-1.9	-0.5
Excluding exceptional factors 3/	-6.2	-4.3	-2.7	-0.9	-3.7	-1.1	-1.9	...
Domestic balance 4/	-2.7	-0.6	1.4	1.2	0.7	1.7	2.2	3.4
Total financing	16.2	3.9	2.3	-2.2	0.7	0.8	1.9	0.5
Financing abroad	-1.2	-3.8	-3.5	-0.3	0.5	0.2	0.3	2.0
Domestic financing	18.3	7.8	6.1	-1.8	0.2	0.6	1.6	-1.5
Excluding net lending	8.2	7.8	6.1	-0.1	1.9	0.9	1.9	-1.5
Memorandum items: (In percent of GDP, unless otherwise indicated)								
Defense, public order, and security	8.5	8.6	...	...	...	...	...	...
Health, education, and social services	16.4	16.3	...	...	...	...	...	...
GNP at current prices (in millions of maloti)	7,247.6	7,706.4	7,941.3	8,619.1	8,615.5	9,412.0	9,395.4	10,514.3
GDP at current prices (in millions of maloti)	5,733.3	6,197.1	6,393.7	6,975.1	7,067.7	7,733.0	7,946.7	8,865.0

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

1/ Fiscal year from April to March.

2/ Net lending in 1999/2000 consists of recapitalization of the old Lesotho Bank amounting to M 575.7 million, and in 2001/02 net lending was negative as M 120 million of the Lesotho Bank treasury bills were redeemed. In 2002/03, it consists of M 18.7 million of loan repayments to the government from parastatals.

3/ Exceptional factors in 1999/2000 include the recapitalization of the old Lesotho Bank amounting to M 575.7 million and the early repayment of domestic loans on behalf of the Lesotho Highlands Development Agency/Muela Hydropower Project amounting to M 263.8 million. In 2000/01, they include one-off expenditure of M 98.9 million in payments of arrears to SACU, and revenue of M 85 million in dividend payments from Lesotho Flour Mills and 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 transferred to government as revenue for the sale of electricity, and M 11.7 million from the sale of assets from Lesotho Flour Mills.

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

Table 7. Lesotho: Central Government Operations, Quarterly, 2001/02-2002/03 1/

	2001/02 (Cumulative)				2002/03 (Cumulative)							
	Q3		Q4		Q1		Q2		Q3		Q4	
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
	(In millions of maloti)											
Revenue	2,133.1	2,081.3	2,864.9	2,787.8	725.8	728.8	1,487.3	1,484.2	2,113.1	2,184.5	3,053.6	3,011.0
Tax revenue	1,794.2	1,747.7	2,389.2	2,378.0	601.8	576.6	1,285.7	1,246.6	1,826.3	1,875.4	2,619.0	2,589.1
Customs revenue	1,078.7	1,079.5	1,438.2	1,438.2	367.5	367.5	735.0	735.0	1,102.5	1,102.5	1,470.0	1,470.0
Noncustoms tax revenue	715.5	668.3	951.0	939.8	234.3	209.1	550.7	511.6	723.8	772.9	1,149.0	1,119.1
Income taxes	447.1	408.4	579.1	579.5	124.7	107.1	331.4	306.0	483.4	463.0	710.6	705.0
Sales tax / value-added tax (VAT)	219.5	215.6	306.5	302.0	88.4	78.7	176.8	161.8	176.8	242.7	353.6	323.6
Petrol levy	39.3	38.4	52.0	50.9	18.7	21.8	37.4	39.7	56.0	61.0	74.7	82.3
Other tax revenues	9.6	5.9	13.4	7.4	2.5	1.5	5.1	4.1	7.6	6.2	10.1	8.2
Nontax revenue	338.9	333.6	475.7	409.8	124.0	152.2	201.6	237.6	286.8	309.2	434.6	421.9
Grants	147.1	131.6	257.6	188.8	98.6	89.2	197.2	202.9	295.8	422.3	394.4	622.6
<i>Of which for famine relief</i>	...	...	...	...	...	0.0	...	97.0	...	194.0	...	291.0
Total expenditure and net lending	2,080.8	2,121.8	2,852.4	3,024.5	866.4	860.0	1,751.1	1,851.6	2,522.2	2,826.7	3,513.3	3,786.7
Current expenditure	1,889.5	1,731.5	2,464.8	2,398.9	680.6	688.2	1,365.6	1,536.8	1,935.7	2,292.1	2,728.9	3,055.2
<i>Of which: famine relief</i>	...	...	...	...	...	20.0	...	124.0	...	256.0	...	373.0
Wages and salaries	737.8	744.3	984.7	992.4	276.0	265.0	552.0	538.2	827.9	807.2	1,103.9	1,076.3
Interest payments	136.8	147.7	198.9	203.3	51.9	43.9	108.1	113.2	160.3	166.1	214.2	224.0
External	81.2	92.0	118.0	126.0	27.6	20.5	59.6	63.8	87.5	92.4	117.2	126.0
Domestic	55.6	55.7	80.9	77.3	24.3	23.4	48.5	49.4	72.8	73.7	97.0	98.0
Other expenditure	1,014.9	839.5	1,281.2	1,203.2	352.7	379.3	705.5	885.4	947.5	1,318.8	1,410.8	1,754.9
Goods and services	752.6	536.3	940.8	806.9	242.0	255.8	484.1	625.4	726.1	914.4	968.1	1,202.8
Transfers and subsidies	262.3	303.2	340.4	396.3	110.7	123.5	221.4	260.0	221.4	404.4	442.7	552.1
Capital expenditure	431.2	510.3	627.6	745.6	190.7	176.3	395.3	324.2	601.1	548.8	803.9	750.2
Domestically funded	236.4	238.3	337.0	373.1	77.5	60.8	155.0	141.5	232.5	224.6	310.0	300.8
Externally funded	194.8	272.0	290.6	372.5	113.2	115.5	240.3	182.7	368.6	324.2	493.9	449.4
Grant funded	112.1	109.6	161.2	166.8	73.6	32.5	147.2	49.9	220.8	142.3	294.4	245.6
Loan funded	82.7	162.4	129.4	205.7	39.6	83.0	93.1	132.8	147.8	181.9	199.5	203.8
Net lending 2/	-120.0	-120.0	-120.0	-120.0	-4.9	-4.5	-9.8	-9.4	-14.6	-14.2	-19.5	-18.7
Overall balance before grants	-67.7	-40.5	-107.5	-236.7	-140.6	-131.2	-263.8	-367.4	-409.1	-642.2	-459.7	-775.7
Overall balance after grants	79.5	91.1	150.1	-47.9	-42.0	-42.0	-66.6	-164.5	-113.3	-219.9	-65.3	-153.1
Total financing	-79.5	-91.1	-150.1	47.9	42.0	42.0	66.6	164.5	113.3	219.9	65.3	153.1
External financing	-83.6	4.0	-22.9	32.0	-15.7	1.3	3.2	39.5	-2.0	7.2	18.1	23.1
Loan drawings	120.3	200.0	213.7	292.0	39.6	83.0	140.2	179.3	195.0	228.4	294.2	296.8
Amortization	-178.5	-196.0	-236.6	-260.0	-55.3	-81.7	-137.0	-139.8	-197.0	-221.2	-276.1	-273.7
Domestic financing	4.1	-89.7	-127.2	15.6	57.7	41.2	63.4	125.0	115.3	212.7	47.2	130.0
Excluding net lending	124.1	30.3	-7.2	135.6	62.6	45.7	73.2	134.4	129.9	226.9	66.7	148.7
Bank	...	-49.0	...	67.3	...	28.9	...	...	...	...	...	...
Nonbank	...	-40.7	...	-51.7	...	12.3	...	...	...	...	...	...
Residual	0.0	-5.4	0.0	0.3		-0.5		0.0		0.0		0.0

Table 7. Lesotho: Central Government Operations, Quarterly, 2001/02-2002/03 1/

	2001/02 (Cumulative)				2002/03 (Cumulative)							
	Q3		Q4		Q1		Q2		Q3		Q4	
	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Rev. Prog.	Prog.	Rev. Prog.
	(In percent of GDP, unless otherwise indicated)											
Revenue	30.6	29.4	41.1	39.4	9.4	9.2	19.2	18.7	27.3	27.5	39.5	37.9
Customs revenue	15.5	15.3	20.6	20.3	4.8	4.6	9.5	9.2	14.3	13.9	19.0	18.5
Noncustoms tax revenue	10.3	9.5	13.6	13.3	3.0	2.6	7.1	6.4	9.4	9.7	14.9	14.1
Nontax revenue	4.9	4.7	6.8	5.8	1.6	1.9	2.6	3.0	3.7	3.9	5.6	5.3
Grants	2.1	1.9	3.7	2.7	1.3	1.1	2.6	2.6	3.8	5.3	5.1	7.8
Total expenditure and net lending	29.8	30.0	40.9	42.8	11.2	10.8	22.6	23.3	32.6	35.6	45.4	47.7
Current expenditure	27.1	24.5	35.3	33.9	8.8	8.7	17.7	19.3	25.0	28.8	35.3	38.4
Wages and salaries	10.6	10.5	14.1	14.0	3.6	3.3	7.1	6.8	10.7	10.2	14.3	13.5
Interest payments	2.0	2.1	2.9	2.9	0.7	0.6	1.4	1.4	2.1	2.1	2.8	2.8
Other expenditure	14.6	11.9	18.4	17.0	4.6	4.8	9.1	11.1	12.3	16.6	18.2	22.1
Goods and services	10.8	7.6	13.5	11.4	3.1	3.2	6.3	7.9	9.4	11.5	12.5	15.1
Transfers and subsidies	3.8	4.3	4.9	5.6	1.4	1.6	2.9	3.3	2.9	5.1	5.7	6.9
Capital expenditure	6.2	7.2	9.0	10.5	2.5	2.2	5.1	4.1	7.8	6.9	10.4	9.4
Net Lending	-1.7	-1.7	-1.7	-1.7	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.3	-0.2
Overall balance before grants	-1.0	-0.6	-1.5	-3.3	-1.8	-1.7	-3.4	-4.6	-5.3	-8.1	-5.9	-9.8
Overall balance after grants	1.1	1.3	2.2	-0.7	-0.5	-0.5	-0.9	-2.1	-1.5	-2.8	-0.8	-1.9
External financing	-1.2	0.1	-0.3	0.5	-0.2	0.0	0.0	0.5	0.0	0.1	0.2	0.3
Domestic financing	0.1	-1.3	-1.8	0.2	0.7	0.5	0.8	1.6	1.5	2.7	0.6	1.6
Memorandum items:												
GNP at current prices (in millions of maloti)	8,619.1	8,615.5	8,619.1	8,615.5	9,412.0	9,395.4	9,412.0	9,395.4	9,412.0	9,395.4	9,412.0	9,395.4
GDP at current prices (in millions of maloti)	6,975.1	7,067.7	6,975.1	7,067.7	7,733.0	7,946.7	7,733.0	7,946.7	7,733.0	7,946.7	7,733.0	7,946.7

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 mln of loan repayments to the government from parastatals.

Table 8. Lesotho: Structural Benchmarks and Performance Criteria,  
January 2002–December 2002

Action	Implementation Date	Status
A. Lesotho Revenue Authority and Supporting Measures		
1. Appoint Commissioner General.*	July 31, 2002	Done.
2. LRA becomes operational.**	December 2002	On track.
B. Expenditure Control		
1. Prepare timed action plans (a) to strengthen the Accountant General's office and (b) to put in place a new financial management system.	June 30, 2002	Done.
2. Fill the position of Accountant General.*	July 31, 2002	Delayed.
3. Finalize and announce the plan to introduce performance-based pay for public sector employees.	July 31, 2002	Delayed.
C. Financial Sector Reform		
1. Introduce supervisory and regulatory guidelines for foreign exchange dealers.	April 30, 2002	Not done.
2. Encourage commercial banks to bring delinquent accounts to the commercial court.	April 30, 2002	Done.
3. Develop an integrated financial strategy by first identifying impediments to a smooth-functioning financial market, including capital controls and inefficiencies in the transmission of monetary policy, and then developing a plan to address the so-identified problems.*	May 31, 2002	Done.
4. Establish and publicize regulations on ancillary financial markets including money lenders and transfer agents.	July 31, 2002	Done.

\* Performance criterion for the fourth disbursement.

\*\* Performance criterion for the fifth disbursement.

Table 9. Lesotho: External Financing Requirements and Sources, 1999/2000-2007/08  
(In millions of U.S. dollars)

	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
				Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Gross financing requirements	-313.0	-256.1	-227.2	-268.8	-300.9	-330.2	-402.2	-326.0	-364.0
External current account deficit (excl. off. transfers)	-363.8	-276.4	-190.3	-193.3	-208.9	-226.6	-238.3	-254.1	-288.6
Debt amortization	-25.4	-51.1	-23.8	-93.1	-82.5	-52.0	-130.2	-24.3	-22.8
Medium- and long-term debt 1/	-25.4	-51.1	-23.8	-93.1	-82.5	-52.0	-130.2	-24.3	-22.8
Public sector	-21.9	-46.0	-22.6	-22.7	-22.6	-24.9	-24.6	-22.9	-22.8
Commercial banks	-3.3	-4.7	-1.1	2.4	0.0	0.0	0.0	0.0	0.0
Corporate private sector	-0.2	-0.4	-0.2	-72.8	-60.0	-27.1	-105.6	-1.4	0.0
Short-term debt 2/	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
Gross reserves accumulation	82.0	76.8	-8.7	20.7	-8.0	-51.5	-33.6	-46.2	-50.7
IMF repurchases and repayments	-5.8	-5.3	-4.4	-3.1	-1.5	-0.1	-0.1	-1.4	-1.8
Available financing	215.0	222.7	159.4	192.7	248.3	280.8	290.0	305.0	341.7
Foreign direct investment (net)	33.9	31.5	30.0	36.2	45.8	45.6	47.1	48.9	50.9
Debt financing from private creditors	0.0	0.0	0.0	1.1	1.3	1.4	1.5	1.6	19.1
Medium- and long-term financing	0.0	0.0	0.0	1.1	1.3	1.4	1.5	1.6	19.1
To commercial banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
To corporate private sector	0.0	0.0	0.0	1.1	1.3	1.4	1.5	1.6	19.1
Short-term financing (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Official 4/	197.2	167.4	157.2	173.6	192.6	231.2	238.4	249.9	264.5
External grants (net)	175.0	144.6	135.4	155.9	160.0	194.7	210.2	226.1	241.4
Of which: SACU nonduty receipts	135.7	109.4	113.7	96.8	122.6	154.8	167.0	179.6	191.4
balance of payments support 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Multilateral creditors	11.5	22.8	21.8	17.0	32.0	36.3	28.1	23.7	23.1
Bilateral creditors	10.8	0.0	0.0	0.7	0.6	0.2	0.1	0.1	0.0
Of which: balance of payments financing 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Commercial Creditors	6.1	3.1	0.1	1.4	0.5	0.4	0.0	0.0	0.0
Other Public Sector	98.0	33.3	67.8	76.1	52.7	49.3	112.2	21.1	22.3
External Grants	80.5	18.6	12.9	8.4	5.7	7.3	5.1	0.0	0.0
External Loans - Non-Government Guaranteed	17.5	14.7	54.9	67.8	46.9	42.1	107.1	21.1	22.3
IMF	0.0	4.6	8.7	8.5	8.5	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
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other flows 5/	-16.1	19.3	-36.5	-26.7	0.1	2.7	3.1	4.7	7.2

Sources: Central Bank of Lesotho; and 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 those transactions that are undertaken for the purpose of financing a balance of payments deficit or an increase in reserves.

4/ Includes both loans and grants.

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

Table 10. Lesotho: Phasing of Disbursements Under the PRGF Arrangement, 2001-04

Date	Disbursement <sup>1/</sup>		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 completes third review.
September 30, 2002	...	...	Test date for performance criteria.
January 31, 2003	3.5	10	Board completes fourth review.
March 31, 2003	...	...	Test date for performance criteria.
July 31, 2003	3.5	10	Board completes fifth review.
September 30, 2003	...	...	Test date for performance criteria.
January 31, 2004	3.5	10	Board completes sixth review.
Total	24.5	70	

<sup>1/</sup> Disbursements are expected to take place approximately two weeks after the date of the Board meeting.

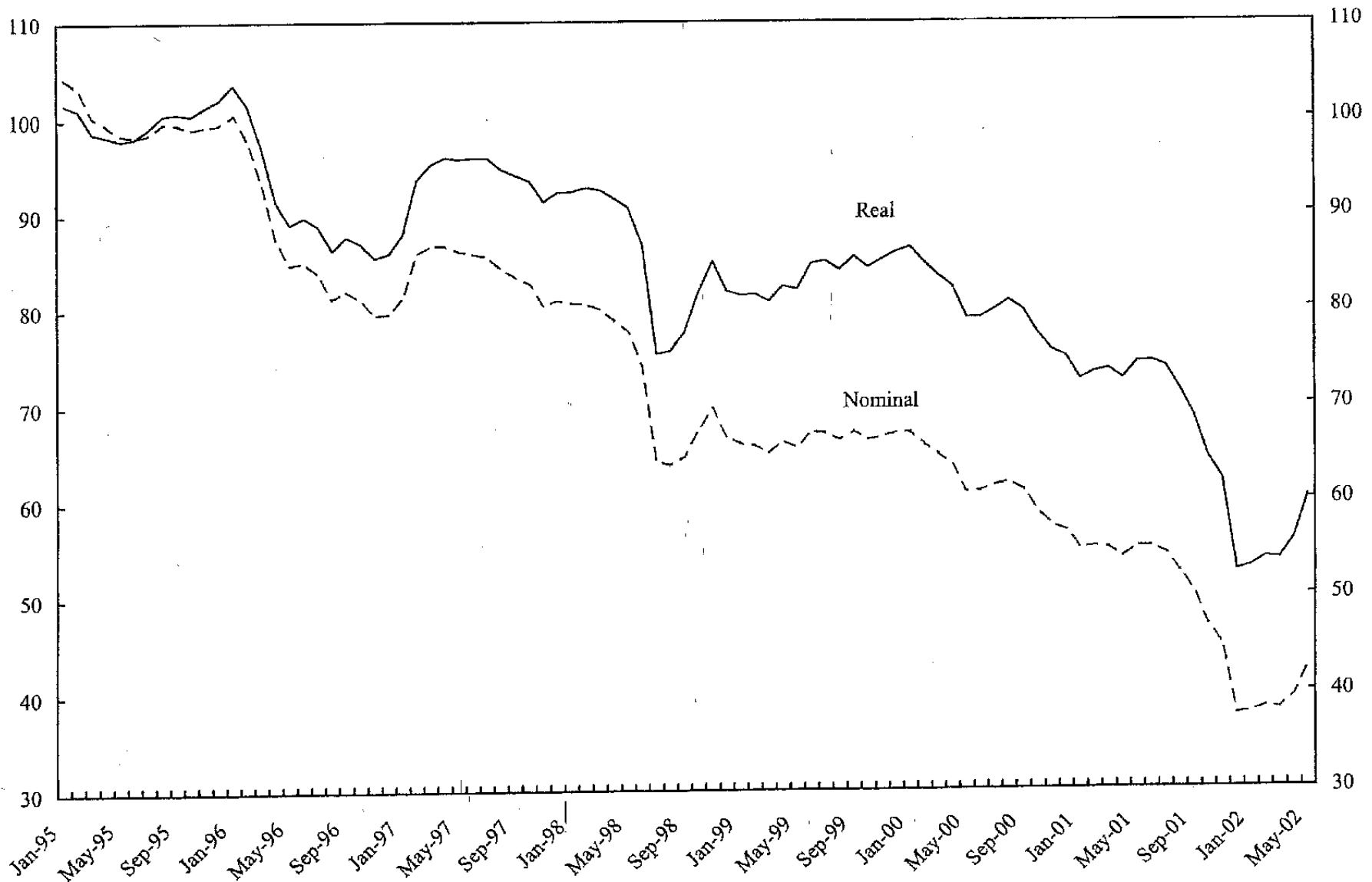
Table 11. Lesotho: Indicators of Financial Obligations to the Fund, 2000/01-2007/08

	Act.	Est.	Proj.					
	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
<b>Debt service to the Fund</b>								
In millions of U.S. dollars	5.2	4.4	3.1	1.5	0.1	0.1	1.4	1.8
In millions of SDRs	4.1	3.6	2.5	1.2	0.1	0.1	1.2	1.5
In percent of exports of goods and nonfactor services	1.9	1.2	0.7	0.3	0.0	0.0	0.2	0.2
In percent of debt service of nonfinancial public sector	7.3	10.8	7.9	4.3	0.4	0.4	4.2	5.5
In percent of gross international reserves	1.1	1.1	0.7	0.4	0.0	0.0	0.3	0.3
<b>Gross Fund financing</b>								
In millions of U.S. dollars	4.4	8.5	8.5	8.5	0.0	0.0	0.0	0.0
In millions of SDRs	3.5	7.0	7.0	7.0	0.0	0.0	0.0	0.0
In percent of Lesotho's financing needs <sup>1/</sup>	1.7	3.8	3.2	2.8	0.0	0.0	0.0	0.0
<b>Fund credit outstanding</b>								
In millions of U.S. dollars	13.2	17.1	23.1	30.2	30.2	30.2	29.0	27.2
In millions of SDRs	10.5	14.1	18.9	24.8	24.8	24.8	23.7	22.3
In percent of quota	29.9	40.3	54.2	71.0	71.0	71.0	68.0	64.0
In percent of exports of goods and nonfactor services	4.9	4.9	5.0	5.6	5.2	4.8	4.2	3.6
In percent of total debt outstanding	2.4	3.2	4.3	5.4	5.3	5.3	5.1	4.8
<b>Memorandum item:</b>								
U.S. dollar/SDR exchange rate	1.26	1.22	1.22	1.22	1.22	1.22	1.22	1.22

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

<sup>1/</sup> 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.

Figure 1. Lesotho: Effective Exchange Rates, January 1995 - May 2002  
 (Index, 1995=100)



Source: IMF, Information Notice System.



September 5, 2002

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

Dear Mr. Köhler:

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 fourth disbursement, in the amount of SDR 3.5 million, be made available following the successful completion of the third 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 2003. The memorandum also outlines the Government's action plan for the financial-year 2002/03, including famine relief. The Government has prepared and submitted to the IMF and the World Bank a preparation status report on the poverty reduction strategy paper, and is preparing a full PRSP.

The Government requests waivers for the nonobservance of the quantitative performance criterion on the ceiling on the domestic financing requirement of the Central Government for end-March 2002 and of the structural performance criterion relating to the Accountant General position, which was not filled by end-July 2002. The quantitative limit was not observed mainly because of disbursement delays on the part of the European Union and the Rand Monetary Compensation Fund. These funds were received after March 31, 2002. The Accountant General position was not filled because the nominated candidate was unable to accept our offer because of a change in family obligations.

In collaboration with Fund staff, the government will review the progress in implementing the program every six months. The fourth review is scheduled to be completed no later than January 31, 2003, and the fifth review no later than August 15, 2003.

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 March 1, 2002. It reviews performance over the six months to March 2002 and outlines the economic program for the period July 2002-March 2003.
2. Medium-term economic objectives center on poverty reduction through employment creation, infrastructure development, natural resource management, human development, and good governance. These are to be achieved through sound fiscal and monetary policies, structural measures to make their implementation more effective and consistent with government objectives, and development of the private sector. Thus, the government aims at economic growth sufficient to raise real per capita income by at least 1 percent a year. The strategy seeks to bolster confidence in the economy, promote domestic and foreign investment, stimulate export growth, and create an environment for the private sector to create jobs.

#### II. PERFORMANCE UNDER THE PROGRAM

3. The program promotes macroeconomic stability by limiting government deficits, setting a floor on international reserves of the central bank, and prohibiting nonconcessional external financing of the central government. Monetary policy is determined by the pegged exchange rate-regime. Structural measures focus on improving tax administration and expenditure control, but also include initiatives to improve the financial system.
4. Parliamentary elections were conducted on May 25, 2002. The process went smoothly and was judged free and fair by international observers. All major parties are now represented in Parliament. In consequence, confidence in Lesotho's economy is already building, and an upswing in private investment can be expected.
5. Lesotho's economy has been buffeted by unusual weather conditions during the 2001-02 growing season, the regional food shortage, and sharp swings in the value of the South African rand against major currencies. These shocks have had adverse consequences for the agricultural sector and caused food prices, especially for maize meal, to soar. On the other hand, the currency depreciation has given a boost to competitiveness, and with Lesotho's AGOA status, helped clothing exports to the United States to surge. Growth in this area is limited by the availability of factory shells. With the uncertainty about the election process now in the past, it is likely that the private sector will begin to invest in more fixed capital in Lesotho and therefore build complete factories, including structures, themselves.

6. The Government of Lesotho declared a state of famine in April 2002. High rainfall in October-November 2001 prohibited planting in many areas, and hail and frost during the growing season exacerbated crop shortfalls. In consequence, the cereal shortfall in 2002/03 is estimated at about 220 thousand metric tons. Government has put in place a response plan for the temporary emergency that will cost an estimated M370 million, approximately three-fourths of which is to be financed through grants. Details are presented below.

7. Three of the four quantitative targets in the Government's economic program for end-March 2002 were achieved. The quantitative criterion on domestic financing of the government was exceeded by M 143 million, but this amount was almost entirely due to delays in a budget support grant from the European Union (M 70 million) and in a payment from the Rand Monetary Compensation Fund (M 66) million. Because these delays were beyond the control of Government and considering that payments have been received, Government requests a waiver on this performance criterion from the IMF.

8. The accountant general position was not filled because the preferred candidate was unable to move to Lesotho for personal reasons. Because this was beyond its control, Government requests a waiver of this performance criterion. All other structural performance criteria were achieved and all but two structural benchmarks were completed.

#### **A. Fiscal Policies**

9. As noted above, the Government's domestic financing requirement for end-March 2002 exceeded the program maximum. However, after adjusting for delays in disbursements from the European Union and the Rand Monetary Compensation Fund noted above, the program target was missed by only M 7 million, or less than 0.1 percent of GDP. Tax revenue was slightly below target, while nontax revenue missed the budget projection by M 65 million, largely due to an overestimate of income from charges and fees in the original budget and the delayed transfer from the Rand Monetary Fund. These shortfalls were offset to some extent by above budget electricity revenue and other property income. Further scrutiny of this item has led to the conclusion that actual collections underperformed relative to budget submissions from many ministries. Collection estimates for 2002/03 have been revised accordingly.

10. Current expenditure was M 65 million below the program target despite overruns in some areas. A weaker-than programmed exchange rate during the last quarter of the financial year pushed up external debt service costs, while wages paid to foreign mission employees were above the expected amount. Pension costs rose above budget in part because of Government's decision to enforce its mandatory retirement age of 55 years. Spending on other goods and services was under budget by approximately M 90 million after reclassification that moved some items such as veterans' pensions and contract gratuities to the transfers heading. Some of the decline cannot be attributed to specific categories because of weaknesses in budget reporting. Ministry staff have made some headway in reducing this category and anticipate that more progress will be made over the next few months. Externally financed capital spending was above projection because of improvements in project planning.

### **B. Monetary Policies**

11. Net foreign and domestic assets of the Central Bank of Lesotho (CBL) were within their respective floor and ceiling targets for end-March 2002. Yields on treasury bills generally remained above those in South Africa, but the gap narrowed significantly during the period to June. The lack of financial intermediation remains a serious problem: the ratio of commercial bank loans to deposits averaged less than 15 percent in 2001.

### **C. Structural Measures**

12. Through end-July 2002, the Government of Lesotho made significant progress toward all structural measures in its economic program, with the exception of filling the Accountant General position. The Commissioner General of the Lesotho Revenue Authority (LRA) was in place by the end of July (a performance criterion). However, owing to an accident involving a family member, the designated Accountant General withdrew his acceptance of Government's offer. As presented in more detail below, substantial progress has been made in preparing action plans to strengthen the Accountant General's office and upgrade or replace the government's financial management system. These are now being reevaluated in light of the setback in filling the Accountant General position. Government has made less progress toward its objective of introducing performance based pay for public employees, but nevertheless remains committed to this principle. It hopes that with the elections over, more attention can be placed on this means of improving government operations.

13. Over the six months to June 2002, the Central Bank of Lesotho focused on the smooth functioning of the new treasury bill auction, strengthening data preparation, macroeconomic research, and developing financial markets. It has established guidelines and regulations for ancillary markets covering ownership, governance, and overall viability of businesses providing nonbank financial services. The Bank has also developed a strategy for strengthening Lesotho's financial markets (a performance criterion) that focuses on alleviating structural impediments by first encouraging competition in the banking system and reviewing laws that have a bearing on financial intermediation. So far, and with the Central Bank's encouragement, Lesotho's commercial banks brought delinquent accounts to the Commercial Court, but these efforts have yet to pan out. Thus, the Bank achieved its structural performance criterion and benchmarks, with the exception of announcing guidelines for foreign exchange dealers. This benchmark was postponed as the Bank decided it should be linked to capital account liberalization in the future.

### **III. THE ECONOMIC PROGRAM FOR THE PERIOD APRIL 2002–MARCH 2003**

14. The economic program aims to implement the 2002/03 budget approved by Parliament in January 2002, improve financial management and tax administration, and work on financial market development, albeit at a measured pace. Major, long-term changes to fiscal policy will await the completion of Lesotho's Poverty Reduction Strategy Paper,

now timed for November 2002. Government is addressing forcefully the regional food situation within this framework and the revenue shortfall that has recently come to light.

#### **A. Revisions to the 2002/03 Program**

15. The fiscal stance in the 2002/03 budget was to be approximately neutral, with only modest changes envisaged in the domestic balance compared with 2001/02. It was sustainable in terms of the domestic borrowing requirement and in terms of foreign debt. Excluding Government's response to the food situation, which is outlined in Section B below, the overall fiscal stance is projected to remain broadly the same. Some revenue and expenditure projections have been adjusted to reflect new information, and as outlined below, new policies considered, including M 45 million in supplementary spending cuts to offset revenue projections that have been revised downward. Estimates indicate that when Government's response to the famine are factored in, budget and monetary measures of performance would remain acceptable provided the anticipated response from the international community is forthcoming.

16. Recurrent spending is expected to fall below budget, owing to the supplementary spending cuts. These include reductions in international travel and spending on office equipment. To guard against slippages, Cabinet has been advised that new requests for spending beyond what can be covered by the contingency should not be made, except for those directly related to famine relief or important health care needs. Other revisions to the fiscal projections include pension costs that are now expected to be higher because of further classification improvements but also reflecting end-of-service payments to Ministers, members of Parliament, and teachers at the Lerotholi Polytechnic Institute, which is to become autonomous. Vehicle lease costs appear to be running above budget, and in response Government intends to implement cost saving measures that have been recommended by a task force of government representatives working with Imperial Fleet Services. Cabinet has agreed to increase subventions to the Christian Health Association of Lesotho. The estimated wage bill has been lowered in line with anticipated vacancy rates.

17. Tax collection projections have been lowered slightly. Projections of income tax collections were reduced reflecting new information and despite higher nominal GDP growth. Much of the expansion would come from higher textile production, where most employees fall below the income tax cutoff. Sales tax collections have been revised down based on actual receipts in the first quarter and because the earlier projections had not taken into account tax refunds, which are now netted from gross collections according to the new *Government Financial Statistics (GFS)* standard. There is a risk that they could fall further over the next six months. In response, the sales tax department is redoubling its efforts to reduce tax avoidance at border posts. There has been a significant downward revision to the other nontax category because scrutiny of administrative fees revealed that budget projections, reflecting ministry submissions, were overstated.

## B. Famine Relief

18. Lesotho has been hit by adverse weather conditions that have cut the harvest. In addition, maize prices in the regional market have approximately doubled since last year. In mid-April, Government announced a famine relief program that will reduce the impact of these developments on Lesotho's poor. The plan, developed by a task force led by the Ministry of Agriculture, provides unsifted maize meal at no cost (100 percent subsidy) to children, the elderly, and the sick (Table 1). Unemployed persons would also receive free unsifted maize meal in exchange for work on public projects. To address the impact of higher prices on other low-income individuals, the plan provides a 20 percent subsidy on unsifted maize meal sold. This food would be distributed through existing suppliers and transportation channels to the extent possible. Recipients of free maize meal are already being screened and procedures are being put in place to reduce the chance of fraud. The total cost of the plan is estimated at M 373 million (approximately \$37 million).

19. The subsidies to maize meal are intended to last only until the next harvest when prices in the region are expected to return to pre-crisis levels. To bolster next year's crop, donors, led by UNDP, are looking at ways to provide seed and other inputs, as well as technical assistance to strengthen farming techniques. They also hope to provide health and other aid in rural areas. Government will review these offers and adapt the economic program as necessary while keeping the overall macroeconomic objectives in mind.

20. Government has already identified approximately M 23 million in funding for famine relief and has appealed to donors for the remaining M 350 million. As of end-July, donors have committed to providing 59,000 tons of grain. In addition, Government expects to receive an additional M 136 million (\$13.5 million). The shortfall, approximately M 82-million, would be financed by drawing down Government balances at the central bank. Government considered requesting additional financial assistance from the IMF, but at the present time has decided against this avenue. It would reconsider IMF assistance later in the year if costs of famine relief are higher than expected or if donor assistance does not materialize

21. Government financing of famine relief will result in changes to the quantitative performance criteria in the economic program. Specifically, domestic financing will rise by about M 83 million by end-March 2003 and net domestic assets of the central bank will rise by about the same amount. Because most of the spending will be for imported maize and medical supplies for the young, international reserves will decline by a corresponding \$8 million. Government believes that these changes will not jeopardize macroeconomic stability, provided it maintains control of other parts of the budget. Because of the uncertainties involved in predicting famine related costs—including the price of maize meal—and donor support, adjustment clauses have been added to the Technical Memorandum of Understanding. These allow for the quantitative performance criteria to change automatically if costs or support assumptions are not realized.

22. To reduce the impact of the shock to food prices on the poor, Government has considered exempting unsifted maize meal from the 10 percent sales tax. On further consideration, Government has decided that it would be more efficient to increase the general unsifted maize meal subsidy under the relief plan from 20 percent to 30 percent and leave the tax in place. The cost saving on unsifted maize meal for the population would be the same in both cases, 30 percent, but the subsidy-only plan would be easier to administer. Tax officials had concluded that it would be difficult to exempt unsifted maize meal only, and they would need to exempt all maize products. Moreover, Government has concluded that it would make more sense to leave tax policy unchanged at this time and address the impact of all tax policies on the poor in the context of the PRSP and during deliberations on the budget. The unsifted maize meal subsidy is intended to be temporary and would come to an end after the completion of the famine relief program. In the future, Government could decide, in this broader context, to cut taxes on unsifted maize meal or provide assistance to the poor in other ways that would also benefit farmers.

### **C. Strengthening Financial Management and Tax Administration**

23. Government is committed to improving its financial systems. Over the next nine months, Government intends to strengthen management of the Treasury department, begin the process of upgrading or replacing its financial management system, and bring to an end the longstanding problem of unaudited public accounts. These tasks are difficult, but can be successfully completed with unwavering support at the highest levels. In the end, the objective is for financial accounts that are transparent, comprehensive, capable of independent verification, and reviewed by Parliament. Government is cognizant that improvements could require additional funds.

24. Government's attempts to recruit a new Accountant General fell through at the last minute, as explained above. In consequence, it is rethinking how best to achieve its objective of improved financial tracking and spending control in the near term and a revamped financial management system in the medium term. It remains committed to building a strong management team in the Treasury Department, and will appoint at least two Deputy Accountants General. A local Accountant General designate will be named within 12 months of the new Accountant General taking office, on his or her advice. The details of this expanded structure will be worked out when the Accountant General is in place and would likely require technical assistance or deputies experienced in the day to day operations of a smooth-functioning government treasury. Government will restart the process by advertising the Accountant General position no later than end-September. In the meantime, Government will seek an international resident advisor to assist the acting Accountant General in the interim period.

25. Government recognizes the critical importance of preparing audited accounts for presentation to Parliament. This task has not been completed for several years and recent attempts to bring audits up to date have been hampered by gaps in the records and more generally the passage of time. In addition, there have been differences in professional views on how to achieve this objective. Government has decided that the best way to proceed in

these circumstances is to establish a balance sheet or "statement of affairs" as of end-March 2002 that would involve reconstructing balances from third parties such as the Central Bank. Other financial assets and liabilities would be treated in the same way. As a matter of urgency, Government will establish a team consisting of accountants, the Auditor General, and outside assistance with international expertise in government accounting for this task. The team will prepare the best possible financial statement within a fixed time frame and present it to Parliament. Substantial differences between these reconstructed balances and those currently on the government books would need to be classified as unauthorized expenditure that would need to be investigated and, if not resolved, then ratified by Parliament. In this way, Government would have a clean starting point for future annual audits beginning with the 2002/03 financial year.

26. Lesotho's current financial tracking system, GOLFIS, has some deficiencies including the lack of a general ledger module. In addition, it currently does not capture all government accounts, is not integrated with other government systems, and does not always prevent expenditure over warranted amounts. To address these and other shortcomings, Government will initiate a two part study aimed at improving or replacing GOLFIS. The first phase will review the needs of government in this area and compare these with the capabilities of available systems including GOLFIS. The second phase will specify the desired system and prepare necessary tender documents. A study will begin shortly to plan later phases of this project.

27. The Treasury Department is currently overburdened with voucher-related activities, in part because of a high number of emergency requests. These requests take up resources that otherwise could be devoted to budget monitoring, preparing reports for management, and other critical tasks. As a near-term solution, the Accountant General will reintroduce the batch system for voucher processing. In this system, ministries and departments will submit vouchers in bundles (batches) on designated days only. Experience has shown that this process will help to streamline work flow, ensure that all payments are properly recorded, and that all expenditure is authorized in the budget.

28. The Government of Lesotho is pressing ahead with efforts to improve tax administration. In the near term these efforts will help to bolster tax compliance, while later on they will provide Government with choices in tax policy, including the establishment of a resource base with which to address priorities identified in the PRSP.

29. The Commissioner General of the new LRA assumed duty on July 29, 2002. The appointee has considerable experience in tax administration in Southern Africa. Government is committed to supporting the LRA and the efficient tax administration it will bring. Government is moving ahead with the LRA preparations and has provided M30 million in this year's budget for startup expenses so that the LRA can begin operations by end-December 2002, if not sooner.

30. Government recognizes that tax collections, especially at border posts, are running below expectations, in part due to the transition to the LRA. Therefore, over the next few



months, tax officials will continue to strengthen compliance. Officers have been reminded of their duties and Government's policy of no tolerance toward tax evasion. Government will also re-deploy its task force on sales tax evasion at border posts.

#### **D. Monitoring the Macroeconomy and Financial Market Development**

31. In the period ahead, the Central Bank of Lesotho will continue to strengthen its macroeconomic capabilities. It will refine its macroeconomic projections and will look into publishing these projections on a semiannual basis. Currently, the Ministries of Finance and of Development Planning are attempting to build capacity in the areas of macroeconomic policy, economic projections, and fiscal strategy. These agencies will cooperate in these initiatives, both in the context of the PRSP and the annual plan and budget process.

32. The Central Bank has identified the need to bolster balance of payments data and analysis, in particular in view of the declining, yet still important, remittances from Basotho miners in South Africa, the expansion of textile-related trade flows, and questions concerning the accuracy of trade flow and capital account data with respect to South Africa.

33. One of the main impediments to faster economic growth is the lack of financial intermediation. As part of the comprehensive strategy to tackle institutional and structural weaknesses that are hindering private credit growth, the Central Bank of Lesotho has decided to establish a credit bureau. This decision is supported by Lesotho's financial institutions because it would provide creditors valuable information on the creditworthiness of customers. In the same way, it would benefit borrowers by rewarding them with less costly access to credit. The economy as a whole would benefit as the establishment of a credit bureau would contribute toward a culture of loan repayment that in turn would raise the growth potential of the economy. The Bank hopes to have the bureau operating by end-January 2003, but recognizes that the timetable is uncertain because the bureau would necessarily involve participation of the private sector. As part of its overall strategy, Bank officials are 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.

#### **E. The PRSP**

34. The poverty reduction strategy paper (PRSP) process is moving ahead and gaining speed. The government now expects first drafts of the paper to be reviewed by Cabinet in November 2002. A progress report was submitted to the IMF and World Bank Executive Boards in January 2002.

### **IV. PROGRAM MONITORING**

35. To monitor policy implementation under the program, quantitative and structural performance criteria and benchmarks are set out in Tables 2 and 3 of this memorandum. Quantitative performance criteria for end-September 2002 will be conditions for the fifth disbursement and criteria for end-March 2003 will be conditions for the sixth disbursement.

Structural performance criteria in Table 2 will also be conditions for the fifth and sixth disbursements as indicated.

36. 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) and 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.

37. Government recognizes that there have been delays in providing data in the recent past. It is making every effort to rectify this situation as timely and accurate information facilitate program monitoring. Government notes that some delays were due to efforts to reclassify data and improve quality more generally.

38. 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: Food Relief Program and Assumptions, 2002/03 <sup>1/</sup>

	June	September	December	March	Full year
	Maloti <sup>2/</sup>				Grain <sup>3/</sup>
Relief program					
Unsifted maize meal, beans, and oil					
Food aid for the most vulnerable	20	79	165	237	90,000
Subsidy for general population	0	29	58	87	110,000
Supplementary food for children under 5 years	0	13	27	40	
Operating costs	0	3	6	9	
Total Requirement	20	124	256	373	200,000
Less:					
Donor support in kind	0	52	104	155	59,000
Financial commitments and pledges	0	46	90	136	
Commitments	0	19	37	56	
Pledges	0	27	53	80	
Total donor support	0	98	194	291	
GoL commitment	20	27	62	82	
IMF augmentation					
Other donor support					
Financing gap	0	0	0	0	

Source: Ministry of Finance.

<sup>1/</sup> Fiscal year begins April.<sup>2/</sup> Millions of maloti.<sup>3/</sup> Metric tons.

Table 2. Lesotho: Quantitative Benchmarks and Performance Criteria,  
June 2002 - June 2003

	2002				2003	
	June Est.	Prog.	Sep. 1/ Rev. Prog.	Dec. Prog.	Mar. 1/ Prog.	June Prog.
(In millions of maloti)						
Ceiling on the domestic financing requirement of the central government <sup>2/</sup>	41	63	125	213	130	10
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-3486	-3488	-3427	-3346	-3341	-3335
(In millions of U.S. dollars)						
Floor on the stock of net international reserves of the Central Bank of Lesotho <sup>3/</sup>	363	363	360	352	352	352
Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector (cumulative from end-November 2000) <sup>4/ 5/ 6/</sup>						
Maturity of less than one year <sup>7/</sup>	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 <sup>6/</sup>	0	0	0	0	0	0

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

1/ Performance criteria.

2/ June, September, December 2002, and March 2003 are cumulative from end-March 2002.

June 2003 is cumulative from March 2003. September program at M 63 million has been corrected for an error. In Table J of the MEFP in the March 2002 Staff Report, it was incorrectly stated as M -64 million due to an arithmetic error in Table 4.

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 3. Lesotho: Structural Benchmarks and Performance Criteria, July 2002– March 2003

Action	Implementation Date
<p>A. Lesotho Revenue Authority, VAT, and supporting measures</p> <ol style="list-style-type: none"> <li>1. LRA becomes operational. *</li> <li>2. Re-commence VAT registration drive and visits to traders.</li> <li>3. Introduce VAT</li> </ol>	<p>December 31, 2002</p> <p>March 1, 2003</p> <p>June 30, 2003</p>
<p>B. Financial Management</p> <ol style="list-style-type: none"> <li>1. Construct the government's balance sheet as of March 31, 2002 comprising all government accounts and below the line financial assets and liabilities.*</li> <li>2. Begin the recruitment process for an Accountant General.</li> <li>3. Complete a timed action plan to strengthen financial management based on the recommendations of the IMF and EU technical assistance reports.*</li> <li>4. Begin phase one of the study into an integrated financial management system for government. This will entail identifying requirements, evaluating current resources, and making recommendations on closing the resource gap.*</li> <li>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 pre-authorize payment orders under signature of the Accountant General.*</li> <li>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.**</li> </ol>	<p>December 31, 2002</p> <p>September 30, 2002</p> <p>October 31, 2002</p> <p>October 31, 2002</p> <p>November 30, 2002</p> <p>February 28, 2003</p>
<p>C. Other measures</p> <ol style="list-style-type: none"> <li>1. Work with the private sector to establish a credit bureau.</li> <li>2. Begin to publish Central Bank of Lesotho macroeconomic projections.</li> </ol>	<p>January 31, 2003</p> <p>January 31, 2003</p>

\* Performance criterion for the fifth disbursement.

\*\* Performance criterion for the sixth disbursement.

INTERNATIONAL MONETARY FUND

GOVERNMENT OF LESOTHO

Technical Memorandum of Understanding

September 5, 2002

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 2 of the government's Memorandum on Economic and Financial Policies (MEFP).

2. The remaining test dates for assessing observance of quantitative targets during the financial year April 2002–March 2003 will be end-September 2002, end-December 2002, and end-March 2003. The end-September 2002 and end-March 2003 targets will constitute quantitative performance criteria, the end-December 2002 and end-June 2003 targets will constitute quantitative benchmarks. In addition, the ceilings on the stock of external payments arrears and new nonconcessional external debt are continuous performance criteria. The third review under the program is scheduled for completion by September 20, 2002. End-September 2003 quantitative performance criteria for the financial year April 2003–March 2004 will be set at the fourth 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.<sup>1</sup>

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<sup>1</sup> Program cross exchange rates: South African rand per U.S. dollar: 10.25; U.S. dollar per pound sterling: 1.537; U.S. dollar per SDR: 1.330; U.S. dollar per Euro: 0.9975; Swiss franc

(continued)

4. **Adjustment clause:** The program target for the NIR of the Central Bank of Lesotho in any quarter will be adjusted downward (upward) by the shortfall (surplus) in donor support for famine relief shown in Table 1 of the MEFP. It will be adjusted downward (upward) by the amount that the grain requirement is less than (greater than) that shown in Table 1 of the MEFP. The adjustment will be converted into U.S. dollars at the market exchange rate.

5. **Adjustment clause:** The program target for the NIR of the Central Bank of Lesotho in any quarter will be adjusted upward by the amount of any advance non-duty receipts from the Southern Africa Customs Union (SACU) in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter. 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.

6. **Supporting material:** The Central Bank of Lesotho will provide data on its NIR and on SACU non-duty receipts on a monthly basis within one week of the end of the month. The NIR data will be provided in a table showing the 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**

7. **Definition:** The net domestic assets (NDA) of the Central Bank of Lesotho are defined as the difference between reserve money (currency in circulation plus total bank deposits at the central bank) and 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).

8. **Adjustment clause:** The program target for the NDA of the Central Bank of Lesotho in any quarter will be adjusted upward (downward) by the shortfall (surplus) in donor support for famine relief shown in Table 1 of the MEFP. It will be adjusted upward (downward) by the amount that the grain requirement is less than (greater than) that shown in Table 1.

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per U.S. dollar: 1.473; Swedish crown per U.S. dollar: 9.163; Botswanan pula per U.S. dollar 6.203; . Program loti per U.S. dollar exchange rate: 10.25.

9. **Adjustment clause:** The program target for the NDA of the Central Bank of Lesotho in any quarter will be adjusted downward by the amount of any advance non-duty receipts from the Southern Africa Customs Union (SACU) in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

10. **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

11. **Definition:** The central government includes the central administration and all district administrations. The domestic financing requirement of the central government is defined as net credit to, and other claims on, the government from the banking system (Central Bank of Lesotho and the commercial banks), plus net credit to, and other claims on, the government from the non-bank sector. It will be calculated as the cumulative change from 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.

12. **Adjustment clause:** The program target for the domestic financing requirement of the central government will be adjusted upward (downward) by the shortfall (surplus) in donor support for famine relief shown in Table 1. It will be adjusted upward (downward) by the amount that the grain requirement is less than (greater than) that shown in Table 1.

13. **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. 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. External debt service, amortization, and disbursements will be calculated at program exchange rates.



14. **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**

15. **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.

16. **Adjustment clause:** None.

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

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

18. **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.

19. **Adjustment clause:** None.

20. **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**

21. **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.

22. **Adjustment clause:** None.

23. **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'S THREE-YEAR ARRANGEMENT UNDER THE PRGF FACILITY:**

**Timetable and Modalities for the Reporting Requirements Outlined in the Technical Memorandum of Understanding**

The table below specifies the timetable and other modalities for data reporting with a view to ensuring a smooth flow of timely and comprehensive data needed in monitoring Lesotho Three-Year Arrangement under the PRGF. If possible, all data should be transmitted to the IMF via email. In the event that a data transmission is delayed more than 5 business days, an explanation for the delay, together with the expected transmission date of the late data should be communicated to the IMF.

<b>Variable</b>	<b>Data Description</b>	<b>Reporting Periodicity</b>	<b>Reporting Lag</b>
<b>A. Floor on the Stock of Net International Reserves of the Central Bank of Lesotho</b>	<p>1) Table showing: a) the currency breakdown of the reserve assets and reserve liabilities of the CBL, converted into U.S. dollars using the program exchange rates between the U.S. dollars and other reserve currencies; and</p> <p>b) the above-mentioned NIR figure converted into maloti using the program loti/U.S. dollar exchange rate;</p> <p>c) SACU non-duty receipts.</p>	Monthly	One week
<b>B. Ceiling on the Stock of Net Domestic Assets of the Central Bank of Lesotho</b>	<p>1) Central Bank's balance sheet</p> <p>2) Table of selected monetary indicators covering the major elements the CBL's of balance sheet.</p>	<p>Monthly</p> <p>Weekly</p>	<p>21 days of the end of the month.</p> <p>Two weeks</p>

Variable	Data Description	Reporting Periodicity	Reporting Lag
<b>C. Ceiling on the Domestic Financing Requirement of the Central Government</b>	1) Monetary Survey and other monthly monetary statistics (01R, 06R, 10R, 10G, 20R, 20G, 30G).	Monthly	30 days
	2) The following items should be included as memorandum items at the bottom of the Monetary survey: - outstanding balances in the privatization account or accounts - outstanding balance in the SACU revenue pool account - outstanding balance in the government's blocked account - outstanding stock of monetary policy T-bills - new T-bills issued during the month - T-bills redeemed during the month	Monthly	30 days
	2) Table showing the details of all government financing operations from the banking sector and from nonbank public (Table containing government debt held by central bank, commercial banks and nonbank public, T-bill holdings valued including accrued interest).	Monthly	30 days
	3) Detailed monthly budget operations and tax arrears reports. (From the Ministry of Finance).	Monthly	30 days
<b>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</b>	Details of all new commitments and government guarantees for external borrowing, with detailed explanations. (From the Ministry of Finance).	Monthly	30 days

<b>Variable</b>	<b>Data Description</b>	<b>Reporting Periodicity</b>	<b>Reporting Lag</b>
<b>E. Ceiling on the Amount of New External Debt Contracted or Guaranteed by the Public Sector, with Original Maturity of Less than One Year</b>	Details of all new commitments and government guarantees for external borrowing, with detailed explanations. (From the Ministry of Finance).	Monthly	30 days
<b>F. Ceiling on the Stock of External Payments Arrears</b>	Details of arrears accumulated on interest and principal payments to creditors. will be reported within one week from the date of the missed payment.	NA	Within one week from the date of the missed payment.

**LESOTHO: FUND RELATIONS**  
As of June 30, 2002

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

<b>II. General Resources Account:</b>	<u>SDR million</u>	<u>%Quota</u>
Quota	34.90	100.0
Fund holdings of currency	31.36	89.9
Reserve position in Fund	3.54	10.1
<b>III. SDR Department:</b>	<u>SDR million</u>	<u>%Allocation</u>
Net cumulative allocation	3.74	100.0
Holdings	0.45	12.1
<b>IV. Outstanding Purchases and Loans:</b>	<u>SDR million</u>	<u>%Quota</u>
ESAF/PRGF arrangements	14.05	40.2

**V. Financial Arrangements:**

<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>
PRGF	03/09/2001	3/08/2004	24.50	10.5
Stand-by	09/23/1996	9/22/1997	7.17	0.0
Stand-by	07/31/1995	7/30/1996	7.17	0.0

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

	<u>Forthcoming</u>				
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal	1.4	1.8	0.4	0.0	0.4
Charges/Interest	0.1	0.1	0.1	0.1	0.1
<b>Total</b>	<b>1.5</b>	<b>1.9</b>	<b>0.5</b>	<b>0.1</b>	<b>0.5</b>

**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.

A Stage One safeguards assessment of the CBL was completed on July 02, 2001. The assessment concluded that a Stage Two (on-site) visit 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 currency, the rand. For the 12-month period ended May 2002, the nominal effective exchange rate depreciated by 1.4 percent and the real effective exchange rate depreciated by 2.4 percent. The Central Bank of Lesotho (CBL) deals with commercial banks mainly in South African rand. As of June 30, 2002, the rand (maloti) rate per U.S. dollar was M 10.37.

**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:**

Mission: banking supervision	MAE	short term	1997
Government expenditure management	FAD	long term	1997-98
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

**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's 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 June 31, 2002, IDA had approved 29 credits amounting to US\$332.6 million, of which US\$226.7 million was disbursed; US\$56.4 million was canceled; and US\$53.4 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\$16.1 million has been disbursed and US\$19.8 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.

Lesotho: World Bank Lending Operations

(As of July 31, 2002; in millions of U.S. dollars, unless otherwise indicated)

Sector	Disbursed Credits		Disbursing Credits and Loans				Total Approved	Total	Total Disbursed	Percent	Percent of Total
	Original amount Disbursed 1/2/	Original amount	Disbursed 2/	Undisbursed 2/	(F) =	Credit Loans	Disbursed	and Undisbursed	of Total	Disbursed and	
	(A)	(B)	(C)	(D)	(E)	(D) + (E)	(G)=(A)+(C)	(H)=(B)+(D)	(I)=(E)+(H)	Disbursed	Undisbursed
<b>Credits:</b>											
Education	77.7	67.2	0.0	0.0	0.0	0.0	77.7	67.2	67.2	16.9	16.1
Transport 3/	84.4	59.4	0.0	0.0	0.0	0.0	84.4	59.4	59.4	15.0	14.3
Agricultural/land management and conservation	34.4	17.3	0.0	0.0	0.0	0.0	34.4	17.3	17.3	4.4	4.2
Industry	27.5	24.5	0.0	0.0	0.0	0.0	27.5	24.5	24.5	6.2	5.9
Water supply	6.0	5.1	0.0	0.0	0.0	0.0	6.0	5.1	5.1	1.3	1.2
Urban development	26.4	10.8	0.0	0.0	0.0	0.0	26.4	10.8	10.8	2.7	2.6
Health and population	22.1	16.6	0.0	0.0	0.0	0.0	22.1	16.6	16.6	4.2	4.0
Lesotho Highlands Water Project	9.8	10.4	0.0	0.0	0.0	0.0	9.8	10.4	10.4	2.6	2.5
Privatization	39.6	15.0	0.0	0.0	0.0	0.0	39.6	15.0	15.0	3.8	3.6
Social Protection	4.7	0.3	0.0	0.0	0.0	0.0	4.7	0.3	0.3	0.1	0.1
<b>Total</b>	<b>332.6</b>	<b>226.7</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>332.6</b>	<b>226.7</b>	<b>226.7</b>	<b>57.1</b>	<b>54.4</b>
<b>Loans</b>											
Lesotho Highlands Water Project	155.0	85.1	155.0	85.1	19.8	104.9	310.0	170.2	190.0	42.9	45.6
<b>Total credits and loans</b>	<b>487.6</b>	<b>311.8</b>	<b>155.0</b>	<b>85.1</b>	<b>19.8</b>	<b>104.9</b>	<b>642.6</b>	<b>396.9</b>	<b>416.7</b>	<b>100.0</b>	<b>100.0</b>
Repayments		37.8		18.9				56.8			
Cancellation	106.5		-50.1				56.4				
<b>Total obligation</b>		<b>274.0</b>		<b>66.1</b>				<b>340.1</b>			

Source: IBRD.

1/ Original principal less cancellations.

2/ Reflects adjustment for exchange rate movements.

3/ Infrastructure Project and Road Rehabilitation and Maintenance Project.

**NEWS  BRIEF**

FOR IMMEDIATE RELEASE

News Brief No. 02/98  
FOR IMMEDIATE RELEASE  
September 20, 2002

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

**IMF Completes Review Under Lesotho's PRGF Arrangement and Approves US\$4.6 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Lesotho's performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. The Board also granted waivers of two performance criteria. As a result, Lesotho will be able to draw up to SDR 3.5 million (about US\$4.6 million) under the arrangement immediately.

Lesotho's three-year PRGF arrangement was approved on March 9, 2001 (see [Press Release No. 01/8](#)) for SDR 24.5 million (about US\$32 million). So far, Lesotho has drawn SDR 10.5 million (about US\$14 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.

Following the Board's discussion on Lesotho, Shigemitsu Sugisaki, Deputy Managing Director and Acting chair, stated:

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EXTERNAL RELATIONS DEPARTMENT

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“The Lesotho authorities remain committed to the economic program supported by the PRGF. They have worked hard to keep the program on track despite difficulties posed by the regional food shortage and delays in receiving foreign aid and transfers. Economic growth in 2001/02 has outperformed expectations under the program, and the peaceful elections in May 2002 should boost confidence in the economy and its future growth.

“Two performance criteria related to the ceiling on domestic financing and fiscal expenditure monitoring were not observed. Since the nonobservance of both these performance criteria was largely beyond the government’s control and corrective actions have been initiated, the Executive Board granted waivers for the noncompliance.

“The government declared a state of famine in April 2002 and has put in place a food relief plan, which has been incorporated into the program. Donors have committed some support, but the plan will cost the government an estimated 1 percent of GDP in 2002/03. The government has adequate resources to meet this level of emergency food spending, as long as expenditure in other areas remains under control. Nevertheless, additional financing could prove necessary, with augmentation of IMF support to Lesotho, as well as donor financing, being possibilities that could be considered in that regard.

“Strengthening financial management remains a priority for the authorities. The government’s plans in this area cover short-term measures to bolster spending control and tracking, and also longer-term restructuring of the Treasury department. High priority measures for the near-term include clearing the backlog of unaudited government public accounts and recruiting for a new Accountant General. To counter fiscal slippages that began to emerge in June, the authorities have made some spending cuts. The government should be prepared to make further adjustments if necessary, while safeguarding priority poverty programs.

“The authorities have made progress in strengthening tax administration and the Lesotho Revenue Authority should be operational by the end of 2002. Better tax administration can play an important and needed role in addressing anticipated revenue shortfalls,” Mr. Sugisaki stated.