

Lesotho: 2001 Article IV Consultation and the Second Review Under the Poverty Reduction and Growth Facility Arrangement and Request for Waiver of Performance Criterion—Staff Report; Public Information Notice and News Brief on the Executive Board Discussion; and Statement by the Executive Director for Lesotho

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2001 Article IV consultation with Lesotho and the Second Review Under the Poverty Reduction and Growth Facility Arrangement and Request for Waiver of Performance Criterion, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **December 11, 2001**, 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 March 4, 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;
- the Public Information Notice (PIN) and the News Brief summarizing the **views of the Executive Board as expressed during the March 18, 2002, Executive Board discussion** of the staff report that concluded the Article IV consultation;
- a statement by the Executive Director for Lesotho.

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

Letter of Intent;*	Understanding;*
Memorandum of Economic and Financial Policies;*	Poverty Reduction Strategy Paper Status Report - Joint Staff Assessment;
Technical Memorandum of	Statistical Annex

*May also be included in Staff Report.

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

Copies of this report are available to the public from
International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623 7430 • Telefax: (202) 623 7201
E-mail: publications@imf.org • Internet: <http://www.imf.org>

Price: \$15.00 a copy

**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

LESOTHO

**Staff Report for the 2001 Article IV Consultation and the Second Review Under the
Poverty Reduction and Growth Facility Arrangement
and Request for Waiver of Performance Criterion**

Prepared by the African Department

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

Approved by Jürgen T. Reitmaier and Liam P. Ebrill

March 4, 2002

Contents	Page
Executive Summary	3
I. Introduction	4
II. Recent Developments.....	5
III. Report on Discussions	9
IV. External Financing	18
V. Staff Appraisal.....	19
Boxes	
1. Structural Measures.....	21
2. Regional and Bilateral Trade Developments	22
3. Problems with Public Accounting and Information Systems	23
Figures	
1. Output and Prices	24
2. Fiscal Developments, 1992/93-2001/02.....	25
3. Monetary Development.....	26
4. Effective Exchange Rates, January 1994-November 2001	27

Tables

1.	Selected Economic and Financial Indicators, 1999/2000-2007/08.....	33
2.	Balance of Payments, 1998/99-2007/08.....	34
3.	Central Government Operations, Annual, 1999/2000-2003/04	35
4.	Central Government Operations, Quarterly, 2001/02-2002/03.....	37
5.	Central Bank Balance Sheet, March 2001-March 2004.....	39
6.	Monetary Survey, March 2001-March 2004.....	40
7.	Quantitative Benchmarks and Performance Criteria, June -September 2001	41
8.	Structural Benchmarks and Performance Criteria, June -October 2001	42
9.	External Financing Requirements and Sources, 1999/2000-2007/08	43
10.	Phasing of Disbursements Under the PRGF Arrangement, 2001/04.....	44
11.	Indicators of Financial Obligations to the Fund, 2000/01-2007/08	45

Appendices

I.	Letter of Intent.....	41
	Attachment I: Memorandum on Economic and Financial Policies.....	42
	Table 1. Quantitative Benchmarks and Performance Criteria, December 2001- September 2002.....	50
	Table 2. Structural Benchmarks and Performance Criteria, January-October 2002	51
	Attachment II: Technical Memorandum of Understanding	52
II.	Relations with the Fund.....	57
III.	Financial Relations with the World Bank Group.....	59
IV.	Statistical Issues	61
V.	Selected Social and Demographic Indicators.....	66
VI.	Alternative Measures of Fiscal Balance.....	67

Executive Summary

1. **The economic program remains on track.** Key economic indicators are performing as expected, and all quantitative performance criteria for end-September 2001 were observed. However, one structural performance criterion, making the Lesotho Revenue Authority (LRA) operational, was delayed because of late parliamentary action, and one benchmark, completing the 2000/01 public accounts for auditing, was not completed because of a decision to complete accounts from 1993/94 in sequence. Plans are now in place to accomplish these objectives.
2. **Economic growth is expected to moderate somewhat to just under 3 percent in 2001/02.** Adverse weather conditions will offset the stimulus provided by rising clothing exports. The global economic slowdown is expected to have a small impact on Lesotho because most of its traditional exports go to countries in the region that have been less affected than the advanced economies.
3. **The Lesotho loti, which is pegged to the South African rand, depreciated by 37 percent against the U.S. dollar during 2001.** This decline is expected to raise annual inflation in 2002 by about 2 percentage points. The nominal and real effective exchange rates, however, have been largely unaffected because most of Lesotho's trade is with South Africa and because the two countries' inflation rates move in tandem.
4. **The current account deficit for 2000/01 is estimated to have been 16 ½ percent of GDP, underscoring Lesotho's longstanding trade imbalance.** However, strong export growth under the U.S. African Growth and Opportunity Act will help reduce this deficit to 7½ percent of GDP in 2001/02.
5. **Understandings were reached for quantitative performance criteria for end-March and end-September 2002.** Current spending is programmed to remain at 35 percent of GDP in 2001/02, down from over 40 percent in 1999/2000.
6. **Structural measures are intended to strengthen medium-term fiscal sustainability and economic growth prospects.** Measures related to fiscal policies include making operational the LRA, making progress toward clearing the backlog of unaudited accounts, and initiating the financial management component of the Lesotho Public Sector Improvement and Reform Project. Following the successful introduction of treasury bills for monetary policy, the central bank will develop a strategy to boost financial intermediation.
7. **There has been significant progress with the PRSP, and a final report is expected to be submitted to the cabinet in the third quarter of 2002.**
8. **Elections are scheduled for May 25, 2002.**

I. INTRODUCTION

1. **A staff team visited Lesotho during November 26–December 11, 2001 to conduct the 2001 Article IV consultation discussions and the second review under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement.**¹ Discussions were held with Finance Minister M. K. Tsekoa, 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 coordinated its activities with World Bank staff and local donor representatives.

2. **In the attached letter of intent and memorandum on economic and financial policies (Appendix I), the Minister of Finance reviews policies and performance under the program during the first half of 2001 and describes objectives and policies through March 2003.** The authorities are requesting a waiver for the structural performance criterion for making operational the Lesotho Revenue Authority, which was not completed.²

3. **The most recent Article IV consultation was concluded on March 9, 2001.** At that time, Directors emphasized outward-looking policies and private sector development as the best economic strategy for Lesotho, and they welcomed the authorities' efforts to privatize state-owned enterprises and encourage private sector investment. More recently, in concluding the first review of the program on July 20, 2001, Directors welcomed the authorities' commitment to adhere to tight expenditure targets and to spending in priority areas such as health and education. They agreed that, over the medium term, it would be important to bring down the share of recurrent public spending in GDP in order to promote private sector development and employment creation.

4. **Lesotho maintains an exchange system free of restrictions on payments and transfers for current international transactions.** Lesotho's core economic data are largely adequate for program monitoring, although, as noted below, there is room for improvement in the consistency of trade, balance of payments, and national accounts data. Lesotho's relations with the Fund and the World Bank are described in Appendices II and III, respectively. Statistical issues are described in Appendix IV, and social and demographic indicators are provided in Appendix V. A joint staff assessment (JSA) of the authorities'

¹ The mission team comprised Mr. Green (head), Ms. Medina Cas, Mr. Walsh (all AFR), Mr. Hatanpaa (TRE), and Mr. Mitchell (PDR). Mr. Mafararikwa (office of the Executive Director) participated in some of the policy discussions. Mr. Green and Ms. Medina Cas returned to Lesotho to complete discussions on January 7-9, 2002.

² The Executive Board approved a three-year arrangement under the PRGF for SDR 24.5 million on March 9, 2001. The second disbursement of SDR 3.5 million took place on July 27, 2001.

progress report on the poverty reduction strategy paper (PRSP) has been issued separately to the Board (EBD/02/32, 3/4/02).

II. RECENT DEVELOPMENTS

5. **Lesotho's economic program remains on track.** Key economic indicators are performing as projected, all quantitative performance criteria for the second review under the PRGF arrangement were observed, and substantial progress was made in completing structural benchmarks (Box 1). One structural performance criterion, making operational the Lesotho Revenue Authority, and one structural benchmark, presenting the 2000/01 (April-March) public accounts for audit, were not observed, but plans are now in place for their completion. A second structural benchmark relating to off-budget accounts was mostly completed. All below-the-line accounts have been eliminated, and the major autonomous funds, such as the Roads Fund, will be brought on budget in 2002/03. Audits of these funds for 2000/01 have yet to be completed (see Table 8).

Political Background

Prime Minister:	Bethuel Mosisili
Finance Minister:	Mohlabi K. Tsekoa
Central Bank Governor:	E.M. Matekane

Elections are now scheduled for May 25, 2002. Two major factors underlying the postelection riots in 1998 have been addressed through validation of voter records and the addition of 40 parliamentary seats, to be filled by proportional representation. The budget for 2002/03 was presented to parliament in late January and approved in late February, clearing the way for parliament to be dissolved for the election campaign period. There are at least six major parties in Lesotho, including the ruling Lesotho Congress for Democracy (LDC) and the Lesotho People's Congress, the latter of which is headed by former Minister of Finance K. Maope.

A. Macroeconomic Developments

6. **Economic growth has picked up and inflation has declined since the 1998 political disturbances.** Output growth for 2000/01 (April-March) was 3¼ percent, largely reflecting buoyant textile exports to the United States (see below) and a pickup in retail distribution (Table 1 and Figure 1). Weather-related problems in the agriculture sector are likely to contribute to a slight slowing in the pace of expansion in 2001/02 and to higher food prices. Consumer price inflation was 7 percent in December 2001—a level slightly above that in South Africa, partly owing to the larger weight of food in Lesotho's consumer price basket. Unemployment remains high, an estimated 40 percent of the labor force,

because many of the gold miners formerly employed in South Africa have not been absorbed into the formal sector. Worker remittances, which had been approximately 40 percent of GNP in the late 1980s, fell to about 22 percent of GNP in 2000.

7. **The deterioration in the global economic environment has not had a significant impact on Lesotho's economic performance.** Lesotho has so far been insulated from the slowdown in the advanced economies because its main export partners are neighboring developing countries, which have been less affected than their higher-income partners. In addition, Lesotho has not been hurt by declines in world commodity prices because it is a net importer of primary commodities. However, the depreciation of the South African rand will cause inflation to rise and will have adverse implications for the government's budget. An immediate export response to the depreciation is unlikely because Lesotho's traditional export partners are in the rand area. Exports from the textile sector, which could, in principle, benefit from the rand depreciation, are currently constrained by capacity limits.

8. **Exports to the United States have risen dramatically under the African Growth and Opportunity Act (AGOA), which greatly reduced trade barriers for clothing and textile exports from Lesotho and neighboring countries.** The agreement with the United States did not come into force until April 2001, but expectations of Lesotho's accession to AGOA status spurred textile manufacturers to locate assembly plants in the country, and foreign direct investment in this area rose sharply. In consequence, clothing and textile exports increased by 54 percent by September 2001 and made up almost 30 percent of exports. Currently, clothing manufacturing is an assembly-type operation and does not add significantly to GDP but has made this industry the largest employer in Lesotho.³ However, planned future foreign direct investments—M 150 million has already been indicated by investors—should raise value added in this sector in the future.

9. **The current account deficit for 2000/01 (including official transfers) is now estimated to have been 16 ½ percent of GDP, underscoring Lesotho's long-standing large trade deficit** (Table 2). However, strong growth in textile exports under AGOA, combined with lower imports of investment goods—as the current phase of the Lesotho Highlands Water Project (LHWP) nears completion—and a drop in imports in U.S. dollar terms is projected to reduce the current account deficit to 7½ percent of GDP in 2001/02. Gross official reserves for end-November 2001 were equivalent to 7½ months of imports of goods and services, and net reserves remained on track.

10. **Lesotho's public sector imbalance has been reduced sharply since 1999/2000, when the economy was recovering from recession** (Tables 3 and 4 and Figure 2). Since then, the domestic borrowing requirement, excluding net lending, has fallen from more than 8 percent of GDP to a small repayment (projected for 2001/02), and the domestic balance,

³ Output figures for the relevant period are not available. Expert data are taken from the U.S. International Trade Commission.

which is a measure of the government's absorption of domestic resources, has been reduced by more than 3 percentage points of GDP (Appendix VI). Much of the overall improvement is due to the decline in current spending as a share of GDP from 40½ percent in 2000 to 35½ percent in 2001/02.

11. The government's domestic borrowing requirement overperformed relative to the program for end-September 2001 by approximately 1½ percent of GDP.⁴ Wages and salaries were below initial budget estimates because the enforcement of the government's mandatory retirement age (55 years) and difficulties in recruiting, especially professionals, resulted in significant vacancies. Capital spending remained below initial projections because of delays in donor funding and problems with project implementation. However, vehicle expenses were more than 70 percent above target, and sales taxes were somewhat below target. Remediation in both areas is discussed in Section III.

12. Total government indebtedness is relatively low. In 1999/2000, domestic debt more than tripled to 15¼ percent of GDP as a result of a bond issued to recapitalize the Lesotho Bank prior to its privatization, and of domestic financing of the budget deficit. The debt ratio subsequently declined with the improvement in the government balance, but has risen again in 2001/02 because of the issuance of treasury bills for monetary policy purposes.⁵ External public debt is projected to increase from 63 percent last year to 73 percent of GDP by end-2001/02, largely as a result of valuation changes caused by the depreciating loti.⁶ However, external debt service in 2001/02 is projected to be only 7½ percent of exports of goods and services.

13. Net international reserves and net domestic assets of the central bank were well within their respective floor and ceiling targets for September 2001 (Tables 5 and 6). A substantial outflow of net foreign assets in April-May 2001 was reversed by June, following an increase in the interest rate paid on commercial bank deposits at the central bank (Figure 3). Moreover, the capital outflows that were expected to accompany the introduction of the new treasury bill auction in September 2001 failed to materialize because of the attractive yields on new treasury bills. However, there were some structural breaks in

⁴ Net lending was excluded from the performance criterion in order to eliminate the effects of the amortization of M 120 million in treasury bills that had been issued to finance bank restructuring.

⁵ Issuance of treasury bills for monetary policy purposes in the second half of 2001 increased the gross government debt by M 500 million, or 7 percent of GDP. Proceeds were deposited in a blocked account at the central bank so that net indebtedness of the government did not increase.

⁶ In net present value (NPV) terms, total public debt is 48½ percent of GDP and 131½ percent of exports of goods and services.

monetary statistics in connection with the transition to the new treasury bill instrument. Reserve money and net domestic assets of the central bank fell as the banking sector's structural liquidity surplus was shifted from remunerated deposits at the central bank to treasury bills. Official reserves, however, were unaffected and stood at 7½ months of projected imports of goods and services at end-September 2001.

14. **Lesotho is a member of the Common Monetary Area, and, therefore, its currency, the loti, is pegged to the South African rand.** Thus, the loti depreciated by 37 percent against the U.S. dollar during 2001, mostly in the closing months of the year. Because much of Lesotho's trade is with its neighbors in the rand area, its nominal effective exchange rate was largely unchanged (Figure 4). The real exchange rate was likewise unaffected because rates of inflation in Lesotho and South Africa are relatively similar. Competitiveness in traditional regional markets, therefore, did not improve. However, the depreciation has made Lesotho more attractive as a destination for foreign direct investment than countries outside the rand area.

B. Structural Measures

15. **Recent efforts to improve the functioning of the private sector economy have centered on Lesotho's privatization program.** During 2001, competition in the telecommunications sector was enhanced: Lesotho's land telephone company was privatized, the government sold its shares in the existing cellular service, and a second cellular company began operations. The electric power sector is next in line for reform: a private management team was given an 18-month contract to operate the Lesotho Electricity Corporation, with a view to improving service and preparing the company for sale. Final privatization would take longer because plans to commercialize the Muela hydroelectric plant have been delayed while an agreement to apportion the costs of the electric plant and the integral water transfer project is worked out between the governments of Lesotho and South Africa.

16. **The Lesotho Public Sector Improvement and Reform Project (PSIRP) has been delayed because of government concerns about the size of the loan component of the financing package.** The authorities expressed a preference for less loan and more grant financing of the project in the context of the depreciating exchange rate. The project, which is being coordinated with World Bank assistance, is slated to cover financial management, governance, and human resource issues in its first phase. While the financing concerns are being worked out, the government, with coordinated donor support, has begun implementing the financial management component, with a view to addressing pressing issues in accounting and expenditure management systems.

17. **There has also been some progress in strengthening Lesotho's private financial sector.** Lesotho's new commercial court is now operating and is beginning to hear cases, although a large backlog exists. In addition, the bank restructuring of 1999-2000 is showing benefits. The remaining commercial banks meet local prudential requirements, and the

liquidator of the old Lesotho Bank has been successful in recovering bad debts; as a result, some of the government bonds that were used to recapitalize the bank have been retired.

18. **Lesotho's trade policies are mainly determined by its membership in the Southern African Customs Union (SACU) and the Southern African Development Community (SADC).** Key developments include new institutional procedures for determining the common tariff policy and a new SACU agreement on the distribution of the regional customs pool (Box 2). The agreement, however, has not yet been ratified by member countries' parliaments. Moreover, there has been only slow progress with regional tariff reduction at the SADC level. Independently, the government signed AGOA in April 2001.

C. Social Issues

19. **At least 40 percent of Lesotho's population is poor, and efforts to reduce poverty are progressing, albeit slowly.** Lesotho's poverty reduction strategy paper was initially delayed, but it is now moving ahead. Preliminary and planning stages have been completed, and consultation discussions at the district level are planned for March 2002. A draft paper is expected to be presented to the cabinet in the third quarter of 2002. The authorities are aware of the importance of assessing poverty-reducing expenditures. Progress in this area can be expected with the PRSP and also as expenditure management is improved.

20. **As in all countries in the region, HIV/AIDS is an overriding social concern.** According to the World Bank, about one-fourth of adults are HIV positive, and life expectancy at birth declined from 53 years in 1980 to 45 years in 1999. The disease is now threatening to overwhelm the country's health resources and in the period ahead will hold down economic growth and wealth creation. It is also beginning to tear at Lesotho's extended family system, which has been the country's natural social safety net.

III. REPORT ON DISCUSSIONS

21. **Discussions with the authorities covered macroeconomic prospects, impediments to future growth and poverty reduction, and the economic program.** The staff welcomed the strong efforts to implement policies and the resulting successes in meeting all quantitative performance criteria and most structural measures. Key points raised in the discussions included the following:

- Economic growth will slow somewhat in the near term, reflecting the global slowdown and recent weather conditions. The rand depreciation will raise inflation and put pressure on government spending, but not significantly boost exports in the near term. These shocks have added to economic uncertainty and risk.

- All quantitative performance criteria were observed for end-September 2001 (Table 7). However, the Lesotho Revenue Authority (LRA) did not become operational (a structural performance criterion for end-September 2001), and public accounts were not presented for audit (a structural benchmark; Table 8). Plans were put in place to complete these tasks.
- Understandings were reached on quantitative performance criteria for end-March and end-September 2002 and on new structural measures that aim to put the LRA back on track, establish a plan to clear the backlog of unaudited accounts, and begin work on the financial management component of the Lesotho Public Sector Improvement and Reform Project (PSIRP). (See Tables 1 and 2 of the government's memorandum on economic and financial policies (MEFP)).

A. Economic Activity and Medium-Term Prospects

22. **The slowdown in the global economy and the terrorist attacks on the United States are expected to have only a moderate impact on Lesotho's economic prospects.** Officials from the Ministries of Finance and Development Planning agreed with the staff team that the baseline economic growth estimate for 2001/02 was unchanged from six months ago because the impact of the markdowns in growth assumptions in the advanced economies (based on the IMF World Economic Outlook) was offset by recent information showing a stronger-than-expected domestic economy and gains in clothing and textile exports to the United States. Falling nonfuel commodity prices would improve Lesotho's terms of trade because it is a net importer of these goods; however, the benefits of lower U.S. dollar oil prices in 2002 relative to assumptions made before September 11 have been reduced because of the recent depreciation of the South African rand. For 2002/03, economic growth projections have been reduced by $\frac{1}{2}$ of 1 percentage point to about $2\frac{3}{4}$ percent, reflecting weaker export markets (see table below). The adverse implications of the slowdown in global export markets, however, would be at least partially offset by the benefits of AGOA, even if clothing and textile output continues to be constrained by production capacity.

23. **Officials and the staff agreed that the sharp depreciation of the South African rand in late 2001 could have greater implications for inflation than for the real sector.** The staff indicated that the depreciation could push up prices in Lesotho by about 2 percent in 2002. The officials agreed that, although this could be a possible outcome, it was still too early to make a firm estimate because the rand remained volatile and could regain some of its losses against major currencies. The impact on output would be minimal in the short run because approximately 90 percent of Lesotho's exports are to South Africa.

Lesotho: Medium-Term Scenario, 2000/01-2006/07

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
	Actual	Rev. Prog.	Prog.	Prog.	Prog.	Prog.	Prog.
Real GDP (percent change)	3.2	2.9	2.8	3.5	3.9	4.0	4.1
Consumer price index (percent change)	7.0	7.8	8.4	6.4	5.9	5.4	4.9
Domestic balance (percent of GDP)	1.4	1.5	1.7	2.2	2.9	3.0	3.3
External current account balance (percent of GDP)	-16.6	-7.4	-6.0	-3.6	-4.4	-3.5	-2.5
Gross reserves (months of imports)	7.4	7.5	6.9	6.6	6.3	6.0	6.0
NPV of total public external debt (millions of U.S. dollars)	42.7	48.5	49.4	44.1	39.3	34.7	30.7

24. **Economic growth is projected to average around 4 percent a year over the medium term.** This projection assumes that above-average rates of growth in textile manufacturing and in the services sector (retail distribution, health, and financial services) will offset below-average growth in the primary sector and stable or declining construction associated with the LHWP. The authorities and the staff agreed that the restoration of sound macroeconomic policies and political stability since the 1998-99 downturn and unrest had provided a basis for Lesotho's emergence from recession and its future expansion. However, to achieve this albeit modest rate of growth of 4 percent, it will be important for the authorities to pursue the structural reforms under Lesotho's economic program. The PSIRP is intended to raise government efficiency and, thereby, free resources for the private sector; the privatization of key utilities and public infrastructure building is intended to bolster the private sector; and the greatly increased spending on education should, over time, help reduce unemployment. Measures aimed at the financial sector that would facilitate investment are discussed below. Price inflation is assumed to eventually decline along with inflation in South Africa because of the fixed exchange rate arrangement.

25. **Current projections indicate that Lesotho's fiscal and external balances and public debt levels are sustainable, however, there are some risks.** First, it is likely that SACU transfers, which currently make up 50 percent of government revenue, will fall in relation to GDP over the medium term because of the global trend toward lower tariff rates and the new SACU and SADC agreements. The authorities ongoing efforts to improve tax administration and expenditure control are intended to reduce Lesotho's reliance on this source of income. Second, Lesotho is now benefiting from inward investment in the clothing and textile sector, but the future of these inflows will depend in large part on expanding access to markets in advanced economies. Third, the sharp nominal exchange rate depreciation in 2001 has clearly improved Lesotho's competitiveness outside of the rand area; however, sound fiscal, monetary, and structural policies will be necessary to help ensure that this gain translates into a sustained real improvement. Finally, HIV/AIDS could

have a greater impact on the medium-term outlook than the ½ of 1 percentage point reduction in growth currently assumed in the projections.⁷

B. Fiscal Policies

Revisions to the 2001/02 budget

26. **Fiscal policy under the program aims to achieve sustainable domestic debt, rely mainly on external financing through grants and concessional loans, and reduce the expansionary impact of the fiscal stance on aggregate demand.** Revisions to the 2001/02 budget, as outlined in the table below, are consistent with these principles. They were made to reflect developments observed during the first half of the financial year.

27. **Ministry officials explained that sales tax projections for the year had been revised downward in light of observed shortfalls.** Smaller-than-expected collections were most likely explained by the transition to the LRA and value-added tax (VAT), as key senior staff had been reassigned to the implementation teams and vacancies had been left open pending staff transfers to the LRA. In addition, border collection officials, fearing job losses ahead, had reduced their work effort. In response, the government had already taken steps to bring LRA implementation back on track and was planning to step up border post enforcement during the transition to the VAT. Both efforts involve structural measures and are explained in paragraph 38 below.

28. **Spending on goods and services through the first seven months of 2001/02 was above anticipated levels, pointing to the possibility of overruns by the end of the financial year.** While wage costs are now projected to be below program because of vacancies, vehicle lease costs are expected to exceed the budget allocation by M 50 million (0.7 percent of GDP). These costs were underestimated in the original 2001/02 when the leasing arrangement replaced government vehicle ownership. Scope for significant cost cutting in the near term is limited because of the substantial penalties for reducing the number of cars under lease in the contract. There is, however, room to save by switching to less expensive vehicles as leases come up for renewal. The authorities agreed, therefore, that the best way to lower costs would be to hold ministries responsible for their expenses, so that they would have the incentive to change the number and mix of vehicles over time as specific leases expired.

⁷ About 24 percent of adults were estimated to be infected with HIV in 1999. A recent World Bank report estimates that HIV/AIDS is now reducing economic growth by ½ of 1 percent a year. By 2015, the impact would rise to 2 ¾ percentage points a year.

Lesotho: Central Government Operations, 1999/2000–2002/03
(In percent of GDP)

	1999/2000	2000/01		2001/02		2002/03
	Act.	Original Program	Prelim. Outturn	Original Program	Rev. Prog.	Program
Revenue	40.3	40.4	41.2	42.0	41.1	39.5
Customs	20.6	18.2	17.7	20.9	20.6	19.0
Noncustoms	12.3	12.4	12.9	13.9	13.6	14.9
Other	7.4	9.9	10.7	7.1	6.8	5.6
Grants	2.3	3.4	2.0	5.5	3.7	5.1
Total expenditure and net lending	58.8	47.7	45.4	47.3	42.6	45.4
Current expenditure	40.4	38.8	37.4	35.8	35.3	35.3
Capital expenditure	8.4	8.9	8.1	11.6	9.0	10.4
Net lending	10.0	0.0	0.0	0.0	-1.7	-0.3
Overall balance, before grants <u>1/</u>	-8.5	-7.7	-4.7	-5.3	-4.3	-6.2
Overall balance, after grants <u>1/</u>	-6.2	-4.3	-2.7	0.2	-0.6	-1.1
Memorandum items:						
Domestic balance <u>1/</u>	-2.7	-0.6	1.4	3.7	1.5	1.7
Domestic financing <u>2/</u>	8.2	7.8	6.1	-1.3	-0.1	0.9

1/ Excluding exceptional factors.

2/ Excluding net lending.

29. **Minister Tsekoa explained that in late November the cabinet had approved a M 85 million supplementary spending package.** Of this, approximately M 18 million (¼ of 1 percent of GDP) had been added to current spending for health care (M 12 million) and for the Lesotho Petroleum Fund Board (M 6 million).⁸ The staff team agreed that these additions were in line with government priorities and policy and observed that the rise in health spending was particularly welcome. However, it suggested that the government take extra steps to ensure that overruns occur only in emergency situations and that last-minute spending freezes would not be needed. The Minister of Finance responded that he would

⁸ The Lesotho Petroleum Fund Board sets product prices so that the balance of the fund fluctuates by no more than M 4 million. The board was established in early 2001, and initially owing to teething problems, set prices below costs so that the fund was depleted. Procedures are now being changed to avoid future problems.

issue notices to all ministries reminding them that spending allocations would be binding. In addition, he would replenish the emergency contingency reserve for the remainder of the year with M 20 million to ensure that proper budget procedures would be followed should an urgent situation emerge.

30. **The remaining M 67 million (1 percent of GDP) in the supplementary budget has been earmarked for domestic capital spending.** This supplement targets roads and health-related infrastructure and is intended to replace some externally financed projects that were delayed and will not be completed in the current financial year. The staff agreed that these projects were in line with the government's objectives and would not raise capital spending above the original budget because of the even larger shortfalls foreseen in externally financed capital projects. Official representatives assured the staff team that regular procurement and monitoring procedures would be followed, and that some of the supplementary allocation might not be spent.

31. **These and other changes in the budget led to understandings that the domestic borrowing requirement for the 2001/02 financial year would be revised upward (implying a smaller debt repayment).** The revisions would also result in a projected overall deficit excluding grants of 4.3 percent of GDP (compared with the initial program deficit of 5.3 percent of GDP) and, at the same time, a projected domestic surplus of 1.5 percent of GDP (compared with 3.7 percent of GDP in the initial program).⁹ The authorities and the staff agreed that the fiscal policy goals of the program, namely, sustainable domestic debt and a nonexpansionary fiscal stance relative to 2000/01, had been preserved.

The 2002/03 budget

32. **The budget plan for 2002/03 was approved by the cabinet and submitted to parliament in late January; it was approved in late February 2002 before parliament was dissolved for the elections now scheduled for May 25.** The overall balance (excluding net lending) will be in line with the original medium-term program, and the domestic balance will improve somewhat relative to 2001/02. Some domestic financing would be required but would not jeopardize domestic debt sustainability. Accompanying structural measures are aimed at putting the transition to the LRA and VAT back on track and initiating the financial management component of the PSIRP. Both are key areas for achieving the fiscal medium-term objectives.

⁹ Exceptional factors are excluded. In 2001/02, these are the amortization of M 120 million in treasury bills used to recapitalize the old Lesotho Bank (a negative entry under net lending in the official budget presentation because earlier net lending is being reversed) and the unbudgeted M 73 million transfer from the Muela hydroelectric plant, which was collected from electricity sales over the past two years. These were excluded from fiscal balance measures because they are not recurrent income.

33. **Revenue in relation to GDP would fall by 1½ percentage points in 2002/03, despite an increase in sales and income taxes of 1¼ percentage points of GDP.** The transfer of customs collections from SACU is to rise by only 2 percent in nominal terms (and therefore to fall to 19 percent of GDP), reflecting a decline in Lesotho's share of the pool,¹⁰ and nontax revenue is projected to decline mainly because the central bank will stop paying interest on government deposits as of April 1 2002.¹¹ The authorities explained that the changeover to the LRA before the end of the financial year (see paragraph 38) would boost collection efficiency by easing staff shortages and bolstering moral. In addition, sales tax collections would be enhanced as a result of a contract with Crown Agents to assist at key border posts. The staff team, while agreeing that both developments would help strengthen collections, noted that revenues could fall short of expectations if the opening of the LRA were delayed or if economic growth slowed more than anticipated.

34. **The staff welcomed the government's efforts to hold down overall current spending while providing additional resources in priority social areas.**¹² The education budget has been increased by 20 percent, in part to fund the expansion of free primary education and in accordance with the government's emphasis on human resource development, and provisions for election costs have been raised. Health spending has been increased by 8 percent. The rise targets immunization and mother and child health care. Budgeted defense outlays have been reduced relative to 2001/02, and the number of new embassies planned for 2002/03 has been scaled back from five to three. Provisions for transfers and subsidies have been increased by about ¾ of 1 percent of GDP, owing to the reclassification of some items from goods and services. Transfers are mainly composed of education and scholarships (approximately one-half of the total), pensions, and transfers to private health care operations.

35. **Public employees would be granted an 8 percent pay rise in 2002/03.** The adjustment was justified on the basis of declining real wages over the past two years and

¹⁰ SACU payments are based on collections with lags of two years. Therefore, the rise in customs revenue that normally would be associated with a currency depreciation will not affect Lesotho until the 2004/05 fiscal year. The actual rise will depend on Lesotho's share of the pool and the transition provisions in the new sharing system.

¹¹ The new central bank law prohibits interest payments on government deposits. At the time the budget was submitted, the central bank and the government had not yet completed discussions on how this prohibition, as well as the cost of treasury bills for monetary policy options, would affect central bank profits and transfers to the government.

¹² The exchange rate depreciation will make this accomplishment all the more difficult. Budget estimates assumed an exchange rate of M 10.3 per U.S. dollar, the rate prevailing on November 30, 2001. The exchange rate was M 11.4 per U.S. dollar on January 31, 2001.

growing vacancies in the public service, especially in higher-skill areas. The resulting wage bill will, however, be smaller than the initial budget estimate for 2001/02 as a share of GDP. Moreover, the authorities explained that, as the wage vote was typically underspent because vacancies went unfilled during the year, the actual wage bill should decline as a share of GDP. Plans to introduce in the next budget performance-related pay adjustments that would help ease recruitment problems are discussed in paragraph 40 below.

36. **Capital spending is projected to rise by 28 percent, or 1½ percentage points of GDP in 2002/03, compared with revised estimates of the outturn for 2001/02.** The emphasis would be not only on infrastructure spending including roads and schools, but also on privatization and reform of the utility sector¹³. The staff team again acknowledged that the planned spending matched government priorities, but noted that actual capital spending had fallen well below plan in recent years and that this bias in expenditure estimates had contributed to uncertainties in interpreting the fiscal stance. For example, assuming that about 80 percent of planned capital spending actually occurs—the approximate implementation rate in 2001/02—the overall balance, excluding grants, would show a fiscal expansion of about ½ of 1 percentage point of GDP (compared with an expansion of nearly 2 percentage points under the budget assumption of full implementation).

37. **The staff team, therefore, recommended that the domestic balance measure of fiscal policy also be used in assessing fiscal policy** (see Appendix VI). This measure is not affected by ambitious estimates of externally financed capital projects and their financing flows. In addition, it gives an indication of the government's absorption of domestic resources, important when considering potential inflationary pressure, because capital projects are import intensive. The authorities said that they would consider the domestic balance measure as a possible operational objective for fiscal policy.

Structural measures supporting fiscal policies

38. **The authorities indicated that the opening of the LRA would need to be delayed until end-December 2002 for practical considerations.** They explained that significant progress had been made in setting up the LRA, but the recruitment of an experienced Commissioner General was taking longer than expected. The government was now working with the U.K. Department for International Development (DFID) on the search process and indicated that it might not be until July 2002 that a suitable candidate could be appointed. It could then take an additional six months for the new Commissioner General to put in place the senior staff and modify the implementation plan if necessary. The VAT would then be implemented after the LRA became operational. The staff, while concerned with the delay in implementing this performance criterion, accepted the revised timetable as practical and

¹³ The project to privatize utilities is funded in part by a World Bank loan and is considered a capital expenditure.

prudent. It underscored the importance of the interim revenue measures outlined in paragraph 33.

39. **The authorities indicated that the government would undertake several concurrent steps to address the problem of weak financial management, which had contributed to the backlog of unaudited public accounts and the observed difficulties in budget execution** (Box 3). First, the Ministry of Finance would develop, with IMF and other donor technical assistance, a plan to eliminate the backlog of unaudited accounts.¹⁴ Second, it would recruit an experienced Accountant General and establish a plan to strengthen the Accountant General's office in the near term. Third, the government would begin the financial management component of the PSIRP without waiting for the full project to get under way. Donors have indicated support for these initiatives and in some cases have already committed financial assistance. In particular, the IMF technical assistance mission is now scheduled for early April, and work has started on recruiting the Accountant General. Thus, the authorities have been striving to make up for time lost in the PSIRP delay.

40. **The authorities announced that performance-related pay for public employees would be introduced in 2003/04.** Preliminary steps, including performance reviews, had already begun at the time of the discussions, and the government intends to have a full plan in place by July 2002, in time for the next budget round.

C. Monetary and Financial Sector Policies

41. **With the successful introduction of the treasury bill auction, monetary policy aims to hold reserve money in a M 200-M 250 million range in the near term,** implying a decrease of 5 percent of GDP from 2000. This operating target is consistent with government budget and expected balance of payments flows, and with the overriding constraint of the pegged exchange rate arrangement. Broad money is programmed to grow slowly over the next few quarters, below nominal GDP growth, reflecting the current lending climate, but this growth projected to pick up later on as planned improvements in the financial sector lower lending risks and the costs of bad loan recovery. Foreign reserves are programmed to remain above seven months of imports through September 2002. This level implies that central bank reserves will be more than three times greater than narrow money.

42. **The primary objectives of financial structural policies will be to broaden access to loan and deposit opportunities for small and medium-sized firms and investors, to**

¹⁴ Attempts to bring the accounts up to date by using domestic resources were not successful because professional opinion indicated that it would be necessary to complete the accounts sequentially from 1994/95 onward. IMF technical assistance scheduled for March will assess how best to accomplish this task and, with the government and other donors, form a plan to do so. The benchmark will be reset pending this advice.

improve the efficiency of the financial system, and maintain bank soundness. To accomplish these objectives, Governor Matekane indicated that the central bank would first complete a study on the existing impediments in the financial system and ways to remove them. The bank has already identified the international payments system, a secondary market for treasury bills, greater competition for deposits, and a modernized legal framework for securities as areas that will be addressed in the overall plan. Liberalization of the capital account will also be included, but will be phased in slowly. While the plan is being formulated, the bank will continue to improve the auction system and other aspects of indirect monetary control, for example, by improving information provided to the market and making the Lombard facility operational. The staff team agreed with the approach outlined by Governor Matekane and observed that it would be important to develop an integrated medium-term strategy, especially when considering capital and exchange market liberalization.

D. Other Issues

43. **Although Lesotho's data are adequate for surveillance and for program monitoring, there is room for improvement.** Recent progress with data issues includes improved central bank monetary reports and participation in the regional effort to move toward the General Data Dissemination System. The staff did, however, observe potential inconsistencies in trade, balance of payments, and production data that were related to a possible underreporting of clothing and textile production and exports. It also observed that the timeliness of the collection of the government's budget data and the reconciliation of that data with monetary accounts could be improved. The provision of reserves, foreign currency liquidity, and external debt data is adequate and improving. However, some further progress in these three areas would be welcome.

44. **The Central Bank of Lesotho has prepared a timetable for the implementation of the recommendations identified in the Stage One safeguards assessment, which was completed on July 2, 2001.** To address the most urgent remedial measures identified in the safeguards report and to meet its commitment for the second review of the arrangement with the IMF, the central bank has appointed external consultants to prepare a financial reporting template that will ensure compliance with International Accounting Standards (IAS). The authorities are committed to strengthening the audit process and have instituted an audit committee. In addition, the external consultants will assist the bank in enhancing its data reconciliation procedures to ensure the integrity of reserves data reported to the IMF.

IV. EXTERNAL FINANCING

45. **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. Foreign direct investment is expected to remain broadly constant over the medium term. The Fund disbursed SDR 3.5 million on July 27, 2001, and total proposed Fund financing over the three-year PRGF arrangement

totals SDR 24.5 million (Table 10). Debt-service payments to the Fund are projected to decline from 2 percent of exports of goods and nonfactor services in 2000/01 to ½ of 1 percent in 2006/07 (Table 11).

V. STAFF APPRAISAL

46. **The macroeconomic situation has improved significantly since the 1998-99 recession.** Economic growth has been restored to just under 3 percent in 2001/02, while consumer price inflation fell to 7 percent in December 2001. The slowdown in the global economy and the recent depreciation of the South African rand will, however, delay a further increase in economic growth and raise inflation to about 8½ percent in 2002/03. A sharp improvement in the current account deficit starting in 2001/02 is expected, in part owing to a surge in exports to the United States under the African Growth Opportunity Act (AGOA).

47. **The staff welcomes the government's strong efforts to implement its economic program.** For 2001/02, government domestic borrowing is projected to be eliminated, so that the government would be fully financed by external grants and concessional loans. The 2002/03 economic program incorporates some domestic financing, in part because of higher spending on priority areas such as education, but this should not jeopardize domestic debt sustainability or cause domestic overheating. Overall, the staff team is encouraged to see that current spending is not projected to rise relative to GDP.

48. **The government is working hard to improve tax administration and make the Lesotho Revenue Authority (LRA) operational by end-December 2002.** The staff team encouraged them to work carefully to ensure a solid foundation for what would become an important institution. Regrettably, the replacement of the sales tax with a VAT also has been postponed as it is linked to the creation of the new tax authority. The staff recognizes that this delay in implementing the performance criterion is unavoidable and welcomes the government's plan to enlist a private firm to bolster sales tax collections at border posts in the interim period. It recommends that the authorities' request for a waiver be approved on the basis of progress to date.

49. **The staff welcomes the government's commitment to strengthen financial management.** The authorities should be commended for the improvements already seen in the budget process, including the timely presentation of the 2002/03 budget to parliament and the delivery of a budget speech that matched policies with priorities while taking into account realistic financial constraints. The Minister of Finance has also taken steps to eliminate spending overruns, for example by encouraging ministries to take responsibility for their vehicle lease costs. The authorities should be commended further for near-term plans to clear the backlog of unaudited accounts and build capacity in the Account General's office by recruiting an experienced Accountant General and providing staff training. Donor support for these efforts will be critical. Finally, the staff endorses the government's commitment to the Lesotho Public Sector Improvement and Reform Project and its efforts, supported by the donor community, to jumpstart the financial management component.

50. **Monetary policy is anchored by Lesotho's membership in the Common Monetary Area and the exchange rate peg to the rand.** This arrangement has served Lesotho well, and the staff team supports its continuation. Lesotho's exports will remain competitive, provided much of the recent currency depreciation can be maintained in real terms.

51. **The Central Bank of Lesotho successfully introduced in September 2001 a treasury bill auction for monetary policy purposes.** With this success, the transition to indirect monetary policy instruments is nearly complete, and the staff encourages the central bank to improve the system over the next few months, for example by reporting auction results on a timely basis and beginning the operation of the Lombard facility. The staff welcomes the central bank's plans to develop an integrated strategy for further strengthening Lesotho's financial markets. It agrees with the overall objectives of providing an environment in which financial institutions will offer competitive rates of return for savers, as well as loans to small and medium-sized businesses. The central bank's gradual approach toward capital account liberalization is appropriate, and its prompt response to the IMF safeguards assessment is encouraging.

52. **Lesotho's data are adequate for Article IV surveillance and program monitoring consultation discussions.** The government's participation in the regional effort to strengthen data collection and eventually comply with the GDDS is to be commended, and the staff hopes progress can be made in the near future in strengthening balance of payments and output data and their consistency. In addition, the authorities' efforts to improve data and information sharing across government ministries and between the government and the central bank are welcome.

53. **The overall approach to fiscal, monetary, and structural policies being pursued by the government and the central bank will strengthen Lesotho's medium-term economic prospects.** The authorities are clearly committed to a sound macroeconomic environment, the privatization program, market-friendly financial policies, and public sector reform. The staff also recognizes the government's increasing awareness of HIV/AIDS, but it believes that more could be done to prevent the further spread of the disease.

54. **The staff recommends completion of the second review and approval of the waiver for the nonobservance of the performance criterion relating to the Lesotho Revenue Authority for end-September.**

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

Box 1. Structural Measures

Status of structural measures

All structural measures under the staff-monitored program (January-September 2000) were met. Most structural targets for the period April 2001-September 2001 were met (Table 8). The Lesotho Revenue Authority did not become operational (performance criterion for September 2001), and the 2000/01 accounts were not presented for audit (a benchmark for October 2001). Steps are being taken to address these delays. Completion of the public expenditure review remains on hold pending the start of the Public Sector Improvement and Reform Project (PSIRP) in the second half of 2002.

Coverage of structural conditionality in the current program

Structural measures are listed in Table 8 of the staff report and Table 2 of the memorandum on economic and financial policies. The most important include the following:

- improving tax administration, including establishing a national revenue authority, is part of the program to boost tax revenue and to create a level playing field for all taxpayers and appointing an experienced commissioner general is now an explicit condition;
- strengthening expenditure management is a critical first step in bringing down Lesotho's high level of government spending and strengthening budget reporting and debt statistics is a critical part of this step;
- moving ahead with the PSIRP—it will begin to address problems with expenditure management and help prepare the public accounts for audit; and
- planning the next steps for financial sector reform, which will ensure a coordinated approach to financial market development.

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 early 2002. Structural benchmarks in the IMF-supported program are intended to be complements to the 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, in this context, pertaining to commercial law and property rights.

The Privatization Unit of the Ministry of Finance is working to privatize Lesotho's electric utility.

Box 2. Regional and Bilateral Trade Developments

Multilateral issues

A new Southern Africa Customs Union (SACU) agreement further broadening and liberalizing the trade regime of member countries was initiated in October 2001 but has not been ratified by member parliaments. The new agreement proposes (a) the establishment of institutional structures for policy, administration, and dispute resolutions; (b) the design of common policies focusing on industrial development, competition, and unfair trade practices; and (c) a new revenue-sharing formula for the apportioning of SACU revenue.¹

A proposal to phase out by 2004 quantitative restrictions, primarily on beer, dairy products, poultry, bread, and vegetables is being considered. While committed to trade liberalization, the authorities felt that this time frame was not sufficient to allow these industries to develop and sustain competition from the larger and more technologically advanced South African producers. Additionally, the authorities noted that dumping by South African distributors of subsidized and duty-free wheat and flour imported under the European Union (EU)-South Africa Free Trade Agreement compounded the problem. The authorities viewed this arrangement as a threat to their ability to compete and inconsistent with the intent of the common external tariff in SACU.

Slow progress has been made under the SADC to further reduce tariff levels. As of November 2001, Angola, the Democratic Republic of Congo, and Seychelles had not submitted their Instruments of Implementation of the Trade Protocol. However, negotiations were ongoing to establish fair rules of origin to facilitate intra-SADC trade. The rules of origin under consideration limit the proportion of import content in production to at most 60 percent, for preferential access of products from the textiles, electronics, and machinery industries to SADC markets.

Bilateral arrangement

The government continues to exploit trading initiatives consistent with its export-led strategy for growth. Most notably was the signing in April of the African Growth and Opportunity Act (AGOA) with the United States. This initiative has provided a boost to the exports of Lesotho's textile sector, which by September² had recorded a 54 percent increase over the comparable period in 2000. The value of textiles exported under AGOA was US\$67 million, or 43 percent of textile exports. Export growth is expected to continue because the depreciation of the rand increases Lesotho's competitiveness. The events of September 11 and the slowing of the U.S. economy did not result in a cancellation of orders and is not expected to have an adverse impact on the economy in the short term.

Prospects for exploiting the African, Caribbean, and Pacific (ACP) Cotonou Agreement for further industrial development are limited because of restrictive rules of origin and capacity constraints. The rules of origin in the agreement limit access to the EU to products fully produced within Lesotho or with inputs from ACP countries and South Africa.

¹This links payments to customs and excise duties collected in the common revenue pool. Customs duties will be distributed among members according to their share of intra-SACU imports, excluding reexports. Excise duties will be split into two components: 85 percent will be shared according to each member's share of total SACU GDP, and the remaining 15 percent will form a development component that will be distributed in reverse correlation to the member's GDP per capita.

²According to data provided by the U.S. International Trade Commission.

Box 3. Problems with Public Accounting and Information Systems¹

There are a number of areas in which public accounting and information systems could be improved:

- There is a general lack of central control, and timely and comprehensive budget reporting. Accounting practices, and revenue and expenditure forecasting are sometimes weak. Spending controls are not always applied.
- GOLFIS (the Government of Lesotho Financial and Information System) is a computerized accounting system. It is not fully operational and does not interact adequately with other systems used, for example the debt-management system at the Ministry of Finance and the government's payroll and employment systems.
- Within GOLFIS, there is incomplete coverage of spending, unrecorded foreign aid flows, and misclassification of some spending categories.
- The Ministry of Finance and Planning has a fragmented structure, and there is poor communication between departments.

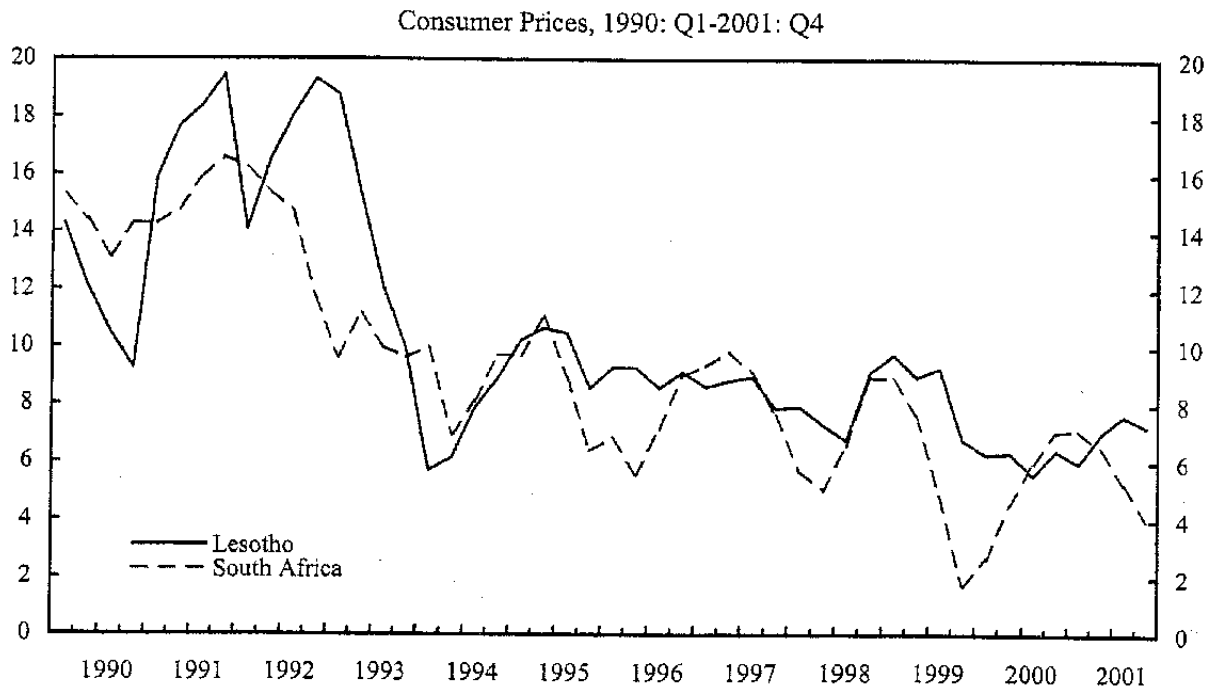
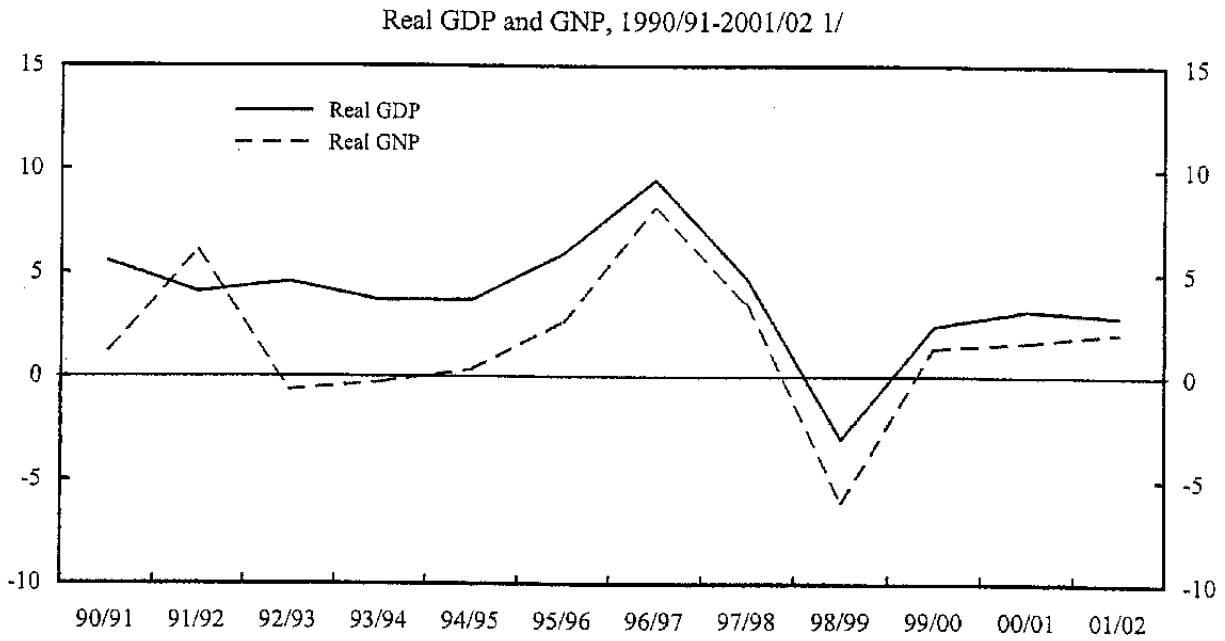
These shortcomings have contributed to the following monitoring and control problems:

- The Treasury does not produce summary consolidated reports.
- The Ministry of Finance and Planning does not produce final fiscal data, only provisional data, and government accounts have not been audited since 1994/95 (April-March).
- Expenditure monitoring is difficult. For example, total spending on a monthly basis is estimated from central bank deposits (domestic financing) and receipts. This practice demonstrates the government's weak control over current spending.

The Ministry of Finance and Planning has begun to tackle some of these problems. Below-the-line accounts have been eliminated, and some off-budget operations will be brought onto the budget in the 2002/03 financial year. Ultimately, these problems will be addressed by the financial management component of the Public Sector Improvement and Reform Project (PSIRP).

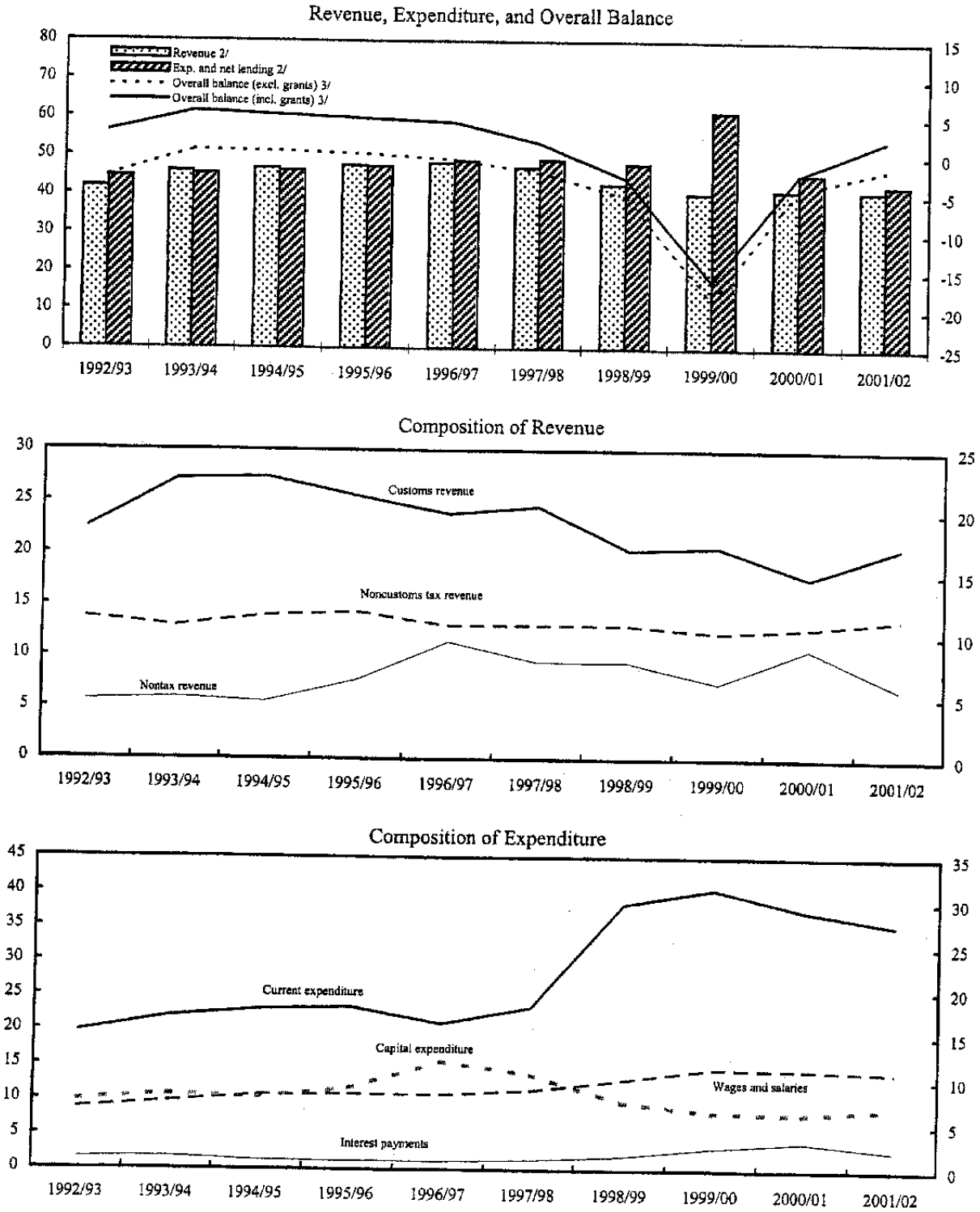
¹This box is based on the World Bank's "Public Expenditure and Budget Management Review of Lesotho" (1999).

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



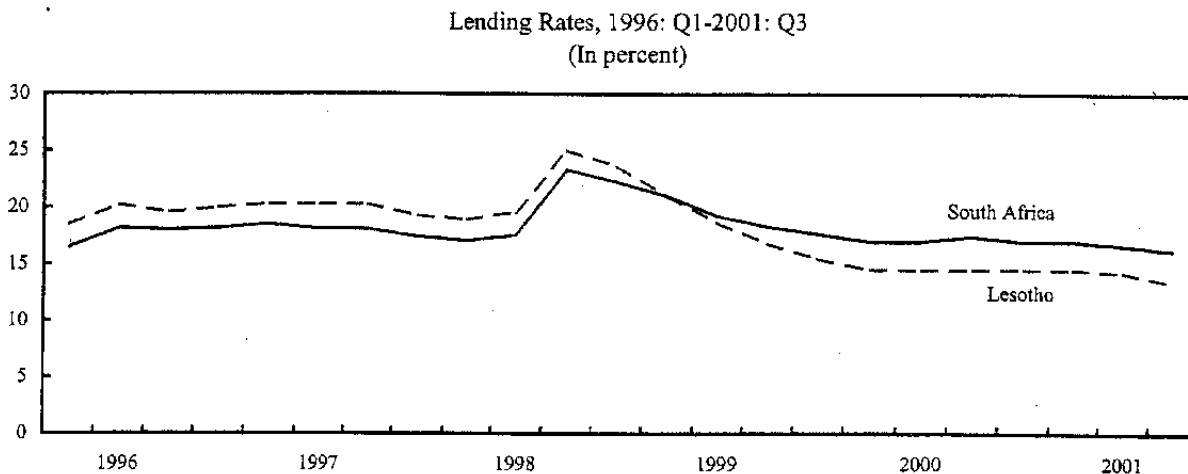
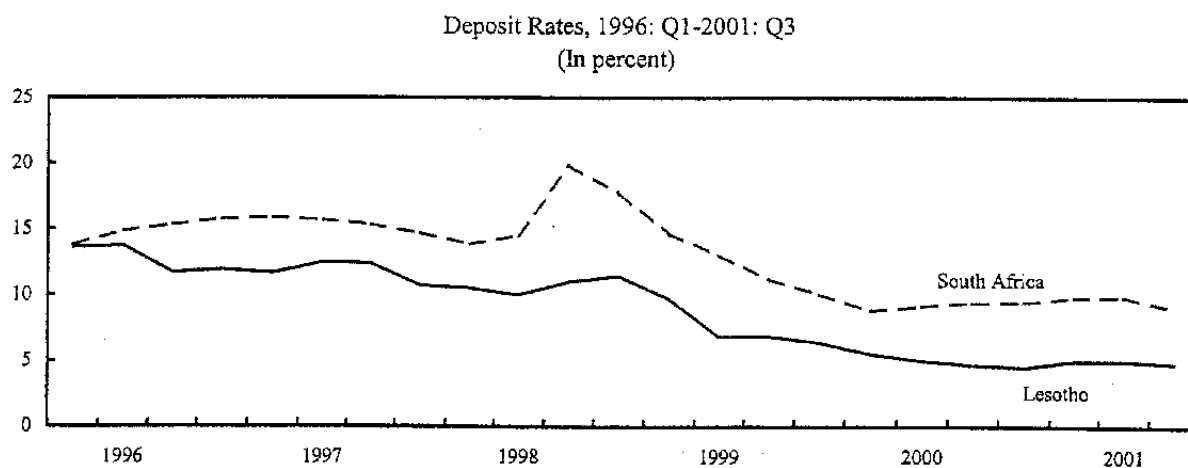
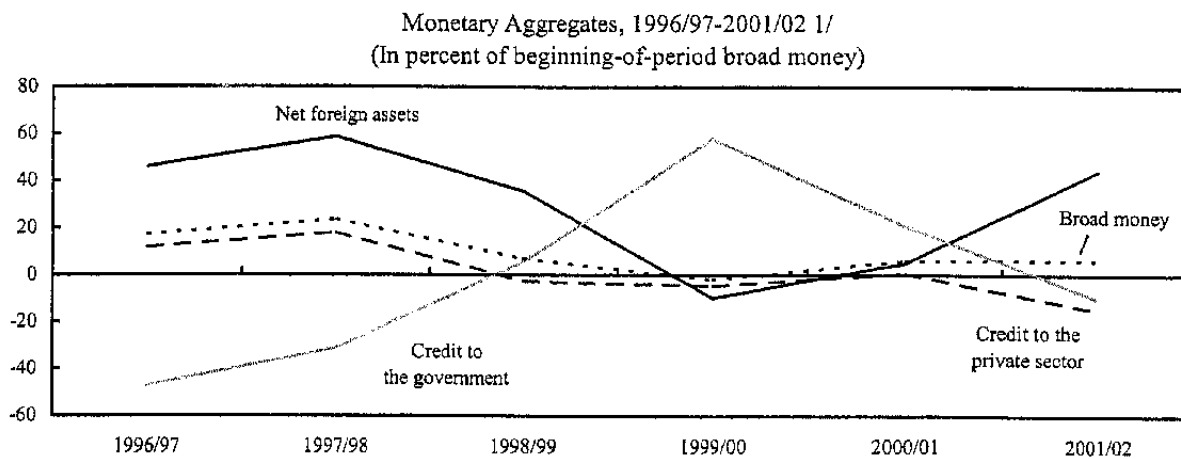
Sources: Lesotho authorities; and Fund staff estimates.
1/ Fiscal year begins April 1.

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



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

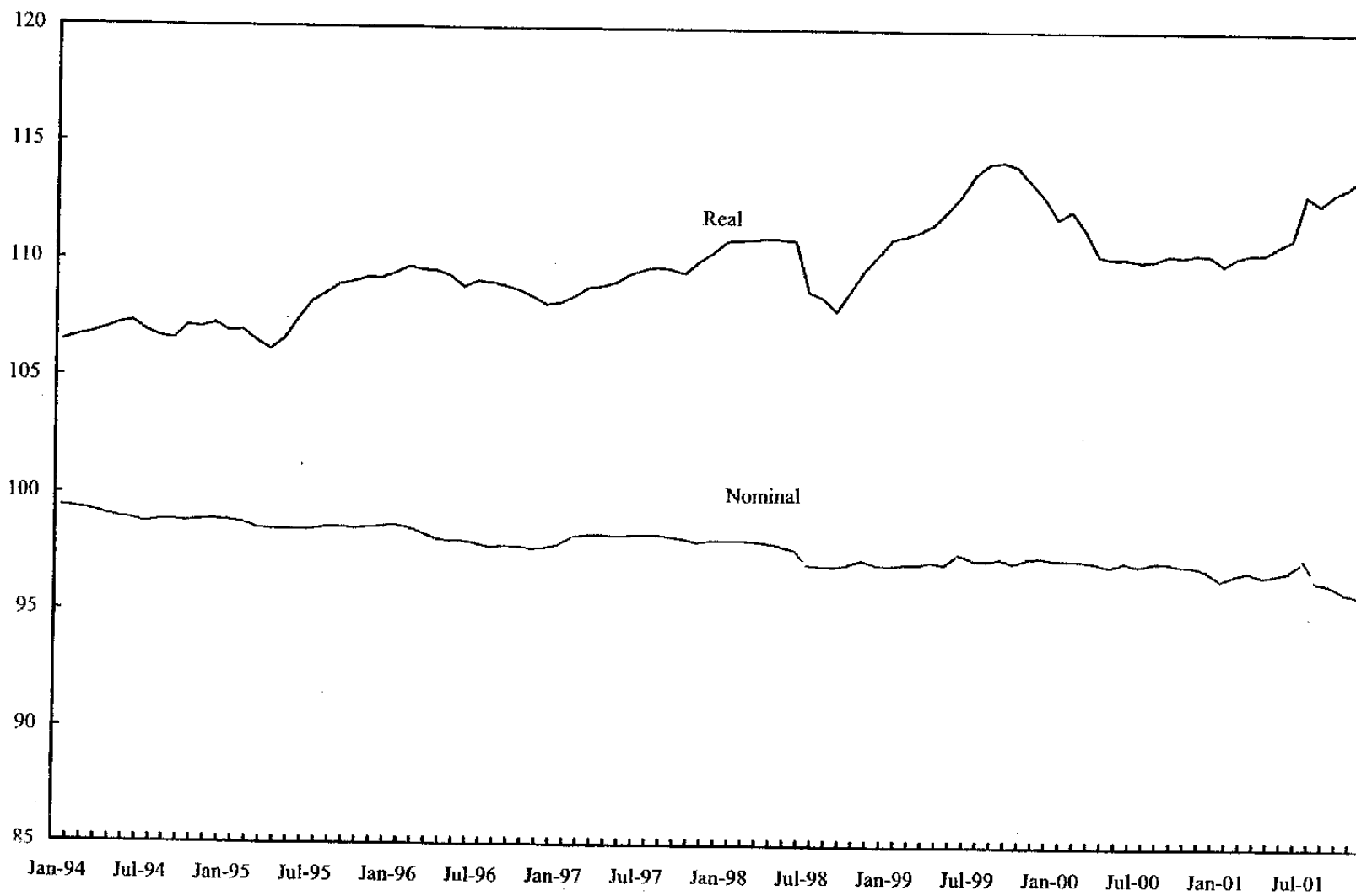
Figure 3. Lesotho: Monetary Developments



Sources: Lesotho authorities; and IMF, *International Financial Statistics*.

1/ Fiscal year begins April.

Figure 4. Lesotho: Effective Exchange Rates, January 1994 - November 2001
(Index, 1990=100)



Source: IMF, Information Notice System.

Table 1. Lesotho: Selected Economic and Financial Indicators, 1999/2000-2007/08 1/

	1999/00	2000/01	2001/02		2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	Act.	Act.	Prog.	Rev. Prog.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise specified)										
National income and prices										
Real GDP	2.4	3.2	3.1	2.9	2.8	3.5	3.9	4.0	4.1	4.1
Real GNP	1.4	1.7	2.8	2.1	1.3	3.4	2.5	3.7	3.6	3.8
Consumer price index (end of period)	6.3	7.0	6.1	7.8	8.4	6.4	5.9	5.4	4.9	4.5
Nominal GDP (in millions of maloti)	5,733.4	6,377.2	6,866.5	6,975.1	7,733.0	8,582.1	9,464.3	10,386.9	11,350.4	12,352.5
Nominal GNP (in millions of maloti)	7,247.7	7,941.0	8,541.7	8,619.1	9,412.0	10,435.8	11,353.3	12,429.8	13,519.9	14,676.8
External sector 2/										
Exports, f.o.b.	4.3	39.7	14.8	38.8	15.6	8.7	9.7	9.3	9.2	10.2
Imports, f.o.b.	8.1	5.2	8.2	7.4	6.7	5.8	8.1	7.0	6.7	7.8
Net labor income	8.7	4.7	3.7	0.8	-1.0	7.8	-1.7	11.1	9.5	12.0
Real effective exchange rate 3/	0.5	-13.6	...	...	...	...	...	...	...	...
Government budget										
Revenue (excluding grants)	6.4	13.6	9.8	9.1	5.9	12.2	8.9	7.8	8.8	8.2
Total expenditure and net lending	38.3	-14.1	12.2	2.6	10.8	11.0	8.1	7.8	7.8	5.3
Current expenditure	19.3	2.8	3.2	3.5	11.1	11.1	6.4	6.8	7.2	7.1
Capital expenditure and net lending	112.8	-51.2	53.9	-1.5	9.9	10.9	13.8	11.1	9.5	0.0
Money and credit 4/										
Net foreign assets	-9.8	5.1	-7.9	41.3	-11.1	0.9	3.1	2.5	11.7	11.5
Net domestic assets	7.7	1.1	12.8	-29.7	21.2	7.6	4.9	5.1	-4.1	-4.3
Credit to the government	57.9	20.9	-26.8	-10.1	2.3	-4.2	-4.2	-5.0	-8.0	0.0
Credit to the rest of the economy	-4.6	0.7	-16.4	1.3	10.2	6.5	6.2	7.4	2.0	-6.7
Broad money	-2.1	6.1	4.9	11.6	10.1	8.6	8.1	7.6	7.6	7.2
Velocity (GDP/average broad money)	3.3	3.9	3.8	3.6	3.6	3.7	3.7	3.8	3.9	3.9
(In percent of GDP, unless otherwise specified)										
Investment and saving 5/										
Investment	35.2	33.5	34.1	32.3	32.5	31.9	31.9	33.4	33.6	32.8
Public	8.4	8.1	11.6	9.9	9.8	9.0	8.8	10.4	10.6	9.8
Private	14.7	15.2	15.6	15.6	16.1	16.6	17.1	17.5	18.0	18.5
Lesotho Highlands Water Project	12.1	10.3	6.9	6.8	6.6	6.3	6.0	5.5	5.0	4.6
Gross national savings (including remittances)	12.8	16.9	19.9	24.9	26.5	28.3	27.4	29.9	31.1	30.9
Public	2.2	5.8	11.7	9.4	9.3	8.7	9.6	9.9	10.3	10.2
Private	10.7	11.1	8.2	15.5	17.2	19.6	17.8	20.0	20.8	20.7
Government budget										
Revenue	40.3	41.2	42.0	41.1	39.5	39.9	39.4	38.7	38.5	38.3
Total grants	2.3	2.0	5.5	3.7	5.1	4.1	4.3	4.3	4.3	3.9
Total expenditure and net lending	61.6	45.4	47.3	42.6	45.4	45.5	44.6	43.8	43.2	41.8
Overall balance (before grants)	-18.5	-4.3	-5.3	-1.5	-5.9	-5.5	-5.1	-5.0	-4.6	-3.5
Overall balance (after grants)	-16.2	-2.3	0.2	2.2	-0.8	-1.5	-0.8	-0.7	-0.4	0.5
Domestic balance	-2.7	1.4	3.7	1.5	1.7	2.2	2.9	3.0	3.3	3.3
Primary balance	-13.0	1.8	3.4	5.0	1.9	2.0	2.0	1.6	1.6	2.2
Gross government domestic debt	15.2	11.9	22.6	15.9	14.9	13.5	10.4	9.5	8.7	8.0
External sector										
Current account balance (excluding official transfers)	-35.0	-31.1	-31.7	-23.9	-21.3	-18.4	-18.7	-17.2	-16.1	-15.3
Current account balance (including official transfers)	-22.4	-16.6	-14.2	-7.4	-6.0	-3.6	-4.4	-3.5	-2.6	-2.0
Stock of public external debt	67.8	62.8	75.6	72.7	75.0	70.9	67.9	65.1	62.4	59.5
Debt-service ratio 6/	8.1	13.2	8.4	7.5	7.6	6.8	6.5	5.9	5.4	4.9
Net present value of total public external debt	...	42.7	38.5	48.5	49.4	44.1	39.3	34.7	30.7	27.1
(In millions of U.S. dollars, unless otherwise specified)										
Gross official reserves (end of period)	470.1	393.4	350.6	381.7	360.3	366.5	369.7	372.0	399.7	429.5
Gross official reserves (in months of imports of goods and services)	7.5	7.4	5.7	7.6	6.9	6.6	6.3	6.0	6.0	6.0

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

1/ Fiscal year beginning in April.

2/ In maloti.

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

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

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

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

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

	1998/99	1999/00	2000/01		2001/02		2002/03 Proj.	2003/04 Proj.	2004/05 Proj.	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.
			Prog.	Act.	Prog.	Rev.Prog.						
Trade balance	-589.9	-608.0	-487.5	-483.6	-458.2	-353.6	-316.3	-321.9	-338.5	-351.3	-363.6	-382.6
Exports, f.o.b.	191.5	188.4	199.7	221.6	210.0	241.8	248.8	266.0	287.2	310.1	335.3	368.7
Imports, f.o.b.	-781.4	-796.4	-687.1	-705.2	-668.1	-595.4	-565.1	-587.9	-625.7	-661.4	-698.9	-751.2
Services (net)	-11.1	-1.8	-4.7	-3.0	-4.7	-4.6	-4.1	-3.0	-2.6	-1.5	-0.6	0.1
Receipts	39.9	45.6	41.7	41.4	38.0	34.1	33.0	35.7	38.0	41.3	44.4	48.2
<i>Of which: water royalties (and power sales)</i>	13.2	13.0	12.1	12.3	11.6	10.2	9.8	10.6	11.5	12.5	13.3	14.4
Payments	-51.0	-47.4	-46.4	-44.4	-42.7	-38.7	-37.1	-38.6	-40.7	-42.8	-45.1	-48.2
Income (net)	242.6	245.7	207.3	213.6	200.3	176.6	160.4	174.1	174.8	186.7	196.2	209.7
Labor income (net)	238.6	244.7	208.0	215.7	195.7	171.0	150.7	159.7	154.6	157.5	161.0	165.8
Receipts	284.5	278.2	229.8	243.2	225.0	197.3	181.7	184.7	187.9	191.8	196.2	202.4
<i>Of which: miners' wages</i>	231.1	224.0	181.3	193.7	177.6	155.0	141.2	142.3	143.4	145.2	147.3	150.6
Payments	-45.9	-33.5	-21.8	-27.6	-29.3	-26.3	-31.1	-25.0	-33.4	-34.3	-35.3	-36.6
Investment income (net)	4.0	1.0	-0.6	-2.1	4.6	5.6	9.8	14.4	20.2	29.1	35.3	43.9
Receipts	64.8	44.1	34.8	34.0	37.0	33.7	35.1	40.4	45.9	54.3	60.1	68.7
Payments	-60.8	-43.1	-35.4	-36.0	-32.4	-28.1	-25.3	-26.0	-25.7	-25.2	-24.9	-24.7
<i>Of which: interest on debt</i>	-17.8	-17.4	-21.2	-20.5	-15.4	-12.8	-11.3	-11.8	-11.1	-10.2	-9.4	-8.7
Unrequited transfers	139.5	155.9	128.0	128.3	146.4	126.5	115.6	121.6	127.5	133.0	141.7	150.9
Official	136.9	153.9	125.1	125.8	143.9	124.1	113.2	119.2	125.0	130.5	139.1	148.3
Southern African Customs Union nonduty receipts	115.2	135.7	109.8	109.4	122.3	109.8	99.8	105.4	110.7	115.7	123.8	132.2
Rand compensation	10.0	10.1	8.9	9.0	8.4	7.5	7.0	7.1	7.2	7.3	7.5	7.7
Other	11.6	8.1	6.5	7.5	13.3	6.8	6.4	6.7	7.0	7.4	7.9	8.4
Private	2.7	2.1	2.9	2.4	2.4	2.4	2.4	2.4	2.5	2.5	2.6	2.7
Current account (including official transfers)	-218.9	-208.2	-156.8	-144.7	-116.2	-55.1	-44.4	-29.1	-38.9	-33.1	-26.3	-21.8
Current account (excluding LHWP 2/)	36.1	-133.5	-224.6	-95.7	-229.9	-9.4	-21.1	-12.7	-20.2	-22.7	-19.8	-15.5
Capital and financial account	253.9	214.6	153.8	179.4	116.2	55.1	44.5	29.1	38.9	33.2	26.2	21.8
Capital account (transfers received)	16.4	21.1	21.9	18.7	30.9	17.3	28.1	22.5	26.8	29.2	31.2	31.1
<i>Of which: LHWP 2/</i>	2.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2
Financial account	237.5	193.5	131.8	160.7	85.2	37.8	16.3	6.6	12.1	3.9	-5.0	-9.3
Direct investment	217.0	153.9	98.2	119.7	97.8	106.2	83.0	69.9	93.0	52.2	69.8	70.3
Other investment	-16.4	-42.7	-23.6	-38.5	-43.7	-81.6	-90.1	-57.1	-77.7	-46.0	-47.1	-49.9
Assets	18.3	-30.7	8.9	2.0	2.4	5.8	-4.1	-4.1	-3.9	-3.8	-3.9	-3.8
Liabilities	-34.7	-12.0	-32.5	-40.4	-46.0	-87.5	-85.9	-53.0	-73.8	-42.2	-43.1	-46.1
Loans	5.7	-12.9	-25.7	-30.4	-53.7	-76.9	-81.4	-44.8	-74.0	-42.5	-43.4	-46.3
General government	5.8	-12.7	-25.5	-30.0	16.1	-2.1	7.6	19.2	22.6	23.3	23.0	23.0
Disbursements	26.1	15.0	27.8	20.8	43.7	24.9	34.3	43.5	47.9	48.4	47.7	48.1
Repayments	-20.3	-27.7	-53.3	-50.8	-27.6	-27.0	-26.7	-24.2	-25.3	-25.1	-24.8	-25.1
Private (net)	-0.1	-0.2	-0.2	-0.4	-69.8	-74.8	-89.0	-64.0	-96.6	-65.8	-66.4	-69.3
Other liabilities	-40.4	0.9	-6.8	-10.0	7.6	-10.5	-4.6	-8.2	0.3	0.3	0.3	0.3
CBL liabilities	-10.0	4.2	-1.7	-5.3	7.2	-6.9	-4.6	-8.2	0.3	0.3	0.3	0.3
Commercial banks' liabilities	-30.4	-3.3	-5.2	-4.7	0.4	-3.6	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserve assets 3/	37.0	82.3	22.8	79.4	31.1	13.3	21.4	-6.2	-3.2	-2.3	-27.7	-29.8
Errors and omissions	-35.1	-6.4	3.0	-34.6	0.0	0	0	0	0	0	0	0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	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/ Transaction-based data, excluding the effects of exchange rate changes; a minus sign indicates an increase in reserves.

Table 3. Lesotho: Central Government Operations, Annual, 1999/2000-2003/04 1/

	1999/00	2000/01		2001/02		2002/03	2003/04
	Act.	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Proj.
	(In millions of maloti)						
Revenue	2,312.8	2,505.8	2,626.6	2,884.5	2,864.9	3,053.6	3,425.2
Tax revenue	1,888.8	1,892.8	1,941.9	2,394.5	2,389.2	2,619.0	2,942.4
Customs revenue	1,183.1	1,126.2	1,126.1	1,438.2	1,438.2	1,470.0	1,578.4
Noncustoms tax revenue	705.7	766.6	815.8	956.3	951.0	1,149.0	1,364.1
Income taxes	419.5	436.0	468.8	529.9	579.1	710.6	851.7
Sales tax / value-added tax (VAT)	238.0	270.0	279.8	365.0	306.5	353.6	423.8
Petrol levy	43.6	56.0	62.0	58.0	52.0	74.7	77.3
Other tax revenues	4.6	4.6	5.2	3.4	13.4	10.1	11.2
Nontax revenue	424.0	613.0	684.7	490.0	475.7	434.6	482.7
Grants	130.0	208.8	125.6	377.7	257.6	394.4	350.0
Total expenditure and net lending	3,373.4	2,958.0	2,897.9	3,250.5	2,972.4	3,513.3	3,901.4
Current expenditure	2,318.5	2,403.8	2,382.6	2,457.2	2,464.8	2,728.9	3,031.4
Wages and salaries	835.9	925.0	921.8	1,006.6	984.7	1,103.9	1,200.6
Interest payments	183.4	257.7	259.4	222.4	198.9	214.2	296.4
External	101.6	142.7	148.3	126.9	118.0	117.2	123.6
Domestic	81.8	115.0	111.1	95.5	80.9	97.0	172.8
<i>Of which: bank restructuring</i>	45.0	65.0	33.0	57.2	44.8	47.0	45.6
Other expenditure	1,299.2	1,221.1	1,201.4	1,228.2	1,281.2	1,410.8	1,534.4
Goods and services	1,028.8	1,006.0	924.0	887.8	940.8	968.1	1,052.9
Transfers and subsidies	270.4	215.1	277.4	340.4	340.4	442.7	481.5
Capital expenditure	479.9	554.2	515.3	793.3	627.6	803.9	870.0
Domestically funded	250.0	280.0	275.0	297.0	337.0	310.0	330.0
Externally funded	229.9	274.2	240.3	496.3	290.6	493.9	540.0
Grant funded	130.0	159.8	125.6	258.7	161.2	294.4	240.0
Loan funded	99.9	114.4	114.7	237.6	129.4	199.5	300.0
<i>Of which: utility sector loans</i>	...	...	...	60.3	58.3	65.7	95.8
Net lending 2/	575.0	0.0	0.0	0.0	-120.0	-19.5	0.0
Overall balance before grants	-1,060.6	-452.2	-271.3	-366.0	-107.5	-459.7	-476.2
Excluding exceptional factors 3/	-485.6	-478.3	-297.4	-366.0	-300.5	-479.2	...
Overall balance after grants	-930.6	-243.4	-145.7	11.7	150.1	-65.3	-126.2
Excluding exceptional factors 3/	-355.6	-269.5	-171.8	11.7	-42.9	-84.8	...
Domestic balance 4/	-154.1	-35.3	91.2	257.2	108.1	131.9	187.4
Total financing	930.6	243.4	145.7	-11.7	-150.1	65.3	126.2
External financing	-70.9	-238.4	-221.9	76.8	-22.9	18.1	136.7
Loan drawings	99.9	149.4	149.9	307.6	213.7	294.2	394.7
Amortization	-170.8	-387.8	-371.8	-230.8	-236.6	276.1	257.9
Domestic financing	1,048.0	481.8	390.2	-88.5	-127.2	47.2	-10.6
Excluding net lending	473.0	481.8	390.2	-88.5	-7.2	66.7	-10.6
Bank	1,025.3	501.8	366.9	...	...	...	...
Nonbank	22.7	-20.0	23.3	...	...	...	...
Residual	-46.5	0.0	-22.6	0.0	0.0	0.0	0.0

Table 3. Lesotho: Central Government Operations, Annual, 1999/2000-2003/04 1/

	1999/00	2000/01		2001/02		2002/03	2003/04
	Act.	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Proj.
	(In percent of GDP, unless otherwise indicated)						
Revenue	40.3	40.4	41.2	42.0	41.1	39.5	39.9
Customs revenue	20.6	18.2	17.7	20.9	20.6	19.0	18.4
Noncustoms tax revenue	12.3	12.4	12.8	13.9	13.6	14.9	15.9
Nontax revenue	7.4	9.9	10.7	7.1	6.8	5.6	5.6
Grants	2.3	3.4	2.0	5.5	3.7	5.1	4.1
Total expenditure and net lending	58.8	47.7	45.4	47.3	42.6	45.4	45.5
Current expenditure	40.4	38.8	37.4	35.8	35.3	35.3	35.3
Wages and salaries	14.6	14.9	14.5	14.7	14.1	14.3	14.0
Interest payments	3.2	4.2	4.1	3.2	2.9	2.8	3.5
Other expenditure	22.7	19.7	18.8	17.9	18.4	18.2	17.9
Goods and services	17.9	16.2	14.5	12.9	13.5	12.5	12.3
Transfers and subsidies	4.7	3.5	4.3	5.0	4.9	5.7	5.6
Capital expenditure	8.4	8.9	8.1	11.6	9.0	10.4	10.1
Of which utility sector loan	...	...	...	0.9	0.8	0.8	1.1
Net lending 2/	10.0	0.0	0.0	0.0	-1.7	-0.3	0.0
Overall balance before grants	-18.5	-7.3	-4.3	-5.3	-1.5	-5.9	-5.5
Excluding exceptional factors 3/	-8.5	-7.7	-4.7	-5.3	-4.3	-6.2	...
Overall balance after grants	-16.2	-3.9	-2.3	0.2	2.2	-0.8	-1.5
Excluding exceptional factors 3/	-6.2	-4.3	-2.7	0.2	-0.6	-1.1	...
Domestic balance 4/	-2.7	-0.6	1.4	3.7	1.5	1.7	2.2
Total financing	16.2	3.9	2.3	-0.2	-2.2	0.8	1.5
Financing abroad	-1.2	-3.8	-3.5	1.1	-0.3	0.2	1.6
Domestic financing	18.3	7.8	6.1	-1.3	-1.8	0.6	-0.1
Excluding net lending	8.2	7.8	6.1	-1.3	-0.1	0.9	-0.1
Memorandum items:							
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)	7,247.7	7,706.4	7,941.0	8,541.7	8,619.1	9,412.0	10,435.8
GDP at current prices (in millions of maloti)	5,733.4	6,197.1	6,377.2	6,866.5	6,975.1	7,733.0	8,582.1

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 19.5 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 have been received for the amortization of M 120 million of the Lesotho Bank treasury bills, and an unbudgeted M 73 million from Muela transferred to government as revenue for the sale of electricity. In 2002/03, one-off funds will be received from parastatals for the repayment of M 19.5 million of loans.

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

Table 4. Lesotho: Central Government Operations, Quarterly, 2001/02-2002/03 1/

	2001/02 (Cumulative)				2002/03 (Cumulative)					
	Q1		Q2		Q3	Q4	Q1	Q2	Q3	Q4
	Prog.	Act.	Prog.	Act.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.
	(In millions of mautsi)									
Revenue	641.6	667.8	1,363.1	1,393.2	2,133.1	2,864.9	725.8	1,487.1	2,113.1	3,053.6
Tax revenue	538.9	583.7	1,154.3	1,227.8	1,794.2	2,389.2	601.8	1,285.6	1,826.3	2,619.0
Customs revenue	359.6	359.6	719.1	719.2	1,078.7	1,438.2	367.5	735.0	1,102.5	1,470.0
Noncustoms tax revenue	179.2	224.1	435.2	508.6	715.5	951.0	234.3	550.6	723.8	1,149.0
Income taxes	93.0	135.2	247.1	330.5	447.1	579.1	124.7	331.4	483.4	710.6
Sales tax / value-added tax (VAT)	73.0	74.6	160.0	147.0	219.5	306.5	88.4	176.8	176.8	353.6
Petrol levy	12.4	12.5	26.5	23.6	39.3	52.0	18.7	37.4	56.0	74.7
Other tax revenues	0.8	1.8	1.7	5.5	9.6	13.4	2.5	5.1	7.6	10.1
Nontax revenue	102.8	84.1	208.8	165.4	338.9	475.7	124.0	201.6	286.8	434.6
Grants	35.0	44.5	152.8	95.9	147.1	237.6	98.6	197.2	295.8	394.4
Total expenditure and net lending	744.2	395.2	1,580.3	1,228.5	2,080.8	2,852.4	861.5	1,741.2	2,507.5	3,493.8
Current expenditure	659.5	543.5	1,273.4	1,250.5	1,889.5	2,464.8	680.6	1,365.4	1,935.6	2,728.9
Wages and salaries	246.3	236.7	538.0	481.9	737.8	984.7	276.0	552.0	827.9	1,103.9
Interest payments	61.8	51.5	121.3	81.5	136.8	198.9	51.9	108.1	160.3	214.2
External	37.9	18.4	76.1	43.2	81.2	118.0	27.6	59.6	87.5	117.2
Domestic	23.9	33.1	45.2	38.3	55.6	80.9	24.3	48.5	72.8	97.0
<i>Of which: bank restructuring</i>	15.3	17.8	29.5	26.6	43.6	44.8	0.0	0.0	0.0	47.0
Other expenditure	351.4	255.3	614.1	687.1	1,014.9	1,281.2	352.7	705.4	947.4	1,410.8
Goods and services	266.3	172.9	443.9	503.4	752.6	940.8	242.0	484.1	726.1	968.1
Transfers and subsidies	85.1	82.4	170.2	183.7	262.3	340.4	110.7	221.4	221.4	442.7
Capital expenditure	84.7	91.7	306.9	218.0	431.2	627.6	190.7	395.3	601.1	803.9
Domestically funded	29.7	41.1	148.3	90.3	236.4	337.0	77.5	155.0	232.5	310.0
Externally funded	55.0	50.6	158.4	127.7	194.8	290.6	113.2	240.3	368.6	493.9
Grant funded	35.0	25.8	110.8	68.7	112.1	161.2	73.6	147.2	220.8	294.4
Loan funded	20.0	24.8	47.6	59.0	82.7	129.4	39.6	93.1	147.8	199.5
Net lending 2/	0.0	-120.0	0.0	-120.0	-120.0	-120.0	-4.9	-9.8	-14.6	-19.5
Overall balance before grants	-102.6	152.6	-217.3	44.8	-67.7	-107.5	-140.6	-263.8	-409.0	-459.7
Overall balance after grants	-67.6	197.1	-64.5	140.6	79.5	150.1	-42.0	-66.6	-113.2	-65.3
Total financing	67.6	-197.1	64.5	-140.6	-79.5	-150.1	42.0	66.6	113.2	65.3
External financing	-8.6	-22.4	-32.8	-18.9	-83.6	-22.9	39.6	140.2	195.0	18.1
Loan drawings	20.0	24.8	82.6	96.6	120.3	213.7	39.6	140.2	195.0	294.2
Amortization	-28.6	-47.2	-115.4	-115.5	-178.5	-236.6	-55.3	-137.0	-197.0	-276.1
Domestic financing	76.2	-185.2	97.3	-126.0	4.1	-127.2	2.4	-73.6	-81.8	47.2

Table 4. Lesotho: Central Government Operations, Quarterly, 2001/02-2002/03 1/

	2001/02 (Cumulative)						2002/03 (Cumulative)			
	Q1		Q2		Q3	Q4	Q1	Q2	Q3	Q4
	Prog.	Act.	Prog.	Act.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.	Rev. Prog.
Excluding net lending	75.2	-65.2	97.3	-6.0	124.1	-7.2	7.2	-63.8	-67.2	66.7
Bank	...	-155.8	...	-186.0	...	...	...	...	...	...
Nonbank	...	-28.4	...	60.0	...	...	...	...	...	...
Residual	0.0	10.5	0.0	4.3	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of GDP, unless otherwise indicated)									
Revenue	9.3	9.6	19.9	20.0	30.6	41.1	9.4	19.2	27.3	39.5
Customs revenue	5.2	5.2	10.5	10.3	15.5	20.6	4.8	9.5	14.3	19.0
Noncustoms tax revenue	2.6	3.2	6.3	7.3	10.3	13.6	3.0	7.1	9.4	14.9
Nontax revenue	1.5	1.2	3.0	2.4	4.9	6.8	1.6	2.6	3.7	5.6
Grants	0.5	0.6	2.2	1.4	2.1	3.7	1.3	2.6	3.8	5.1
Total expenditure and net lending	10.8	5.7	23.0	17.6	29.8	40.9	11.1	22.5	32.4	45.2
Current expenditure	9.6	7.8	18.5	17.9	27.1	35.3	8.8	17.7	25.0	35.3
Wages and salaries	3.6	3.4	7.8	6.9	10.6	14.1	3.6	7.1	10.7	14.3
Interest payments	0.9	0.7	1.8	1.2	2.0	2.9	0.7	1.4	2.1	2.8
Of which: bank restructuring	0.2	0.3	0.4	0.4	0.6	0.6	0.0	0.0	0.0	0.6
Other expenditure	5.1	3.7	8.9	9.9	14.6	18.4	4.6	9.1	12.3	18.2
Goods and services	3.9	2.5	6.5	7.2	10.8	13.5	3.1	6.3	9.4	12.5
Transfers and subsidies	1.2	1.2	2.5	2.6	3.8	4.9	1.4	2.9	2.9	5.7
Of which: LHDA/Muela	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	1.2	1.3	4.5	3.1	6.2	9.0	2.5	5.1	7.8	10.4
Net Lending	0.0	-1.7	0.0	-1.7	-1.7	-1.7	-0.1	-0.1	-0.2	-0.3
Overall balance before grants	-1.5	2.2	-3.2	0.6	-1.0	-1.5	-1.8	-3.4	-5.3	-5.9
Overall balance after grants	-1.0	2.8	-0.9	2.0	1.1	2.2	-0.5	-0.9	-1.5	-0.8
External financing	-0.1	-0.3	-0.5	-0.3	-1.2	-0.3	0.5	1.8	2.5	0.2
Domestic financing	1.1	-2.7	1.4	-1.8	0.1	-1.8	0.0	-1.0	-1.1	0.6
Memorandum items:										
GNP at current prices (in millions of maloti)	8,541.6	8,619.1	8,541.7	8,619.1	8,619.1	8,619.1	9,412.0	9,412.0	9,412.0	9,412.0
GDP at current prices (in millions of maloti)	6,866.5	6,975.1	6,866.5	6,975.1	6,975.1	6,975.1	7,733.0	7,733.0	7,733.0	7,733.0

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 19.5 million of loan repayments to the government from parastatals.

Table 5. Lesotho: Central Bank Balance Sheet, March 2001-March 2004

	Prog.	Act.	Prog.	Act.	Prog.	Act.	Act. //	Prog.			Proj.	Proj.
	March 2001	March 2001	June 2001	June 2001	Sep. 2001	Sep. 2001	Dec. 2001	March 2002	June 2002	Sep. 2002	March 2003	March 2004
(In millions of maloti)												
Net foreign assets	2,830.1	3,074.9	3,057.6	3,176.3	2,540.6	3,539.5	3,930.2	3,752.7	3,745.3	3,747.9	3,484.3	3,463.7
Foreign assets	2,924.8	3,470.5	3,485.5	3,568.9	3,004.5	4,007.6	4,404.7	4,333.9	4,326.5	4,355.2	4,112.6	4,176.9
Foreign liabilities	94.6	395.6	427.9	392.6	463.9	468.1	474.5	581.2	581.2	607.3	628.3	713.2
Net domestic assets	-2,218.2	-2,530.4	-2,416.4	-2,514.2	-1,937.4	-3,288.4	-3,631.4	-3,499.3	-3,488.8	-3,488.2	-3,209.0	-3,169.7
Net claims on government	-982.0	-1,066.5	-1,109.8	-1,081.7	-1,195.2	-1,164.5	-1,261.9	-1,401.2	-1,279.8	-1,363.9	-1,401.5	-1,543.4
Claims on government	109.2	108.8	141.1	124.4	177.1	143.0	246.5	246.5	249.5	249.5	252.5	252.5
Government deposits	1,091.2	1,175.4	1,250.8	1,206.0	1,372.3	1,307.5	1,508.4	1,647.7	1,529.2	1,613.3	1,654.0	1,795.9
Official Entities' Deposits	0.0	191.7	200.0	185.0	200.0	184.8	195.3	197.6	200.0	202.5	217.7	236.5
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
Net claims on private sector	0.0	5.8	0.0	3.6	0.0	3.3	3.0	3.0	3.0	3.0	3.0	3.0
Other items (net)	-1,236.2	-1,278.1	-1,106.6	-1,251.2	-542.2	-1,942.4	-2,177.2	-1,903.4	-2,012.0	-1,924.9	-1,592.8	-1,392.9
Other assets	148.1	71.9	87.3	86.3	88.3	73.8	36.3	147.8	7.8	62.9	375.9	550.4
Other liabilities	-1,280.7	-53.8	79.2	-86.2	657.2	-348.3	-100.6	-22.0	-20.0	-20.0	-20.0	-20.0
Capital account	-103.6	-1,296.2	-1,273.2	-1,251.2	-1,287.8	-1,667.9	-2,112.9	-2,029.2	-1,999.8	-1,967.8	-1,948.6	-1,923.3
Reserve money	611.9	544.5	641.2	662.0	603.2	251.1	298.8	253.4	256.5	259.6	275.3	294.0
Maloti outside banks	130.0	142.6	144.6	140.3	146.2	139.9	163.9	150.9	152.7	154.6	166.2	180.5
Currency in commercial banks	22.9	17.7	22.4	23.3	22.7	26.0	40.4	28.9	29.2	29.6	31.8	34.5
Commercial banks deposits	459.1	384.3	474.3	498.4	434.3	85.2	94.5	73.7	74.6	75.5	77.3	78.9
(In units indicated)												
Memorandum items:												
Net foreign assets (in U.S. dollars)	347.3	383.7	378.7	393.9	312.3	393.2	380.7	363.5	362.8	363.0	337.5	335.5
Gross int'l reserves (in percent of M1)	297.1	275.4	300.4	269.2	256.1	298.4	300.8	297.6	293.5	292.1	255.2	239.1
Gross int'l reserves (in months of imports)	5.7	7.4	6.9	7.6	5.9	7.7	7.2	7.6	7.6	7.6	6.9	6.6

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

// At program exchange rates.

Table 6. Lesotho: Monetary Survey, March 2001-March 2004

	Act.	Act.	Act.	Act. 1/	Prog.			Proj.	Proj.
	March 2001	June 2001	Sep. 2001	Dec. 2001	Mar. 2002	June 2002	Sep. 2002	March 2003	March 2004
(In millions of Maloti)									
Net foreign assets	3,670.0	3,717.2	4,148.1	4,596.2	4,422.2	4,418.3	4,424.3	4,196.5	4,217.7
Central bank	3,074.9	3,176.3	3,539.5	3,930.2	3,752.7	3,745.3	3,747.9	3,484.3	3,463.7
Commercial banks	595.1	540.9	608.6	666.0	669.5	673.0	676.4	712.2	754.0
Net domestic assets	-1,847.6	-1,839.3	-2,257.4	-2,617.9	-2,388.9	-2,360.4	-2,341.5	-1,958.0	-1,787.0
Domestic credit	424.1	236.6	202.8	356.3	264.3	434.3	404.2	518.0	569.0
Claims on central government (net)	-579.2	-732.5	-765.1	-631.3	-762.7	-633.1	-709.0	-715.5	-809.7
Central bank	-1,066.5	-1,081.7	-1,164.5	-1,261.9	-1,401.2	-1,279.8	-1,363.9	-1,401.5	-1,543.4
Commercial banks	487.3	349.2	399.3	630.6	638.6	646.7	654.8	686.1	733.7
Claims on the rest of the economy	1,003.3	969.1	968.0	987.6	1,027.0	1,067.4	1,113.2	1,233.4	1,378.8
Other items (net)	-2,271.8	-2,075.9	-2,460.2	-2,974.2	-2,653.3	-2,794.7	-2,745.7	-2,476.0	-2,356.0
Money and quasi money (M2)	1,822.4	1,877.9	1,890.7	2,009.4	2,033.3	2,057.9	2,082.8	2,238.5	2,430.7
Money	1,144.7	1,208.6	1,221.3	1,309.0	1,324.3	1,340.3	1,356.5	1,457.6	1,582.5
Of which currency outside DMBs	142.6	140.3	139.9	163.9	165.9	167.9	170.0	182.7	198.5
Of which demand deposits	802.5	873.4	886.2	939.0	950.5	962.0	973.7	1,046.8	1,137.2
Quasi money	677.7	669.3	669.4	700.4	709.0	717.6	726.3	780.9	848.2
Of which time and savings deposits	677.7	669.3	669.4	700.4	709.0	717.6	726.3	780.9	848.2
(Annual change in percent of beginning-of-year M2, unless otherwise specified)									
Net foreign assets	5.1	16.6	27.8	59.4	41.3	37.3	14.6	-11.1	0.9
Central bank	4.1	22.1	22.9	48.8	37.2	30.3	11.0	-13.2	-0.9
Commercial banks	0.9	-5.5	4.9	10.7	4.1	7.0	3.6	2.1	1.9
Net domestic assets	-222.5	-244.8	-243.0	-291.6	-29.7	-27.7	-4.4	21.2	7.6
Claims on central government (net)	20.9	-0.6	19.3	6.2	-10.1	5.3	3.0	2.3	-4.2
Claims on the rest of the economy	0.7	-0.9	0.7	1.5	1.3	5.2	7.7	10.2	6.5
Claims on the rest of the econ. (yrly. change)	1.2	-1.5	1.3	2.6	2.4	10.1	15.0	20.1	11.8
Other items (net)	-20.5	-3.5	-33.8	-50.6	-20.9	-38.3	-15.1	8.7	5.4
Money and quasi money (M2)	6.1	11.6	14.0	18.1	11.6	9.6	10.2	10.1	8.6
Quasi money (yearly change)	-6.5	-8.7	-4.0	5.3	4.6	7.2	8.5	10.1	8.6

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

1/ At program exchange rates.

Table 7. Lesotho: Quantitative Benchmarks and Performance Criteria,
June -September 2001

	Jun-01		Sept. 2001 1/	
	Prog.	Act.	Prog.	Act.
(In millions of maloti; end of period)				
Ceiling on the domestic financing requirement of the central government 2/	76	-65	97	-6
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-2250	-2518	-1950	-2948
(In millions of U.S. dollars; end of period)				
Floor on the stock of net international reserves of the Central Bank of Lesotho 3/	351	390	312	388
Ceiling on the amount of new nonconcessional external debt contracted or guaranteed by the public sector (cumulative from end-November 2000) 4/ 5/ 6/				
Maturity of less than one year 7/	0	0	0	0
Maturity of one year or more	0	0	0	0
Ceiling on the stock of external payments arrears 6/	0	0	0	0

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

1/ Performance criteria.

2/ Cumulative from end-March 2001. Excludes net lending by the government.

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 repayments periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

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

6/ Continuous.

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

Table 8. Lesotho: Structural Benchmarks and Performance Criteria, June–October 2001

	Action	Implementation Date	Status
A.	Tax administration		
1.	Draw public attention to the government's policy of no tolerance toward tax evasion by reissuing the Ministry of Finance's Ten-Point Plan to Improve Tax Compliance. The Ministry of Finance will issue a reminder that Circular Number 2 of 2001 on guidelines for tax compliance should be applied in full.	June 30, 2001	Done.
2.	The sales tax and income tax commissioners will produce monthly summary reports on tax arrears and third-party payment measures 20 days after the end of the month. The reports will document deviations from legal requirements. *	July 31, 2001	Done.
B.	National revenue authority		
1.	Lesotho Revenue Authority becomes operational. *	September 30, 2001	Not done.
C.	Value-added tax		
1.	Commence registration drive and visits to traders.	July 1, 2001	Done.
2.	Complete installation and testing of VIPs computer software.	August 31, 2001	Done.
D.	Expenditure control		
1.	Establish a timetable to eliminate off-budget spending (below-the-line accounts) by moving these items into ministry or spending department budgets. Autonomous funds, such as the Road Fund and the Lesotho Fund for Community Development (LFCD), will submit audited accounts annually to the Minister of Finance within six months of the end of the financial year.	September 30, 2001	Mostly done ^{1/}
2.	Complete the public sector fiscal accounts for 2000/01 (April-March) and submit these to the Auditor General as required by law within six months of the end of the year.	October 30, 2001	Not done.
3.	Hold a seminar on the budget process at the ministerial level to coincide with the start of the 2002/03 budget cycle.	September 15, 2001	Done.
E.	Financial sector reform		
1.	Establish a regular auction mechanism for treasury bills. *	September 1, 2001	Done.
F.	Statistics strengthening		
1.	Compile detailed monthly budget execution reports and reports on domestic debt within 30 days of the month's end.	June 30, 2001	Done, but sometimes late.

Note : * Denotes performance criterion.

^{1/} Off-budget items were identified and all below-the-line accounts eliminated. Autonomous funds, such as the Road Fund, LFCD and Petroleum Fund, will be brought onto the budget in 2002/03. Annual 2000/01 accounts for the Road Fund and the LFCD were nearly completed for audit. The Petroleum Fund was not in operation for the full 2000/01 financial year. It is intended to audit these partial-year accounts with the accounts for 2001/02.

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

	1999/2000	2000/01	2001/02 Proj.	2002/03 Proj.	2003/04 Proj.	2004/05 Proj.	2005/06 Proj.	2006/07 Proj.	2007/08 Proj.
Gross financing requirements	-310.9	-247.0	-272.1	-252.4	-243.1	-289.4	-258.2	-285.7	-294.3
External current account deficit (excl. off. transfers)	-362.1	-270.6	-179.2	-157.6	-148.3	-163.8	-163.6	-165.4	-170.1
Debt amortization	-25.4	-50.5	-101.7	-113.1	-87.0	-122.2	-92.1	-91.1	-92.5
Medium- and long-term debt 1/	-25.4	-50.5	-101.7	-113.1	-87.0	-122.2	-92.1	-91.1	-92.5
Public sector	-21.9	-45.5	-22.5	-23.5	-22.7	-25.2	-24.9	-23.3	-23.2
Commercial banks	-3.3	-4.7	-3.6	0.0	0.0	0.0	0.0	0.0	0.0
Corporate private sector	-0.2	-0.4	-75.6	-89.6	-64.3	-97.0	-67.2	-67.8	-69.3
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	82.3	79.4	13.3	21.4	-6.2	-3.2	-2.3	-27.7	-29.8
IMF repurchases and repayments	-5.8	-5.3	-4.5	-3.2	-1.6	-0.1	-0.1	-1.5	-1.9
Available financing	310.9	247.0	272.1	252.4	243.1	289.4	258.2	285.7	294.3
Foreign direct investment (net)	153.9	119.7	106.2	85.0	69.9	93.0	52.2	69.8	70.3
Debt financing from private creditors	8.6	7.2	7.0	6.6	6.7	7.1	8.5	8.9	7.9
Medium- and long-term financing	8.6	7.2	7.0	6.6	6.7	7.1	8.5	8.9	7.9
To public sector	8.6	7.2	6.2	6.0	6.4	6.7	7.1	7.5	7.9
Of which: balance of payments financing 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
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	0.8	0.6	0.3	0.4	1.4	1.4	0.0
Short-term financing (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: balance of payments financing 3/	0.0	0.0	0.0	0.0	0.0	0.0	1.0	2.0	3.0
Official 4/	161.9	139.4	142.8	141.5	156.2	166.1	171.8	179.4	188.4
External grants (net)	153.9	125.8	124.1	113.2	119.2	125.0	130.5	139.1	148.3
Of which: SACU nonduty receipts	135.7	109.4	109.8	99.8	105.4	110.7	115.7	123.8	132.2
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	1.6	1.1	5.4	2.9	1.8	1.0	1.0	1.0	1.0
Existing credit lines (through end-2000)	1.6	1.1	5.4	2.9	1.8	1.0	1.0	1.0	1.0
New credit lines (through end-2000)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	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	0.0
Bilateral creditors	6.4	12.5	13.3	25.4	35.3	40.2	40.3	39.3	39.2
To public sector	6.4	12.5	13.3	25.4	35.3	40.2	40.3	39.3	39.2
Existing credit lines (through end-2000)	1.6	0.0	2.4	2.0	0.7	0.3	0.3	0.3	0.3
New credit lines (through end-2000)	4.9	12.5	10.9	23.4	34.6	39.8	40.0	39.0	38.9
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
To private sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	4.6	8.8	8.8	8.8	0.0	0.0	0.0	0.0
Accumulation of arrears (exceptional)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other flows 5/	-13.5	-23.9	7.4	10.6	1.4	23.2	25.7	27.5	27.6

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 ^{1/}		Activity
	Millions of SDRs	Percent of quota	
March 9, 2001	3.5	10	Board approved new three-year PRGF arrangement.
March 31, 2001	...	...	Test date for performance criteria.
July 20, 2001	3.5	10	Board completed first review.
September 30, 2001	...	...	Test date for performance criteria.
March 15, 2002	3.5	10	Board completes second review.
March 31, 2002	...	...	Test date for performance criteria.
September 15, 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	

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

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

	Act.	Prel.	Proj.					
	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Debt service to the Fund								
In millions of U.S. dollars	5.2	4.5	3.2	1.6	0.1	0.1	1.5	1.9
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	2.0	1.6	1.1	0.5	0.0	0.0	0.4	0.5
In percent of debt service of nonfinancial public sector	7.3	11.8	8.6	4.4	0.4	0.4	4.3	5.6
In percent of gross international reserves	1.1	1.1	0.8	0.3	0.0	0.0	0.2	0.2
Gross Fund financing								
In millions of U.S. dollars	4.4	8.8	8.8	8.8	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 ^{1/}	1.8	3.2	3.5	3.6	0.0	0.0	0.0	0.0
Fund credit outstanding								
In millions of U.S. dollars	13.2	17.7	23.9	31.3	31.3	31.3	30.0	28.2
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	5.0	6.4	8.5	10.4	9.6	8.9	7.9	6.8
In percent of total debt outstanding	2.4	3.3	4.3	5.5	5.3	5.1	4.7	4.3
Memorandum item:								
U.S. dollar/SDR exchange rate	1.26	1.26	1.26	1.26	1.26	1.26	1.26	1.26

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

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

March 1, 2002

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th 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 third disbursement, in the amount of SDR 3.5 million, be made available following the successful completion of the second 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. 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 a waiver for the nonobservance of the structural performance criterion on the Lesotho Revenue Authority's (LRA's) being operational by September 30, 2001. However, plans are now in place to have the LRA operational by December 2002, and the authorities will be receiving technical support on this issue from the IMF and other donors.

In collaboration with Fund staff, the government will review the progress in implementing the program every six months. The third review is scheduled to be completed no later than September 15, 2002 and the fourth review no later than January 31, 2003.

Sincerely yours,

/s/
Mohlabi K. Tsekoa
Minister of Finance and
of Development Planning

LESOTHO

MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES

I. INTRODUCTION

1. This memorandum updates the government of Lesotho's memoranda on economic and financial policies (MEFP) dated February 12, 2001 and July 10, 2001. It reviews performance over the six months to September 2001 and outlines the economic program for the period January 2002-March 2003.
2. Medium-term economic objectives center on 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. This will be the main vehicle for meaningful poverty reduction in Lesotho.

II. PERFORMANCE UNDER THE PROGRAM

3. The program promotes macroeconomic stability by limiting the government's access to domestic financing, 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 and data collection.
4. Lesotho's economy has performed better than expected. GDP growth was about 3 percent in 2000, and available indicators suggest a similar rate of economic growth in 2001. Consumer price inflation averaged around 7 percent in the first nine months of 2001, and the external trade deficit was reduced by a surge in textile exports to the United States. Credit to the private sector, however, has remained stagnant.
5. All quantitative program targets for end-September 2001 were achieved. However, while many structural objectives were met, the Lesotho Revenue Authority (LRA) did not become operational on time (a performance criterion for end-September 2001), and the government's financial accounts for 2000/01 (April-March) were not presented for audit by end-October (a structural benchmark) on account of a subsequent change in approach necessitated by professional advice.

A. Fiscal Policies

6. The government's domestic financing requirement was below the program maximum for the first half of the financial year (through September) by approximately M 100 million (1½ percent of GDP). This overperformance reflected larger-than-programmed tax collections and below-program spending.

7. Current spending during the April-September 2001 period was about 38 percent of GDP, or about 1 percent above the program assumption in the budget, while spending on capital projects was 6 percent of GDP, or 3 percentage points below the program. Wage and salary costs were below budget because of an unexpectedly high number of vacancies, but spending on goods and services exceeded the budget by about M 60 million. Within this category, vehicle costs exceeded budget provisions by M 25 million. The below-target capital spending can be attributed to several factors, including delays in donor funding and in project implementation, especially for new projects, which could not get under way until the budget was made law, almost three months after the start of the financial year. The government's plans to address underlying weaknesses in both of these areas are summarized in Section III.

8. Revenue during the six months to September 2001 was about M 30 million (0.4 percent of GDP) above the budget target, largely due to buoyant income tax collections. Sales taxes were somewhat below target, and nontax revenue was more than M 50 million below the target level. Grants were M 55 million below the budget assumption, largely because of delays in signing agreements, in particular with regard to the European Union Poverty Reduction Support Grant.

B. Monetary Policies

9. Net foreign and domestic assets of the Central Bank of Lesotho (CBL) were within their respective floor and ceiling targets in September 2001. An upward adjustment in interest rates paid on commercial bank deposits at the central bank in the first quarter of the financial year and the successful introduction of treasury bill auctions for monetary policy purposes contributed to this outcome. The lack of financial intermediation remains a serious problem: the ratio of commercial bank loans to deposits averaged less than 15 percent in 2000. However, commercial banks are beginning to introduce some new products targeted at small borrowers.

C. Structural Measures

10. The government successfully observed two structural performance criteria and most structural benchmarks scheduled for completion through October 2001. The introduction of treasury bill auctions for monetary policy purposes is noteworthy because it marks an important step in efforts to modernize Lesotho's financial system. Monthly reports on income and sales tax results are helping Ministry of Finance officials monitor these areas and are proving useful in the transition to the LRA.

11. One structural performance criterion and one benchmark were not observed. The LRA did not become operational in September largely because of unexpected delays in parliamentary approval of the necessary enabling legislation. The government has made progress in implementing the authority, including the appointment of a board of directors and decisions related to the organizational structure of the authority. The government was not able to present the 2000/01 public accounts for auditing by the end of October (a benchmark) because of a considered decision to first clear the backlog of unaudited accounts dating from 1995/96 rather than give priority to the most recent year, as the audits should be sequentially linked. The government remains dedicated to these important objectives, and steps to bring them back on track as quickly as possible are outlined below (para. 23).

III. THE ECONOMIC PROGRAM FOR THE PERIOD SEPTEMBER 2001–MARCH 2003

12. Revisions to the 2001/02 budget reflect the government's emphasis on health care and physical infrastructure and were made in the context of significant underspending in the capital budget during the first half of the financial year. New structural measures reflect the government's commitment to improve operations through all facets of the Lesotho Public Sector Improvement and Reform Project. In addition, the government will make every effort to complete the structural measures that were not achieved earlier in the year.

A. Revisions to the 2001/02 Budget

13. Current estimates indicate that the 2001/02 fiscal outcome will differ somewhat from the financial plan adopted by parliament in July 2001. In general, recurrent spending will be higher, capital spending lower, and total tax revenue a bit lower. External financing and, therefore, related capital spending will fall significantly below initial targets. In consequence, the government's domestic financing is expected to exceed initial budget projections, but remain well below the borrowing requirements of past years.

14. Tax collections in the period ahead remain a concern. While income tax collections are now expected to be about M 50 million above estimates in the original budget, shortfalls in sales taxes and nontax revenue are largely offsetting. The tax departments at the Ministry of Finance have worked hard to bring in taxes due and reduce arrears, but staff shortages, especially at senior levels, staff diverted to the LRA and value-added tax (VAT) implementation teams, and uncertainties related to delays in the LRA are cutting into tax collections. Border posts are a particular problem.

15. The government has announced plans to increase spending by M 85 million (1¼ percent of GDP) during the remainder of the financial year. Approximately 75 percent of these additional funds will go to infrastructure development, and 20 percent to health infrastructure and health-related purchases. They are to be financed in large part by income generated by the Muela hydroelectric facility, which was transferred to the government from the Lesotho Highlands Development Authority. These funds are being collected on behalf of the government while the electric tariff pricing is being negotiated.

16. Government has set aside an additional M 50 million in the administrative contingency account. These funds will cover unexpected expenses, including the vehicle lease costs that were underestimated in the original budget (M 51 million), an unanticipated charge by the Lesotho Petroleum Fund Board (M 6 million), and health-related spending approved by cabinet in November (M 12 million). M 20 million will remain in the contingency account in case of an emergency during the last months of the year.

17. The government will continue to scrutinize vehicle lease costs, which represent the largest single source of spending overrun. The preliminary findings of a study by the Ministry of Finance's Privatization Unit indicate that the new leasing arrangement is less costly to the government than vehicle ownership, when all costs are considered. However, there appears to be room to improve efficiency, for example by encouraging ministries to use the least-cost vehicle for each need. To this end, the Minister of Finance has instructed all ministries to monitor their vehicle lease charges against their budget allocations through the end of the year and has notified them that, beginning with the 2002/03 financial year, these charges are to be kept within budget allocation. Fuel charges will be treated similarly. The government is also working with the leasing company to provide to each ministry more timely and accurate information on vehicle use and cost. In this way, Ministries can take responsibility for vehicle-related choices and costs.

18. Donor-financed capital spending is expected to fall below the levels envisaged in the original 2001/02 budget. Part of the underrun is due to Parliament's approval of the budget in July, three months after the start of the financial year. Spending is also below expectations because of delays in project implementation. To strengthen the planning and implementation process, the Ministries of Finance and Development Planning have introduced regular coordination meetings at the staff level. Looking forward, several aspects of the Lesotho Public Sector Improvement and Reform Project (PSIRP), including medium-term planning and procurement reform, will improve capital planning and utilization.

B. The 2002/03 Budget

19. The 2002/03 budget was approved by Cabinet and presented to Parliament on January 25, 2002. The budget clarifies the government's focus on poverty reduction through employment creation, industrialization, and development of water, road, and tourist-service infrastructure. It also contains conservation initiatives to address Lesotho's serious soil erosion problem. Other priorities include good governance, human development through relevant education, and health, including HIV/AIDS.

20. The government's policy priorities will be implemented in an environment of limited financial resources. Overall tax revenue is projected to decline as a share of GDP because of a fall in Southern African Customs Union (SACU) revenue and an expected decline in nontax revenue. There is also a risk that tax collections could fall short of projections because of (a) the possibility of an economic slowdown in Lesotho linked to the downturn in the global economy, and (b) the uncertainties related to delays in LRA and VAT implementation.

21. Total expenditure, excluding net lending, is expected to rise by 1¼ percent of GDP to 45¾ percent in 2002/03, almost entirely due to a 70 percent increase in externally financed capital spending. Current spending is budgeted to grow in line with GDP. Reflecting government priorities, defense spending has been reduced to make room for the already-planned expansion of free primary education and a rise in government pensions that stems from the strict enforcement of existing retirement rules in 2001. In addition, public employees will be given an 8 percent pay increase. The need for this adjustment is demonstrated by growing vacancies in key positions and wage increases over the past two years that did not keep pace with inflation. By holding down the number of new positions, the wage bill is projected to be 14.3 percent of GDP, a level that is high compared with most other developing countries. The government intends to reduce this ratio in the future through more efficient government and private sector development. The government also plans to introduce performance-related pay increases next year as part of its effort to improve the civil service.

22. The fiscal stance for 2002/03 will be slightly contractionary. The domestic balance, which measures the government's absorption of local resources and, therefore, excludes externally financed projects with a high import content, external interest payments, and exceptional factors, is projected to rise by ½ of 1 percent of GDP to a surplus of 2 percent. The domestic borrowing requirement would increase to about ½ of 1 percent of GDP, an acceptable level in view of the low level of government domestic debt. Looking ahead, drawing on resources of the banking system and the nonbank public will be kept to a minimum so that credit is available for private sector development. This constraint will become increasingly important as financial markets are modernized.

C. Structural Measures Supporting Fiscal Policy

23. The government is working to make the LRA operational as soon as possible. Enabling legislation is in place, the board of directors has been appointed, and an organizational plan is being drawn up. In addition, the government has exchanged letters with the United Kingdom Department for International Development (DFID) committing the DFID to assist with implementation, including support for an experienced Commissioner General. By mid-February, the government had contracted with Crown Agents to recruit the Commissioner General. In addition, a DFID evaluation team visited Maseru to advise on the implementation strategy. It is intended that the new Commissioner General be in place by the end of July 2002, and the LRA be operational by the end of December 2002. These are considered practical target dates that would allow for the recruitment of a well-qualified candidate, who would then have sufficient time to put in place senior staff and, if necessary, amend the implementation plan. Before then, the government will work to bolster morale within the tax departments by announcing the intention to help those employees who do not transfer to the new authority. The government has enlisted Crown Agents to assist in enhancing border control for revenue purposes. VAT implementation has necessarily been postponed and is planned to follow implementation of the LRA by about six months. The government requests that an operational LRA by end-December 2002 become a condition for the fifth disbursement.

24. The government is pursuing options to clear the backlog of unaudited public accounts. After the extensive efforts made by the government using domestic resources, it is apparent that outside assistance is necessary. Accordingly, the Minister of Finance has requested help from the IMF; a technical assistance team is now expected to be in Lesotho in March 2002.

25. The government acknowledges the need to strengthen financial management to avoid a future backlog of unaudited accounts and also to improve the information available for expenditure management and budgeting. Plans in this area have been part of the PSIRP, which is currently on hold pending further discussions with the World Bank and other donors. Consequently, the government has taken a series of steps in order to make progress during the interim period before the PSIRP begins. The government has already made a formal request for donor assistance to strengthen the Account General's office in the near term with training and operations support. The government has also asked, and is receiving, help in recruiting an experienced Accountant General. In addition, the government will soon request assistance, including project management, to put in place a new treasury financial information system. When complete, government information systems will be linked so that the managers will have the timely information necessary to administer government operations efficiently.

26. The government is committed to the Lesotho Public Sector Improvement and Reform Project, but it will need the support of development partners to move forward in a coherent, coordinated way. The government hopes that observable progress can be achieved as soon as possible, especially in building-block areas such as financial management (as noted above), human resource management, governance, and justice. At the same time, the government is becoming increasingly concerned about the debt and debt-service obligations of the project as currently envisaged and is considering ways to increase grant funding of the project. This concern reflects recent developments, such as the depreciation of the South African rand, which has increased debt-service costs and the medium-term risk of a sharp decline in customs revenue due to the combined effects of (a) the new SACU agreement and the downward trend in tariff rates worldwide; (b) the South African Trade, Development, and Cooperation Agreement; and (c) the Southern African Development Community (SADC) Trade Protocol.

D. Monetary Policy and Related Structural Measures

27. Monetary policy will continue to reflect the objectives of price stability through Lesotho's membership in the Common Monetary Area (CMA) and financial market development. Over the next six months, the Central Bank of Lesotho will fine-tune the auction system and move ahead with the strategy of increasing private saving and investment through financial market development. Emphasis during the period will be on designing an integrated strategy to strengthen competition and provide the public with the tools and environment to save and invest with reasonable assurance that can profit from its efforts.

28. Performance criteria for net international reserves and domestic assets of the central bank have been set according to the Central Bank's target for reserve money and consistent with the 2001/02 government budget and expected balance of payments flows. In particular, foreign reserves are programmed to remain above 7 months of imports through September 2002. This level implies that central bank reserves will be more than three times greater than narrow money.

29. The Central Bank of Lesotho will build on the introduction of the treasury bill auction by refining internal procedures and improving communications with the Ministry of Finance and the public. The Central Bank will make monetary policy implementation more transparent by publishing auction information on a regular basis and by continuing to work with the public on the modalities of repurchase operations. The Bank has already taken steps to strengthen coordination with the Ministry of Finance, including regular meetings at the staff level to coordinate financing and debt-related issues.

30. To develop an integrated financial strategy, the CBL will complete studies on impediments to the functioning of the financial market. These will include how best to modernize the legal framework pertaining to financial markets, and to undertake reforms in the capital account. It will also look at ways to promote bank lending and competition in the money market. A key objective in this context will be to strengthen the transmission of monetary policy to the private sector. The bank will seek technical assistance from the IMF and other development partners as necessary.

31. The Central Bank and Ministry of Finance have started discussions on implementation of the Central Bank Act 2000, which among, other things, stipulates that the central bank will not pay interest on government deposits. These were an important revenue source reflecting the government's high level of deposits at the Central Bank. Further discussions will focus on making up this revenue loss through dividend payments. The discussions will also take into account the fact that central bank independence is a proven contributor to good macroeconomic performance and additionally the importance of a transparent operating budget at the Central Bank.

E. The PRSP

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

IV. PROGRAM MONITORING

33. To monitor policy implementation under the program, quantitative and structural performance criteria and benchmarks are set out in Tables 1 and 2 of this memorandum. Quantitative performance criteria for end-September 2002 will be conditions for the fourth disbursement. Structural performance criteria in Table 2 will also be conditions for the fourth

disbursement, with the exception of the LRA's becoming operational. This performance criterion will be a condition of the fifth disbursement.

34. 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.

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

Table 1. Lesotho: Quantitative Benchmarks and Performance Criteria,
December 2001-September 2002

	2001	2002		
	Dec. Prel.	Mar. 1/ Prog.	June Prog.	Sep. 1/ Prog.
(In millions of maloti)				
Ceiling on the domestic financing requirement of the central government 2/	124	-7	7	-64
Ceiling on the stock of net domestic assets of the Central Bank of Lesotho	-3,631	-3,499	-3489	-3488
(In millions of U.S. dollars)				
Floor on the stock of net international reserves of the Central Bank of Lesotho 3/	372	363	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
Maturity of one year or more	0	0	0	0
Ceiling on the stock of external payments arrears 6/	0	0	0	0

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

1/ Performance criteria.

2/ December 2001 and March 2002 are cumulative from end-March 2001, and June and September 2002 are cumulative from end-March 2002. They exclude net lending by the government.

3/ At program exchange rates.

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

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

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

6/ Continuous performance criterion.

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

Table 2. Lesotho: Structural Benchmarks and Performance Criteria, January 2002–December 2002

Action	Implementation Date
A. Lesotho Revenue Authority and Supporting Measures	
1. Appoint Commissioner General.*	July 31, 2002
2. LRA becomes operational. **	December 2002
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
2. Fill the position of Accountant General. *	July 31, 2002
3. Finalize and announce the plan to introduce performance-based pay for public sector employees.	July 31, 2002
C. Financial Sector Reform	
1. Introduce supervisory and regulatory guidelines for foreign exchange dealers.	April 30, 2002
2. Encourage commercial banks to bring delinquent accounts to the commercial court.	April 30, 2002
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
4. Establish and publicize regulations on ancillary financial markets including money lenders and transfer agents.	July 31, 2002

* Performance criterion for the fourth disbursement.

** Performance criterion for the fifth disbursement.

INTERNATIONAL MONETARY FUND

GOVERNMENT OF LESOTHO

Technical Memorandum of Understanding

March 1, 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 1 of the government's Memorandum on Economic and Financial Policies (MEFP).

2. The remaining test date for assessing observance of the quantitative targets during the financial year April 2001-March 2002 will be end-March 2002. The test dates during the financial year April 2002-March 2003 will be end-June 2002, end-September 2002, end-December 2002, and end-March 2003. The end-March 2002 and end-September 2002 targets will constitute quantitative performance criteria, the end-June 2002, and end-December 2002 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 second review under the program is scheduled for completion by March 15, 2002. End-March 2003 quantitative performance criteria will be set at the third 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 liquid, convertible foreign liabilities. Pledged or otherwise encumbered assets, including, but not limited to, assets used as collateral or as guarantee for third-party external liabilities are excluded from reserve assets. Reserve assets include cash and balances held with banks, bankers' acceptances, investments, foreign notes and coins held by the Central Bank of Lesotho, Lesotho's reserve position in the Fund, and SDR holdings. Reserve liabilities include nonresident deposits at the Central Bank of Lesotho, use of IMF credit, and any other liabilities of the central bank to non-residents. The stock of NIR at the end of each quarter will be calculated in U.S. dollars using the agreed cross exchange rates.¹

¹ Loti per U.S. dollar: 10.324; South African rand per U.S. dollar: 10.324; U.S. dollar per pound sterling: 1.426; U.S. dollar per SDR: 1.26608; U.S. dollar per Euro: 0.8898.

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

5. **Supporting material:** The Central Bank of Lesotho will provide data on its NIR and on SACU non-duty receipts on a monthly basis within one week of the end of the month. The NIR data will be provided in a table showing the breakdown of the foreign assets and foreign liabilities of the Central Bank of Lesotho in maloti and in U.S. dollars.

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

6. **Definition:** The net domestic assets (NDA) of the Central Bank of Lesotho are defined as the difference between reserve money (currency issued plus total bank deposits at the central bank) and net foreign assets (calculated at program exchange rates as stipulated in paragraph 3). The net foreign assets are defined as foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the Central Bank of Lesotho. Foreign assets and liabilities at the end of each quarter will be calculated in U.S. dollars using the agreed cross exchange rates in Table 1 and converted into maloti using the U.S. dollar–loti exchange rate. The NDA thus include net claims by the Central Bank of Lesotho on the Government (loans and treasury bills purchased less government deposits), claims on banks, and other items net (other assets, other liabilities, and the capital account).

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

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

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

9. **Definition:** The central government includes the central administration and all district administrations. The domestic financing requirement of the central government is defined as net credit to, and other claims on, the government from the banking system (Central Bank of Lesotho and the commercial banks), plus net credit to, and other claims on, the government from the non-bank sector. It will be calculated as the cumulative change from end-March 2001 in fiscal year 2001/02 and as the cumulative change from end-March 2002 in fiscal year 2002/03, 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.

10. **Adjustment clause:** The program assumes that customs revenue from the SACU revenue pool will be received as follows: M359.6 million in each quarter in fiscal year 2001/02, and M367.5 million 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.

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

12. **Definition:** The public sector comprises the central government, the Central Bank of Lesotho, and all enterprises with majority state ownership. A loan is concessional if its grant element is at least 35 percent of the value of the loan, calculated using a discount rate based on commercial interest reference rates (CIRRs) reported by the OECD. For loans of maturity greater than 15 years, the grant element will be based on the ten-year average of OECD CIRRs. For loans of maturity 15 years or less, the grant element will be based on the six-month average of OECD CIRRs. Margins for differing repayment periods would be added to the CIRRs: 0.75 percent for repayment periods of less than 15 years, 1 percent for repayment periods of 15 to 19 years, 1.15 percent for repayment periods of 20 to 29 years, and 1.25 percent for repayment periods of 30 years or more. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted on August 24, 2000, but also to commitments contracted or

guaranteed for which value has not been received. Included in this performance criterion are all current liabilities that are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and that require the public sector (obligor) to make one or more payments in the form of assets (including currency) at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits, and leases) will be subject to the ceiling. Borrowing for the water transport operations of the Lesotho Highlands Water Authority 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.

13. **Adjustment clause:** None.

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

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

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

16. **Adjustment clause:** None.

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

F. Ceiling on the Stock of External Payments Arrears

18. **Definition:** During the period of the arrangement, the stock of external payments arrears of the public sector (central government, Central Bank of Lesotho, and all enterprises with majority state ownership) will 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.

19. **Adjustment clause:** None.

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

LESOTHO: FUND RELATIONS
As of December 31, 2001

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

II. General Resources Account:	<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

III. SDR Department:	<u>SDR million</u>	<u>%Allocation</u>
Net cumulative allocation	3.74	100.0
Holdings	0.46	12.4

IV. Outstanding Purchases and Loans:	<u>SDR million</u>	<u>%Quota</u>
ESAF/PRGF arrangements	12.13	34.8

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	7.0
Stand-by	09/23/1996	9/22/1997	7.17	0.0
Stand-by	07/31/1995	7/30/1996	7.17	0.0

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

	<u>Overdue</u>	<u>Forthcoming</u>				
	<u>12/31/2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal		2.9	1.8	0.4	0.0	0.4
Charges/Interest		0.1	0.1	0.1	0.1	0.1
Total		3.0	1.9	0.5	0.1	0.5

VII. **Safeguards Assessments:**

Under the Fund's safeguards assessment policy, the **Central Bank of Lesotho (CBL)** is subject to a full Stage One safeguards assessment with respect to the **PRGF arrangement** approved on March 9, 2001, which is scheduled to expire on March 8, 2004.

A Stage One safeguards assessment of the **CBL** was completed on July 2, 2001. The assessment concluded that a Stage Two (on-site) visit was unnecessary, but identified certain weaknesses and 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 November 2001, the nominal effective exchange rate depreciated by 1.3 percent and the real effective exchange rate appreciated by 3.0 percent, according to preliminary calculations (based on composition of partner countries). The Central Bank of Lesotho (CBL) deals with commercial banks mainly in South African rand. As of January 31, 2001, the rand (maloti) rate per U.S. dollar was M 11.43.

IX. Article IV Consultation:

The Executive Board concluded the last Article IV consultation (EBS/01/18) on March 9, 2001. Executive Directors noted that Lesotho is facing a downturn of economic growth, high unemployment and poverty, and fiscal and balance of payments pressures as a result of long-term structural changes affecting the economy. Correction of these problems will require bold and sustained action by the authorities over the medium term. Directors therefore commended the authorities for adopting a growth-oriented adjustment program in the context of a three-year PRGF arrangement aimed at restoring the economy to a path of high and sustained growth. Given recent budgetary pressures, Directors underlined the importance of the authorities' commitment to fiscal consolidation, to be achieved through a compression in current expenditure and an increase in noncustoms tax revenue. Directors drew attention to the need to lower and rationalize government expenditure over the medium term, taking note in particular of the need to contain growth in the wage bill, while preserving priority social and capital investment expenditures. Tax administration also needed to be strengthened.

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

XI. Resident Representatives:

None.

Lesotho: Financial Relations with the World Bank Group

The attached table summarizes the World Bank's lending operations. As of December 31, 2001, IDA had approved 29 credits amounting to US\$332.6 million, of which US\$215.5 million was disbursed; US\$56.4 million was canceled; and US\$61.7 million remains undisbursed. An IBRD loan of US\$110 million was approved for Phase IA of the Lesotho Highlands Water Project (LHWP) in July 1991; of which US\$68.9 million was disbursed and US\$41.1 million canceled. A second IBRD loan of \$45 million was approved June 1998 for Phase IB of the Lesotho Highlands Water Project, of which US\$14.3 million has been disbursed and US\$30.7 million undisbursed. The Bank Group's first operation in Lesotho was approved in February 1966. To date, the World Bank has financed six projects in education; six in roads and roads rehabilitation and maintenance; four in agriculture, three in industry, two in water supply (including highland water engineering), two in urban development, three in health, one in privatization, one in social protection and finally one in public sector management.

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

Lesotho: World Bank Lending Operations

(As of December 31, 2001; 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 (A)	Disbursed 1/2/ (B)	Original amount (C)	Disbursed 2/ (D)	Undisbursed 2/ (E)	(F) = (D) + (E)	Credit Loans (G)=(A)+(C)	Disbursed (H)=(B)+(D)	and Undisbursed (I)=(E)+(H)	of Total Disbursed	Disbursed and Undisbursed
Credits:											
Education	77.7	63.7	0.0	0.0	0.0	0.0	77.7	63.7	63.7	16.7	15.4
Transport 3/	84.4	57.1	0.0	0.0	0.0	0.0	84.4	57.1	57.1	15.0	13.8
Agricultural/land management and conservation	34.4	16.1	0.0	0.0	0.0	0.0	34.4	16.1	16.1	4.2	3.9
Industry	27.5	24.5	0.0	0.0	0.0	0.0	27.5	24.5	24.5	6.4	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	2.8	2.6
Health and population	22.1	16.2	0.0	0.0	0.0	0.0	22.1	16.2	16.2	4.2	3.9
Lesotho Highlands Water Project	9.8	10.4	0.0	0.0	0.0	0.0	9.8	10.4	10.4	2.7	2.5
Privatization	39.6	11.3	0.0	0.0	0.0	0.0	39.6	11.3	11.3	3.0	2.7
Social Protection	4.7	0.3	0.0	0.0	0.0	0.0	4.7	0.3	0.3	0.1	0.1
Total	332.6	215.5	0.0	0.0	0.0	0.0	332.6	215.5	215.5	56.4	52.2
Loans											
Lesotho Highlands Water Project	155.0	83.2	155.0	83.2	30.7	113.9	310.0	166.4	197.1	43.6	47.8
Total credits and loans	487.6	298.7	155.0	83.2	30.7	113.9	642.6	381.9	412.6	100.0	100.0
Repayments		37.8		18.9				56.8			
Cancellation	97.5		-41.1				56.4				
Total obligation		260.9		64.3				325.2			

Source: IBRD.

1/ Original principal less cancellations.

2/ Reflects adjustment for exchange rate movements.

3/ Infrastructure Project and Road Rehabilitation and Maintenance Project.

Lesotho: Statistical Issues

National accounts

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

The 1996 STA mission noted that the national accounts data still suffered from several substantial shortcomings, namely: the non-availability of basic underlying data in a number of areas and the need to make extrapolations on partial coverage; the use of historical and outdated input/output relationships in many instances; the use of old benchmarks estimates in deriving current series; and the use of inappropriate trend indicators in a few instances. In terms of the GDP by expenditure categories, a major problem was the derivation of estimates of household expenditure as a residual and major weakness in the timeliness, coverage, and commodity detail on imports. In addition, as the constant price series were constructed in 1980 prices, there was an urgent need to change the base year.

In order to facilitate necessary improvements and expansion of the national accounts and related basic statistics, long-term technical assistance in the form of a resident advisor was provided from July 1998 to January 2000. The expert updated the base year for the national accounts to 1995, improved the methods for compiling imports at constant prices (see below under prices), incorporated new benchmark estimates for several industries, initiated work on simplified institutional sector accounts, implemented a new computer system for compiling the estimates, and documented the compilation methodology for the national accounts. The expert also has initiated several projects for improving the BSL data collection efforts, work programs and working procedures, including improving the manufacturing production index.

The lack of reliable information on LHWP external flows and domestic value-added since 1998 undermines the robustness of recent estimates of GDP. There are also concerns that BSL's data on manufacturing activity is underestimated when compared to Customs' data on manufactured exports. Thus, total GDP may also be understated.

Prices

Due to lack of staff resources, the BSL currently produces only a consumer price index (CPI); as of the 1996 multisector mission, no other indices such as a producer price index (PPI), export, or import indices were in production, although an import index was formerly maintained but discontinued in 1991.

The Lesotho CPI is not a monthly series, but is compiled quarterly and produced in a timely manner in January, April, July, and October of each year. With the assistance of the Fund's resident advisor, the index was updated and is now compiled using weights from the 1994/95 HBS, and is presented with April 1997=100. In addition to the nationwide index, separate indices are compiled and published for high-income households (i.e., households earning more than M 500 according to the 1994/95 HBS) in Maseru City and for low-income households (households earning less than M 500) in all six lowland towns. The index for high-income households is based on different weights than the low income and nationwide indices. The CPI is based on the Laspeyres index formula, and the advisor removed the (minor) index formula errors detected by the 1996 STA mission. Besides these index formula errors, and the then-outdated weights, the 1996 STA mission found that the quality of the index in general was good, and compared favorably with the CPI for other countries in the region.

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

Government finance statistics

Monthly data on government revenue (and grants), current and capital expenditure, and financing of the deficit/surplus are now provided by the Ministry of Finance to AFR on a regular (monthly) basis though often late. There is scope for further improvement in the reporting of current and capital expenditure data with more disaggregation necessary. There is also room for more precise classification of revenue items according to the GFS manual. Overall, there are still often inconsistencies in the fiscal data. The functional breakdown of expenditure is only produced after a long (year) lag, and better tracking of health and education spending is needed to monitor poverty alleviation. It is also necessary to distinguish clearly between current and capital grants, and current and capital external loans. Government fiscal accounts have also not been audited since 1996.

Government finance statistics (GFS) only through 1998 have been reported to STA for publication in the *2001 GFS Yearbook*. There has been improvement in the annual data reported, mainly as regards data on the composition of expenditure. Quarterly fiscal data are reported for *IFS* but with a lag (the February 2002 issue only contains data through March 2001).

Monetary statistics

Between September 1997 and June 1998 the compilation of monetary statistics by the Central Bank of Lesotho (CBL) was interrupted as a result of the failure of the information system in the largest commercial bank. For this period, only estimates of this bank's balance sheet positions were incorporated in the monetary survey. The reporting of monetary data to STA was renewed in July 1998, but there were concerns about the reliability of commercial banks' analytical accounts.

Two money and banking technical assistance missions visited Maseru during October 27–November 11, 1999, and July 31–August 14, 2000, to review the production of the monetary statistics.

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

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

Balance of payments and external debt

Balance of Payments statistics are compiled quarterly by the Central Bank of Lesotho usually with a lag of three months. However these data are not reported to AFR or STA on a timely basis for dissemination in the Fund's statistical publications.

The quality of data has deteriorated. Significant discrepancies have been noted with the trade data compiled by the Central Bank and comparable data produced by the Lesotho Bureau of Statistics. The base data with from which remittances from South Africa (a significant item

in the current account) is estimated needs to be revised from its 1985 base year. Additionally, more detailed coverage of Services, Income, Direct Investment and Portfolio Investment activities of the private sector is required to improve the reliability of the data. Coverage of these sectors has taken on added importance particularly as Lesotho has further integrated with South Africa.

The authorities need to strengthen their institutional capacity to improve the timeliness and quality of data and also need to consider taking steps towards the harmonization of concepts, methodology and data collection for regional balance of payments with its other partners in the Central Monetary Arrangement. Lesotho will participate in the impending General Data Dissemination System (GDDS) workshop for Anglophone African Countries, to be held during February 25-March 9, 2002 in Namibia. The authorities should be encouraged to follow the guidance provided by the GDDS recommendations.

Lesotho: Core Statistical Indicators
(As of February 19, 2002)

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govt. Balance	GDP/GNP	External Debt
Date of latest observation	Jan. 2002	Dec. 2001	Dec. 2001	Dec. 2001	Dec. 2001	Dec. 2001	Q4 2001	Sep. 2001	Sep. 2001	Oct. 2001	Dec. 2000	Jun 2001
Date received								Nov. 2001	Nov. 2001	Dec. 2001	Sep. 2001	Dec. 2001
Frequency of data 1/	D	M	M	M	M	M	Q	Q	Q	M	A	M
Frequency of reporting 1/ 2/	M	M	M	M	M	M	Q	Q	Q	M	V	V
Source of data 3/	S	S	S	S	S	S	S	S	S	S	S	S
Mode of reporting 2/	F	F	F	F	F	F/V	F/V	F/V	F/V	F	F/V	V
Frequency of publication 1/	Q	Q	Q	Q	Q	Q	Q	Q	Q	Q	A	Q
Confidentiality 4/	U	E	E	E	U	U	U	U	U	E	U	U

1/ A=annually; D=daily; M=monthly; Q=quarterly.

2/ F=cable, fax or e-mail; V=staff visits or Article IV consultations.

3/ S=Central Bank of Lesotho, Bureau of Statistics, or Ministry of Finance.

4/ U=unrestricted use; E=embargoed for a period of time.

Lesotho: Selected Social and Demographic Indicators

Population

Population (1999, in millions)	2.1
Annual rate of growth (1990-99)	2.3
Population 14 years and under (percent, 1998)	40
Density (persons per 1,000 hectares, 1996)	685

Population characteristics (1999)

Life expectancy at birth (years)	45
Infant mortality (per thousand)	92
Crude death rate (per thousand)	13
Crude birth rate (per thousand)	34
Fertility rate	4.5
Urban population (percent)	27
Below the national poverty line (percent, 1993)	49

Health

Population per physician (1990-96)	20,046
Population per nurse (1993)	3,000
Immunization rate (percent under 12 months)	
Measles (1995-99)	58
DPT (1995-99)	64
HIV prevalence (1999) 1/	23.6
TB (per 100,000)	407

Access to safe water (1993-97)

Percentage of population	52
Urban	14
Rural	64

Distribution of land

Percentage of arable land	
1960	13.0
1998	10.7

Education

Adult literacy rate (in percent, 1999)	82
Male	72
Female	93
Enrollment rate (1994-99) 2/	
Primary school (net)	70
Male	64
Female	76
Secondary school (net)	18
Pupil-teacher ratio in primary school (1994-98)	46

Labor force (1999)

Total (millions)	1.0
Female (percent)	36.9

Sources: *African Development Indicators 2001*, World Bank; and *World Development Indicators, 2001*, World Bank.

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

2/ As a percent of relevant age group.

Alternative Measures of Fiscal Balance

The fiscal balance serves two distinct purposes, monitoring the impact of fiscal policy on domestic absorption and therefore inflationary pressures, and monitoring debt sustainability. Unfortunately, because of data limitations and conceptual problems, different choices are preferable for different purposes.

Aggregate demand and inflationary pressure

The ideal indicator for this purpose would capture the government's absorption of domestic resources, that is domestically produced goods and services less revenue generated domestically. It would therefore exclude goods and services imported for government consumption and investment and also foreign financing such as grants. For Lesotho:

- The **overall balance after grants** is defined as total revenue and grants minus total expenditure and net lending. This indicator reveals the overall financing needs of the government, but it is affected by factors outside the government's control, largely the amount of external grants, which in Lesotho's case has been less than programmed over the last few years. In addition, the overall balance does not distinguish between domestic- and foreign-produced goods.
- The **overall balance before grants** is defined as the overall balance above but excluding grant financing. It reflects the difference between overall expenditure and the government's capability to fund this through domestic revenue. This measure is appropriate to the extent that grants impact domestic demand, are uncertain or are likely to diminish in the future, or create future liabilities by temporarily financing permanent liabilities.
- The **domestic balance** attempts to focus on domestic resources. It is defined as total revenue, excluding grants, minus domestic expenditure and net lending, excluding foreign financed capital spending and foreign interest payments. This fiscal measure approximates domestic absorption by the government when import content of capital spending is high, as it is in Lesotho. However, there are certain shortcomings with this definition to note: 1) foreign-financed capital spending includes some domestic resources; 2) current spending includes some imported goods and services. Nevertheless, the domestic balance approximates domestic absorption and also removes the uncertainty of grant financing that is outside the direct control of the government.

Debt sustainability

Projections of medium-term public debt levels show that in Lesotho, public debt (including both external and domestic) is projected to fall from 74.7 percent of GDP in 2000/01 to 67.5 percent by the end of 2007/08. This outcome reflects the fact that the *primary surplus* (the overall balance after grants less interest payments) is greater than the real interest rate less real economic growth.



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 02/32
FOR IMMEDIATE RELEASE
March 21, 2002

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

IMF Concludes 2001 Article IV Consultation with Lesotho

On March 18, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Lesotho.¹

Background

After the pick-up in economic growth since the 1998 disturbances, growth is expected to moderate somewhat to just under 3 percent in 2001/02. Adverse weather conditions will offset the stimulus provided by rising clothing exports. The global economic slowdown is expected to have a small impact on Lesotho because most of its traditional exports go to countries in the region that have been less affected by global events than the advanced economies.

Unemployment remains high at an estimated 40 percent because many of the miners previously employed in South Africa have not been absorbed into the formal sector. At least 40 percent of the population lives in poverty, aggravated by the serious HIV/AIDS problem. An estimated quarter of the adult population is HIV positive and life expectancy is declining.

The Lesotho loti, which is pegged to the South African rand, depreciated by 37 percent against the U.S. dollar during 2001. This decline is expected to raise inflation in 2002 by about 2 percentage points. The nominal and effective exchange rates, however, have been largely

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

unaffected because most of Lesotho's trade is with South Africa and because their inflation rates have moved in tandem.

The current account deficit for 2000/01 is estimated to be 17 percent of GDP, underscoring Lesotho's longstanding trade imbalance. However, strong export growth of textiles under the U.S. Africa Growth and Opportunity Act and lower imports will help reduce this deficit to 7½ percent of GDP in 2001/02.

Lesotho's public sector imbalance has been reduced sharply with the overall budget deficit declining from 16 percent of GDP in 1999/00 to an estimated surplus of 2 percent in 2001/02. This has been aided by a fall in current spending from over 40 percent of GDP to 35 percent of GDP in 2001/02. Total government indebtedness is relatively low.

Structural measures are intended to strengthen medium-term fiscal sustainability and economic growth prospects. Measures related to fiscal policies include an operational Lesotho Revenue Authority, progress toward clearing the backlog of unaudited accounts, and initiating the financial management component of the Lesotho Public Sector Improvement and Reform Program. Following the successful introduction of treasury bills for monetary policy, the central bank will develop a strategy to boost financial intermediation. The government has continued to make progress with its privatization program with the sale of the telecommunications company in 2001.

Elections are scheduled for May 2002 following recent political and electoral reforms. The latter reduce the chance of post-election riots occurring as happened in 1998.

Executive Board Assessment

Executive Directors welcomed the improvement in the macroeconomic situation since the 1998-99 recession, with real GDP growth increasing to a moderate pace and inflation falling. They hoped that the slowdown in the global economy and possible price pressures emanating from the recent depreciation of the Lesotho loti, which is pegged to the South African rand, 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 welcomed the government's sustained commitment to fiscal consolidation, that has reduced, and possibly eliminated, the need for domestic borrowing in 2001/02. Some borrowing is envisaged in 2002/03, partly to finance higher spending in priority areas such as education

and infrastructure, but this was not thought to endanger domestic debt sustainability or cause domestic overheating.

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 expressed concerns about the delay in making the Lesotho Revenue Authority (LRA) operational by end-September 2001, and the consequent postponement in replacing sales tax with a value-added tax. They urged the authorities to adhere to their new timetable in these areas.

Directors welcomed the government's commitment to improving financial management and completing the privatization process. They commended progress already made in the budget process, such as the timely presentation of the 2002/03 budget to parliament. They supported plans to eliminate the backlog of unaudited accounts and build capacity at the Accountant General's office. Directors noted with satisfaction the government's continued progress with its privatization program, as illustrated by the sale of the telecommunications company in 2001. They welcomed the government's commitment to the Lesotho Public Sector Improvement and Reform Project. Directors noted that good progress was being made in finalizing the Poverty Reduction Strategy Paper, although the deadline of June 2002 for presentation to cabinet may slip a little given the authorities' efforts to assure quality.

Directors agreed that the current fixed monetary regime with South Africa has served Lesotho well and has kept inflation relatively low. Lesotho's exports should remain competitive, as long as most of the recent currency depreciation can be maintained in real terms. Monetary policy has been enhanced by the Central Bank of Lesotho's successful introduction in September 2001 of treasury bill auctions for liquidity management purposes. Directors welcomed the central bank's intention to develop an integrated strategy for strengthening Lesotho's financial markets. The authorities were encouraged to take further steps to combat money laundering and the financing of terrorism.

Directors noted that Lesotho's data are adequate for Article IV surveillance purposes, but weaknesses were still evident, especially in national accounts and balance of payments and their consistency. Thus, Directors commended the government's participation in the regional effort to strengthen data collection and eventually comply with the Fund's General Data Dissemination System. They welcomed efforts to improve data and information sharing across ministries and the central bank, and urged the authorities to improve the timeliness of reporting of key statistical data.

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

Lesotho: Selected Economic Indicators, 1999/00-2002/03

	1999/00 Act.	2000/01 Act.	2001/02 Prog.	2002/03 Prog.
	(Annual percentage change, unless otherwise specified)			
National income and prices				
Real GDP	2.4	3.2	2.9	2.8
Real GNP	1.4	1.7	2.1	1.3
Consumer price index (end of period)	6.3	7.0	7.8	8.4
Nominal GDP (in millions of maloti)	5,733.4	6,377.2	6,975.1	7,733.0
Nominal GNP (in millions of maloti)	7,247.7	7,941.0	8,619.1	9,412.0
External sector 2/				
Exports, f.o.b.	4.3	39.7	38.8	15.6
Imports, f.o.b.	8.1	5.2	7.4	6.7
Net labor income	8.7	4.7	0.8	-1.0
Real effective exchange rate 3/	0.5	-13.6	...	...
Government budget				
Revenue (excluding grants)	6.4	13.6	9.1	5.9
Total expenditure and net lending	38.3	-14.1	2.6	10.8
Current expenditure	19.3	2.8	3.5	11.1
Capital expenditure and net lending	112.8	-51.2	-1.5	9.9
Money and credit 4/				
Net foreign assets	-9.8	5.1	41.3	-11.1
Net domestic assets	7.7	1.1	-29.7	21.2
Credit to the government	57.9	20.9	-10.1	2.3
Credit to the rest of the economy	-4.6	0.7	1.3	10.2
Broad money	-2.1	6.1	11.6	10.1
Velocity (GDP/average broad money)	3.3	3.9	3.6	3.6
	(In percent of GDP, unless otherwise specified)			
Investment and saving 5/				
Investment	35.2	33.5	32.3	32.5
Public	8.4	8.1	9.9	9.8
Private	14.7	15.2	15.6	16.1
Lesotho Highlands Water Project	12.1	10.3	6.8	6.6
Gross national savings (including remittances)	12.8	16.9	24.9	26.5
Public	2.2	5.8	9.4	9.3
Private	10.7	11.1	15.5	17.2
Government budget				
Revenue	40.3	41.2	41.1	39.5
Total grants	2.3	2.0	3.7	5.1
Total expenditure and net lending	61.6	45.4	42.6	45.4
Overall balance (before grants)	-18.5	-4.3	-1.5	-5.9
Overall balance (after grants)	-16.2	-2.3	2.2	-0.8
Domestic balance	-2.7	1.4	1.5	1.7
Primary balance	-13.0	1.8	5.0	1.9
Gross government domestic debt	15.2	11.9	15.9	14.9
External sector				
Current account balance (excluding official transfers)	-35.0	-31.1	-23.9	-21.3
Current account balance (including official transfers)	-22.4	-16.6	-7.4	-6.0
Stock of public external debt	67.8	62.8	72.7	75.0
Debt-service ratio 6/	8.1	13.2	7.5	7.6
Net present value of total public external debt	...	42.7	48.5	49.4
	(In millions of U.S. dollars, unless otherwise specified)			
Gross official reserves (end of period)	470.1	393.4	381.7	360.3
Gross official reserves (in months of imports of (goods and services)	7.5	7.4	7.6	6.9

Sources: Lesotho authorities; and IMF staff

1/ Fiscal year beginning in April.

2/ In maloti.

3/ Based on partner-country data.

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.

NEWS  BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 02/22
FOR IMMEDIATE RELEASE
March 18, 2002

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

**IMF Completes Second Review Under Lesotho's PRGF Arrangement
and Approves US\$4 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) completed the second review of Lesotho's performance under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement.¹ As a result, Lesotho will be able to draw up to SDR 3.5 million (about US\$4 million) under the arrangement immediately.

Lesotho's PRGF arrangement was approved on March 9, 2001 (see [Press Release 01/8](#)) for SDR 24.5 million (about US\$31 million). So far, Lesotho has drawn SDR 7 million (about US\$9 million).

After the Executive Board's discussion on Lesotho, Mr. Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, stated:

¹ It is intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. The government of Lesotho has prepared an interim PRSP, and a full PRSP is expected to be submitted to the cabinet in the third quarter of 2002. 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.

“The Lesotho authorities remain committed to the three-year economic program supported by the PRGF. The program remains broadly on track as all quantitative performance criteria for end-September 2001 were observed. The authorities have put in place plans for the completion of one structural performance criterion, the establishment of the Lesotho Revenue Authority (LRA) by end-December 2002; and one benchmark, the completion and submission to the Auditor General of the 2000/01 public accounts, which did not meet the original timetable set in 2001. Key economic indicators are performing as expected: the overall fiscal stance continued to improve, economic growth picked up, and inflation remained stable.

“Strengthening financial management remains a priority for the authorities. The government is devising a plan to clear the backlog of unaudited public accounts and build capacity in the Accountant General’s office through staff training and the filling of the Accountant General position. The timely presentation to parliament of the 2002/03 budget is also welcomed.

“The government is now elaborating a prudent and practical new timetable to make the Lesotho Revenue Authority operational by end-December 2002. The replacement of sales tax with a VAT remains linked to the creation of the new revenue authority. This change is expected to significantly improve the efficiency of the tax system.

“The Central Bank of Lesotho successfully introduced in September 2001 a treasury bill auction for monetary policy purposes, and in the months ahead will finalize the move to indirect monetary policy instruments. The central bank is now developing an integrated strategy for the strengthening of Lesotho’s financial markets. The overall objectives remain the development of private sector credit and the safeguarding of bank soundness.

“There has been significant progress towards a full Poverty Reduction Strategy Paper (PRSP), undertaken in a broad-based participatory process. The report is expected to be submitted to the cabinet in the third quarter of 2002,” Mr. Sugisaki said.

**Statement by Cyrus D.R. Rustomjee, Executive Director for Lesotho
March 18, 2002**

My Lesotho authorities thank the staff for their consistent engagement and support since Lesotho embarked on a three year Fund supported program. They also thank the staff for a very candid and balanced report. Staff's engagement, coupled with the sound policies implemented by my authorities over the last year, were instrumental in keeping the current program on track. The consistent efforts by my authorities in implementing the program parameters resulted in all the structural performance criteria as well as the structural benchmarks being met, with minor exceptions. My authorities have also made substantial progress in fulfilling the outstanding program criteria and request waivers for the non-observance of the structural and performance criteria.

Macroeconomic Developments

Lesotho's economic performance during the six-month period to September 2001, was broadly satisfactory. GDP was recorded at 3¼ percent for 2000/01, as my authorities effectively seized the opportunity to increase exports to the United States within the framework created by the African Growth and Opportunity Act (AGOA). This very positive development illustrates the potential for enhanced growth for small economies when developed countries allow for greater access to their markets. Similar benefits are materializing for several low-income countries who are benefiting from the European Unions' "All but Arms" initiative. Nevertheless, GDP growth receded somewhat during the second half of 2001/02, as agricultural output declined significantly, as a result of poor weather conditions, since agriculture still contributes significantly to Lesotho's GDP.

Fiscal Policy

The implementation of fiscal policy during the period under review could be considered as sound. My authorities are committed to continue this course, consistent with program targets. My authorities have worked hard to achieve these aims, which are reflected in the revised 2001/02 budgets and emphasized in the 2002/03 budgets. The assistance by staff in the initial stages of the drafting of the budgets is appreciated.

While achieving the fiscal balance objectives of the program, my authorities had some difficulty in meeting the revenue targets. These difficulties stemmed from the process of implementing a new revenue administration, the LRA, which caused uncertainty among current revenue collecting officials regarding future employment prospects. My authorities maintain that once the new LRA is established, the efficiency of revenue collections will be enhanced. For this reason all the necessary steps are being taken to ensure that the LRA is established toward the end of 2002. Another factor that contributed to the lower than projected revenue collections comprised the preparations to introduce Value Added Tax to replace the current General Sales Tax. My authorities also expect increased revenue

collection from this source, once the teething problems with the implementation of this tax have been overcome.

Minor overruns of expenditure are also envisaged during the period under review. This possibility mainly emanates from the long-term vehicle leasing contract which would result in severe penalties, should the country consider an early exit from the contract. My authorities anticipate that motor vehicle costs will be lowered with the implementation of a new policy to hold line ministries responsible for the transport expenditures of their departments. In order to keep expenditure overruns to a minimum, the government has decided not to fill vacancies for the rest of this year, which would bring wage costs to a level lower than programmed. Furthermore, my authorities are determined to reduce overall government expenditure as well, and these efforts have already resulted in a decline of government's current expenditure as a percentage of GDP from 40½ in 1999/2000 to 35½ in 2000/01.

Monetary and Exchange Rate

Lesotho conducts monetary policy within an exchange rate arrangement in which the Loti is pegged to the South African Rand on a one-to-one basis. As a result of this arrangement the Loti depreciated by 37 percent in nominal terms against the US dollar, following the sharp depreciation of the South African currency toward the end of 2001. The subsequent strengthening of the South African currency from the record low level during December 2001 has subsequently also resulted in a nominal appreciation of the Loti.

Monetary policy operations were also further enhanced during 2001/02 with the successful implementation of the Treasury Bill auction mechanism, after careful planning over a few years by my authorities with the assistance of Fund staff. This mechanism provided the monetary authorities with an operating instrument to control broad money, and the successful operation of the mechanism has resulted in a much-needed reduction of liquidity in the banking system.

Structural Reforms

My authorities persisted with structural reforms during 2001 to enhance the competitiveness and efficiency of the economy. To this end, structural reform measures during 2001 were focused on four areas: privatization of public enterprises, strengthening the private financial sector, increased regional and international integration, and reforms in the public sector.

Firstly, much progress has been made in the telecommunication sector with the privatization of the Lesotho land telephone company, the sale of the government's shares in a cellular phone company, and the issuing of a second cellular phone license, which would facilitate the creation of a second cellular phone company. All of these measures have been implemented to allow for increased efficiency and competition in the telecommunication sector.

My authorities have also continued their efforts with the privatization of the supply of electricity by extending an 18-month contract to a private management company to operate the Lesotho Electricity Corporation. This was an important first step in the process of improving the supply of electricity services and preparing the company for sale. The privatization of the Company will in the view of my authorities gain momentum once an agreement is reached with South Africa regarding an appropriate apportioning of costs in operating the Muela hydroelectric plant and transferring water to South Africa.

Secondly, the efforts to strengthen Lesotho's private financial sector gained momentum, with the establishment of a new commercial court. With the implementation and operation of the court, a strong and clear legal framework for the orderly resolution of commercial disputes has been established, an issue which was previously considered a major impediment to invest in Lesotho. Regarding banking restructuring, the reforms implemented during 1999/2000 also strengthened the overall financial framework, since commercial banks now adhere to local prudential requirements.

Thirdly, as a member of the fourteen-member Southern African Development Community (SADC), my authorities are eagerly working with their SADC partners to secure greater regional trade integration, and within the four-member Southern African Customs Union (SACU) to ensure a consistent framework for revenue sharing within the regional customs pool. To this end, since the level of the revenues apportionable to Lesotho from the SACU pool is expected to decline over the medium term, alternative means are being considered to supplement revenues. The US AGOA Trade dispensation provides an important contribution since exports to the US have already increased significantly.

As regards the Lesotho Public Sector Improvement and Reform Project (PSIRP), financial considerations moved my authorities to delay the project. This project, with World Bank assistance, envisages improvements in the areas of governance, financial management, and public sector human resources. My authorities expressed have the desire that financing for the project should contain a larger grant element (and less of a loan element) than is currently present. The authorities nevertheless remain fully committed to initiating and implementing all components of the program. Consequently, with donor support, the authorities have moved forward with the financial management component of the project, which seeks to effect improvements in Lesotho's public accounting and expenditure management systems. Further donor support would greatly enhance the continuance of the other elements of the project.

Progress with the PRSP

My authorities remain concerned with the high prevalence of unemployment and poverty in the country. In this regard, they consider the PRSP process the appropriate vehicle to address these challenges, which also include the high prevalence of HIV/AIDS. The authorities have placed considerable emphasis on the consultative process, to ensure that all the important stakeholders to the process are adequately represented, including the government, civil society, the private sector and the donor community. Consequently, the process has taken

longer than expected to complete. The planning of the process is indeed now complete and it is envisaged that the draft paper will be presented to the cabinet during the third quarter of 2002.

Economic Program for the Period September 2001-March 2003

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

Policy actions on all fronts are planned. As regards fiscal policy the authorities envisage to continue to consolidate public finances with the focus on poverty reduction through employment creation, industrialization, and the development of water, road, and tourist-service infrastructure. Much effort would also be focused on the implementation of the LRA by end-2002, and the implementation of the VAT. My authorities wish to record their appreciation to the UK's DFID for their commitment to provide the necessary support to ensure that the LRA becomes operational towards the end of 2002. The authorities also intend to pursue their substantial ongoing structural reform agenda and to strengthen auction system within the monetary policy framework.