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Lesotho: Ex Post Assessment of Longer-Term Program Engagement

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LESOTHO

Ex Post Assessment of Longer-Term Program Engagement

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July 19, 2004

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I. INTRODUCTION

1. **Lesotho has had almost continuous involvement with Fund programs since 1988,** with the exception of the period 1997-2000 (Table 1). This included a Structural Adjustment Facility (SAF) (1988-91), which aimed at addressing rising fiscal and external imbalances; an Enhanced Structural Adjustment Facility (ESAF) (1991-94), which aimed at consolidating macroeconomic stability, further strengthening the external position, and carrying out the first phase of structural reforms to diversify the production and export base. These two arrangements were followed by three precautionary Stand-by Arrangements (SBAs) (1994-95; 1995-96; and 1996-97) to keep the reform momentum and maintain investor and donor confidence. Finally, following three years of interruption, Lesotho embarked on a program supported by a Poverty Reduction and Growth Facility (PRGF) (2001-2004), with a view to consolidating the macroeconomic gains achieved so far, continuing the structural agenda, and laying the foundations for sustained growth, job creation, and poverty reduction.[2]

2. **This paper reviews the experience of the Fund's engagement in Lesotho during the period 1991-2004.**[3] Section II briefly presents economic developments prior to these arrangements. Section III reviews performance under Fund-supported programs and analyses the main factors accounting for that performance. Section IV draws lessons from these program experiences and Section V considers the main challenges facing Lesotho. Finally, Section VI discusses the role the Fund can play in helping the authorities to meet those challenges.

II. BACKGROUND AND RATIONALE FOR FUND ENGAGEMENT

3. **Lesotho's economic and financial situation weakened significantly during the 1980s**. Real GDP growth slowed from an average of 7 percent a year in the 1970s to less than 5 percent in the 1980s, while the fiscal deficit and the external position deteriorated. This reflected slower growth of agricultural output because of unfavorable weather and lack of adequate incentives, and stagnating remittances from Basotho workers in South African mines. The adverse effect of these exogenous shocks were exacerbated by institutional deficiencies and weaknesses in policy formulation and implementation, particularly as fiscal expenditure continued to expand as before despite slower revenue growth.

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[2] This was preceded by a nine-month track record staff-monitored program (SMP) in 2000.

[3] The ex post assessment does not cover the SAF. However, including it would not alter its main conclusions.

4. **To restore and sustain a reasonable real GDP growth and increase employment opportunities, while maintaining domestic and external financial stability, the government embarked on a comprehensive adjustment program supported by the SAF**. Under this arrangement, Lesotho made substantial progress in correcting the most serious macroeconomic imbalances inherited from the late 1980s: inflation was gradually reduced, but was still high; the overall fiscal deficit (including grants)—which exceeded 10 percent of GDP in 1988/89—was down to just about 1 percent of GDP by 1991/92; and the external position strengthened.

5. **Despite these gains, economic prospects remained constrained by a fragile and non-diversified domestic production base; weak capacity in core areas of macroeconomic policies; inadequate public expenditure management and loss-making parastatals; extreme vulnerability of fiscal and external outcomes to exogenous shocks; and an underdeveloped financial system**. Addressing these issues took more time than expected. In addition, the 1998 political crisis interrupted the reform effort and reversed some of the previous gains.[4] All these factors played a role in the prolonged Fund involvement in supporting the authorities' structural adjustment program and reform.

III. Developments Under Fund Arrangements

A. Macroeconomic Performance

6. **Lesotho has made significant progress during the period of Fund engagement** in achieving macroeconomic stability, attracting foreign direct investment, privatizing major parastatals, improving monetary policy implementation, and strengthening the banking system. However, performance has been uneven over the period, and Lesotho continues to be vulnerable to a number of exogenous shocks, including declining Southern African Customs Union (SACU) revenues, the phasing out of the quota regime under the World Trade Organization (WTO) Agreement on Textiles and Clothing in 2005 that is likely to erode Lesotho's attractiveness for foreign investment, declining remittances, and recurrent droughts. In addition, the economy faces the HIV/AIDS pandemic (see Box 1).

[4] Political tensions escalated after the elections in 1998, and public demonstrations led to significant destruction of physical infrastructure and a military intervention from South Africa and Botswana.

Box 1: The HIV/AIDS Situation and Challenges in Lesotho

The HIV/AIDS epidemic is a major risk to Lesotho's medium- and long-term prosperity. The prevalence rate—estimated at about 31 percent of the adult population—is one of the highest in the world. As a result of the epidemic, several human development indices have declined considerably, including life expectancy, which has declined from 52 years in 1995 to 43 years in 2001 (see Table 4). More than 10 percent of children 0-14 years old were orphans by end-2001.

The economic impact has also been significant. The high prevalence rate among people 15-49 years old, the main labor force cohort, has raised absenteeism and mortality and reduced productivity and efficiency. In the skilled-intensive civil service, existing capacity problems have been aggravated. In the labor-intensive private sector, the competitive advantage of the export sector could be eroded over the medium term, because of declining labor supply and efficiency losses. Capital accumulation has also been affected, as public and private savings have been diverted to the management of the disease. In the rural areas, poor health related to HIV/AIDS has reduced agricultural productivity and aggravated the food crisis.

A recent study estimates that a program to effectively fight the pandemic with higher spending on health care and curing would cost Lesotho about 3 percent of GDP in 2010.[1] An eroding tax base because of HIV/AIDS would also weaken the fiscal position. The authorities indicated that they are addressing the issues through donor-supported expansion of preventive and curative programs and enhanced and better coordinated institutions.

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[1] Markus Haacker: The Economic Consequences of HIV/AIDS in Southern Africa; IMF Working Paper WP/02/38.

7. **Real economic growth averaged 3.6 percent over 1991-2003, above the average for Sub-Saharan Africa. Outcomes were generally in line with program objectives** (Figure 1 and Tables 2 and 3). Growth was strongest in 1991-95, mainly reflecting the impact of substantial public investment in the Lesotho Highlands Water Project (LHWP). Growth performance weakened during 1996-2000, owing mainly to the political crisis in 1997-98 and the resulting destruction of physical infrastructure, and the adverse effects of exogenous shocks, such as the decline in workers' remittances because of a sharp drop in mining jobs in South Africa, and droughts.

Average Real GDP Growth 1991-2003 (In percent)

	1991-95	1996-2000	2001-03	1991-2003
Lesotho	4.4	2.6	3.7	3.6
Benin	4.2	5.4	5.5	5.0
Botswana	4.1	6.6	3.7	5.0
Burkina Faso	3.8	4.3	4.1	4.1
Ghana	4.7	4.3	4.5	4.5
Kenya	1.7	1.8	1.2	1.6
Malawi	3.5	3.9	1.4	3.2
Mali	2.6	5.3	4.0	3.9
Mozambique	3.5	8.0	9.4	6.6
Namibia	5.7	3.5	2.9	4.2
Senegal	1.5	5.3	4.9	3.7
South Africa	0.9	2.6	2.7	2.0
Swaziland	2.9	3.3	1.6	2.7
Tanzania	1.8	4.2	6.0	3.7
Uganda	7.4	6.3	5.8	6.6
Zambia	-2.9	2.8	4.1	0.9
Zimbabwe	1.4	0.2	-10.9	-1.9
Sub-Saharan Africa	1.2	3.4	3.2	2.5

Source: World Economic Outlook.

8. **Real GDP growth subsequently recovered during 2001-03, as exports of textiles became the main engine of growth.** Reflecting Lesotho's success in attracting foreign direct investment, in particular in the textiles sector, private investment increased from 8 percent of GDP in 1991 to 21 percent of GDP in 2003. Employment in textiles grew from

7,400 in 1990 to an estimated 38,780 in 2002. Growth rates of textiles output averaged almost 10 percent a year between 1990 and 2000, and over 40 percent a year between 2000 and 2002. The sector surpassed public services as the largest employer in Lesotho in 2001, and its share in total exports increased to more than three-fourths at end-2002 from about one-half at the beginning of the 1990s.

9. **A combination of factors explains the success of the textile sector**. First, the government launched policies to attract foreign investors during the 1990s, including measures to reduce the bureaucracy and the provision of factory shells. These actions were well-timed and allowed Lesotho to make full use of the preferential trade arrangement granted under the U.S. African Growth and Opportunities Act (AGOA), starting in 2000. Second, given its landlocked location within South Africa, Lesotho has been able to benefit from South Africa's good infrastructure, with efficient deepwater harbors, good roads, and a dependable railway system. Third, Lesotho has improved the productivity of its human capital. The authorities realized early on that investment in human capital would be crucial and, assisted by the World Bank and bilateral donors, raised investment in education. As a result, literacy rates have increased and it is now expected that universal primary education will be achieved by 2011 (Table 4). Fourth, wages in Lesotho are lower and more competitive than in South Africa. Fifth, previous investment in textiles during the 1980s created a foundation for later expansion.

10. **Lesotho remains one of the poorest countries in the Southern African region.** With a population of 2.1 million, per capita GDP was estimated at US$520 in 2003 (about 15 percent of that of South Africa).[5] Despite relatively strong GDP growth, Lesotho's real GNP grew by 1.2 percent a year only during 1991-2002, far below the average for Sub-Saharan Africa. The number of Basotho working in South African mines has declined, reducing remittances from abroad and in turn Lesotho's GNP. As a result, the national average incidence of poverty changed little in the 1990s, with a slight decline in urban poverty offsetting a slight

Average Real GNP Growth, 1991-2002 (In percent)

	1991-95	1996-2000	2001-02	1991-2002
Lesotho	0.7	1.1	2.4	1.2
Benin	4.2	5.7	5.2	5.0
Botswana	4.1	5.1	4.6	4.6
Burkina Faso	3.8	4.4	4.6	4.2
Ghana	4.3	4.2	4.9	4.3
Kenya	1.8	2.5	1.5	2.0
Malawi	2.9	4.2	-1.1	2.8
Mali	2.7	5.6	3.2	4.0
Mozambique	3.1	8.3	10.9	6.6
Namibia	8.5	2.6	1.4	4.8
Senegal	1.6	5.6	3.0	3.5
South Africa	1.3	2.5	2.8	2.1
Swaziland	2.8	2.8	3.2	2.9
Tanzania	2.2	4.5	6.5	3.9
Uganda	7.2	6.2	6.1	6.6
Zambia	-0.8	3.5	4.6	1.9
Zimbabwe	1.2	2.3	-6.7	0.3
Sub-Saharan Africa	3.5	6.0	7.0	5.1

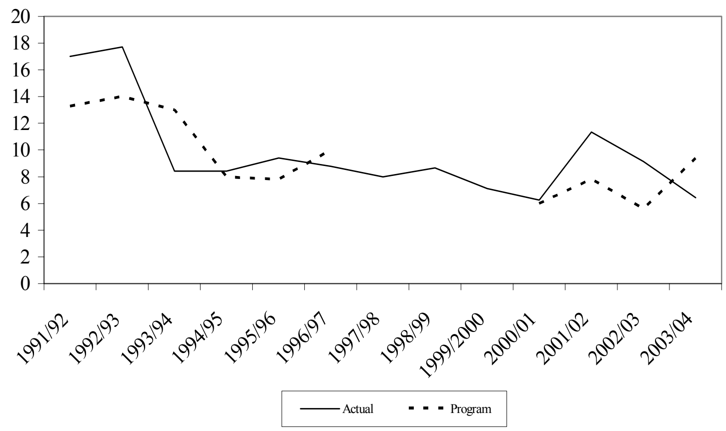
Source: Lesotho authorities; and African Development Indicators.

[5] The correct number of residents is uncertain. About 15 percent of the population was estimated to live in South Africa in 1996. Per capita GDP would increase to about US$620, if it is assumed that about 15 percent of the population still lives in South Africa.

increase in rural poverty (see Box 2). Poverty is widespread among subsistence farmers, living in remote areas with only limited access to the formal economy.[6]

11. **While outcomes were often above program targets, inflation fell from double digits in 1991 to single digit by 1994 and, except for a brief interruption in the early 2000s, remained broadly moderate during the rest of the period.** The favorable performance in the 1990s is closely linked to Lesotho's membership in the Common Monetary Area (CMA) and the peg of the loti to the South African rand. Large budget surpluses also stabilized inflationary expectations in the early years. In addition, performance reflected unanticipated hikes in food prices because of droughts and the pass-through effects from the depreciation of the currency. After a temporary surge in 2001/02, inflation has now receded to a rate close to its past trend, in line with developments in South Africa.

Inflation (in percent, period average), 1991/92-2003/04



Sources: Lesotho Authorities, Fund Staff estimates.

1/ Fiscal year starting April 1.

12. **The external position has improved significantly, but current account deficits remain high:**

- External current account deficits (including official transfers) declined from almost 50 percent of GDP in 1991/92 to about 15 percent in 2002/03 (Figure 2). Buoyant export growth in the manufacturing sector and virtually flat imports—because of declining import by the LHWP—have more than offset the decline in workers' remittances, as well as in foreign aid.

[6] With a human development index (HDI) of 0.510 in 2001, Lesotho is ranked 137 among 175 countries.

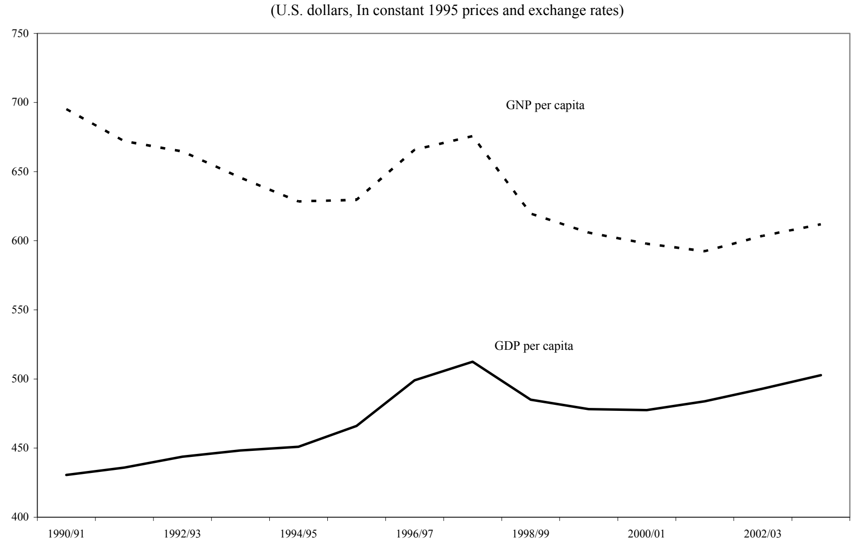
Box 2: Poverty in Lesotho

Despite economic growth, poverty has not declined and a large segment of the population appears not to have shared the benefits of economic growth. The number of ultra poor people grew from 500,000 in 1986/87 to 600,000 in 1994/95.[1] The Gini coefficient—the most widely recognized statistics on income inequality—grew from 0.60 to 0.66 during the same period, where 0 is perfect equality and 1 is perfect inequality. A series of poverty mapping exercises has confirmed that the negative trend remained in the late 1990s.[2]

There are different reasons for this unwelcome development. Safety nets and explicit pro-poor measures in the government budget have not been sufficient to balance other negative trends:

- The creation of new jobs has been insufficient. About 65,000 well-paid miners lost their jobs in South Africa between 1990 and 2002, while the textile industry created about 30,000 new jobs with lower wages during the same period. Although economic growth has raised real GDP per capita, real GNP per capita—which includes remittances from abroad—has declined since the early 1990s (see Figure below).
- Agricultural growth has been weak, making poverty worse, as a majority of the population lives in rural areas.
- The HIV/AIDS pandemic has severe effects on many households. HIV/AIDS usually affects the most productive members of the family, which reduces income. At the same time, meager savings are depleted to pay for medical treatment and funeral costs (see Box 1).
- Many businesses were destroyed with a subsequent loss of wealth and job opportunities during the period of political instability in the late 1990s.

Figure. Lesotho: GDP and GNP per capita, 1990/91-2003/04
(U.S. dollars, In constant 1995 prices and exchange rates)



[1] A person is defined as ultra poor, if his/her actual spending is M 73 maloti (U.S. $11) a month or less, in constant 2002 prices.

[2] The first comprehensive poverty estimates since the mid-1990s are expected to be published later this year.

- Official reserves were built up, reaching impressive levels in the mid 1990s (about nine months of imports), but have since declined to about five months in 2003 (Figure 3).
- External debt service has been manageable because of the concessional nature of external borrowing and the government's cautious debt strategy. The debt-to-GDP ratio rose from 52 percent in 1992/93 to over 70 percent in the late 1990s and early 2000s, reflecting both additional borrowing and the adverse impact of the nominal exchange rate depreciation. The ratio was back below 50 percent in 2003/04, following the recent appreciation of the loti. The external debt service was estimated at less than 10 percent of exports of goods and non-factor services in 2003/04. As a result, Lesotho is not a HIPC.
- The loti appears to have remained broadly competitive. It has depreciated versus most major currencies; currently the real effective exchange rate is about 5 percent below its level of the early 1990s, also mirroring the relatively low inflation in Lesotho (Figure 4).

B. Main Factors Contributing To Economic Performance

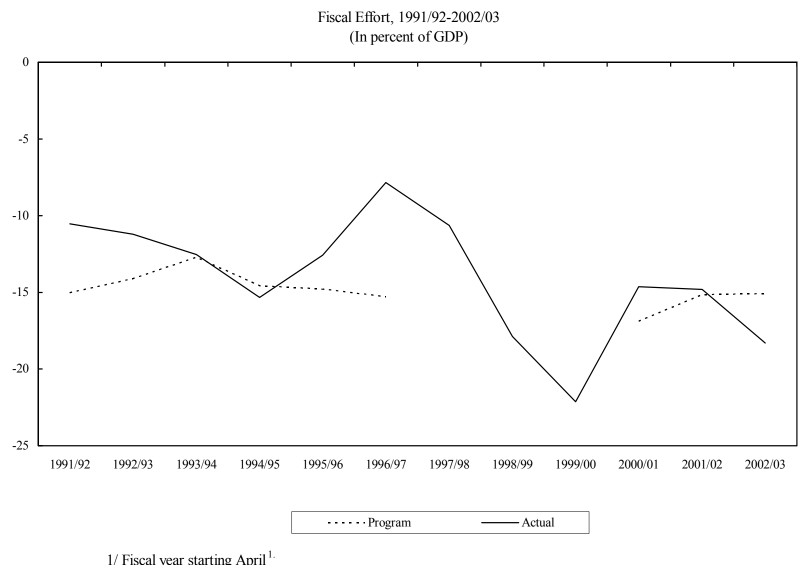
13. **The relatively volatile economic performance was due to exogenous shocks (see paragraph 6 above) and uneven implementation of sound macroeconomic policies and structural reforms; it also reflected political instability and institutional weaknesses**.

Fiscal Policy

14. **Fiscal policy has been the main instrument of demand management in Lesotho because of the currency peg.** Government expenditure is a major component of domestic demand, the bulk of which is satisfied through imports. As monetary policy has been anchored in preserving the peg, fiscal restraint has ultimately been key to improving external competitiveness.

15. **Fiscal performance was broadly in line with program objectives.** Except for the recent period under the PRGF where notable slippages emerged, overall fiscal balances were above expectations (Figure 5). While revenue performance was generally satisfactory at above 40 percent of GDP during the period, it masks a still heavy dependence on SACU revenue. Its share in terms of GDP has declined from a peak of about 27 percent in 1993/94 to 19 percent in 2002/03. Non SACU revenue has partially offset this declining trend. However, after reaching about 25 percent of GDP in the mid-1990s, it has since returned to about 20 percent of GDP, the level registered at the inception of the ESAF.

16. **A measure of underlying fiscal effort shows that performance relative to program was strong in the early years.** [7] Although the overall fiscal position has deteriorated more recently, the recent introduction of the value-added tax (VAT) and the creation of the Lesotho Revenue Authority (LRA) seem to bode well for the urgent need to raise non-SACU revenue in light of the prospective decline in SACU revenue from 2005/06 onward. Tax policy tools have however been limited by the need to avoid substantial deviations of income and indirect tax rates from those applied in South Africa, if competitiveness is to be preserved (including in the labor market) and smuggling to be contained.



17. **Public wages have remained high as a proportion of total fiscal spending.** Wages currently represent about one-third of total expenditure, and have been oscillating between 13 and 16 percent of GDP since the early 1990s. Despite repeated attempts to implement civil service reform, structural rigidities made the reforms difficult to carry forward. Policies to rationalize public employment and limit the increase in nominal wages under the SAF and ESAF were not successful. The integration of the South African and Lesotho labor markets has created an upward pressure on wages—especially for skilled workers, including those in the civil service—given higher productivity and wage levels in South

Government Wage Bill in Selected Southern African Countries,

	In percent of GDP	In percent of Total Expenditure
Lesotho	13.3	30.8
Botswana	13.1	27.4
Malawi	7.0	24.6
Mauritius	6.3	23.7
Mozambique	7.1	24.8
Namibia	13.5	43.3
South Africa	9.6	37.8
Swaziland	12.0	39.4
Tanzania	4.8	21.3
Zambia	8.6	29.2
Zimbabwe	11.0	34.5

Source: Various staff reports; and staff estimates.

[7] Defined as overall budgetary balance, excluding SACU revenue, grants, interest payments, foreign-financed capital expenditure, and exceptional outlays (such as expenditure related to droughts, recapitalization of banks, and LHWP expenditure).

Africa. It was also difficult to resist upward pressures on civil service wages during periods of sizable budget surpluses.

18. **Despite recent progress, the overall reform effort in expenditure management has been slow, and weaknesses remain:** (i) recurrent and investment budgets are not fully integrated, so that the recurrent costs of public capital projects are not properly budgeted for; (ii) budget formulation is largely framed within a one-year horizon that precludes an effective analysis of the implications of current policies and prevents the formulation of a medium-term strategy; annual budgetary allocations are largely framed in an incremental way relative to previous year's ones, thus precluding the potential for savings; (iii) the operations of parastatals are not included in the government budgeting system, often leading to underestimation of the resource needs; and (iv) the legal structure does not provide for clarification of responsibilities; as enforcement of sanctions against over-commitments remains inadequate there is no incentive to adhere to the budgetary appropriations, with the result that the budget does not provide a sound and comprehensive framework for designing and implementing fiscal policy. As a result, the combined weaknesses of the public expenditure management system and the budget process have hindered a more efficient allocation of public resources, particularly toward social spending. This said, the work to improve public financial management is continuing and a medium-term expenditure framework is currently about to be introduced.

19. **The lack of progress in civil service reform and the slow pace of improvement in public expenditure management call into question the extent of program ownership.** Although Lesotho's institutional and administrative capacity is limited, the World Bank and various donors would have been prepared to offer adequate technical assistance if the authorities had demonstrated strong commitment in these two areas.

Monetary and Exchange Rate Policy

20. **The fixed exchange rate regime has served Lesotho well.** While monetary policy is restricted by Lesotho's membership in the CMA, with the loti pegged to the South African rand, this regime has helped to provide macroeconomic stability and anchor inflationary expectations, despite the volatility that the rand has undergone.

21. **Progress was made in improving monetary policy management.** The authorities successfully introduced indirect monetary policy instruments, including the establishment of a securities market for treasury bills; the introduction of central bank paper for monetary policy management; the gradual adoption of market-determined interest rates in 1992 with full deregulation in 1998; and measures to develop an interbank market for short-term funds. With Fund technical assistance, the Central Bank of Lesotho (CBL) improved its capacity in using these instruments.

22. **Progress was also made in strengthening the soundness of the banking system**. Among various measures, the banking supervision was strengthened with technical assistance from the Fund; prudential regulations were applied to commercial bank lending;

and the Lesotho Agricultural Development Bank was closed in 2000 after more than four years of insolvency, while the Lesotho Bank was privatized in 1999. The remaining two commercial banks, which are subsidiaries of South African banks, were recapitalized in 1999 and the capital adequacy, at 19 percent, exceeds the Basel Capital Accord requirement.

23. **However, the financial sector remains small, and structural constraints impede the expansion of credit to the private sector.** Some of the factors behind the shallow financial intermediation include (i) the relatively high rates paid on commercial banks' balances at the CBL, which were generous and represented an attractive and low-risk alternative to direct lending to the private sector;[8] (ii) the narrow and oligopolistic structure of the banking system; (iii) the high lending risk associated with the weak judicial and legal framework contributing to a culture of nonrepayment of loans and difficulties in using land and property as collateral; and (iv) the lack of viable business opportunities.

Other Structural Reforms and Governance

24. **There has been little progress in trade liberalization mainly because of the slow pace of reform in the SACU, which largely determines Lesotho's trade policy**. SACU's common external tariff (CET) only slightly decreased. Moreover, Lesotho's nontariff barriers, which are imposed at the national level, also remained substantially unchanged.[9] In line with the other SACU members, the Fund's trade restrictiveness index for Lesotho declined marginally from 6 in 1997 (first available year) to 5 in 2003, on a scale of 0 to 10, with 10 being the most restrictive.

25. **Despite early difficulties, the authorities advanced quite firmly with the privatization program after some crucial institutional reforms.** In 1995, parliament approved a Privatization Act, critically bringing privatization under the responsibility of one privatization agency, thus replacing the previous setup whereby relevant ministries—and their vested interests—played major and often conflicting roles in privatization. Since then, the government of Lesotho has sold or become a minority owner in a number of enterprises—most notably, the national airline and companies in the transport, banking, and telecommunication sectors. Other companies have been put under management contracts with private operators or liquidated, and various services have been contracted out. Also, the success in attracting foreign direct investment and the rise in private investment (see paras 8 and 9 above) was an indication that the role of the private sector did increase during the program period. The World Bank supported the state enterprise reform with technical assistance.

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[8] These were abolished in September 2001.

[9] These include import permits to protect some locally produced goods, including beer, eggs, raw meat, milk and sugar. Vegetables and fruits are subject to seasonal restrictions.

26. **In recent years, progress was made in addressing governance issues.** Steps were taken to enhance the transparency and accountability in the use of public resources. Incentives and opportunities for rent-seeking opportunities were reduced through deregulation and privatization. An Anti-Corruption Unit (ACU) was set up in November 2002. In 2002, the High Court imposed significant penalties on a foreign company found guilty of bribing former officials of the LHWP, who were found guilty and sentenced to jail. The government has also uncovered several schemes to misappropriate public funds. Steps are under way to strengthen the investigation and prosecution procedures and further coordinate the actions of the ACU with those of the police and LRA. These actions are evidence of the government's resolve to improve governance.

C. Program Design and Implementation

27. **The objectives and focus of Fund programs were largely in line with the most pressing reform needs. However, more emphasis could have been placed during the 1990s on implementation capacity and institution building and on the links between economic growth and poverty.** The SAF and ESAF focused on achieving macroeconomic stability and further strengthening the external position. These were to be attained through fiscal restraint, prudent monetary policy in the context of the fixed exchange rate regime, and key structural reforms to remove major obstacles to growth and promote economic diversification.

28. **Reflecting the crucial role of fiscal policy in achieving and maintaining macroeconomic stability, these early Fund-supported programs targeted fiscal surpluses,** through broadening of the tax base, improvement in the composition of public expenditure, and strengthening of financial management. Such emphasis reflected the need to contain dependence on foreign aid and SACU revenues and decrease Lesotho's vulnerability to exogenous shocks. By targeting large repayments to the domestic banking system, a substantial buildup of international reserves was achieved, an essential requirement for a successful peg.

29. **However, in hindsight, allowing Lesotho to graduate from concessional resources to less concessional financing and short-term programs under the three SBAs seems inappropriate**. While progress was made towards macroeconomic stability under the ESAF, the record was still fragile and reversible, and the major structural agenda was unfinished. A successor ESAF might have been better geared to Lesotho's problems than SBAs, although this would have required an identification of balance of payments needs.

30. Finally, following a lapse in Fund assistance over the period 1997-2000, **the PRGF approved in 2000 gave more consideration to the institutional and administrative problems and, compared with earlier arrangements, more attention was given to sustained growth, job creation, and poverty reduction.** This partly reflected the new focus on poverty, but also the realization that, given Lesotho's lack of progress in social areas, more emphasis needed to be put on equitable growth. Preliminary conclusions

gained from the work on Lesotho's Poverty Reduction Strategy Paper (PRSP) influenced policies in the PRGF.

31. **Program projections of key assumptions and targets were broadly realistic,** in particular in the fiscal area (Table 3). However, while growth performance was positive and largely in line with projections, it was not sufficient to raise the welfare of the population and reduce poverty. A large segment of Lesotho's population did not share the benefits of growth, and government spending on safety nets and explicit pro-poor measures has not been sufficient to balance negative factors. It is also difficult to assess whether growth projections could have been more ambitious as the sources of growth were not clearly identified and there were substantial revisions in the national account data in the late 1990s (Figure 1).

32. **Fund quantitative conditionality has been broadly consistent with the needed macroeconomic stabilization** (Table 5). While under the ESAF program, quantitative performance criteria (PCs) and benchmarks may have been overspecified in the fiscal area, it was in line with the program focus.[10] Asymmetric adjusters were introduced only for excess in foreign aid (which had to be fully saved), while shortfalls could not be accommodated. Under the PRGF arrangement the number of quantitative benchmarks was reduced, and adjusters became less asymmetric pertaining to droughts and aid flows.

33. **Structural conditionality has largely focused on tax and customs administration, public expenditure management, the financial sector, and public enterprise reform** (Table 6). Although the last area is not part of the Fund's core responsibility, most of the structural conditions could be characterized as macrocritical. In addition, the increase in the number of structural conditions over time should not be seen as conflicting with the Fund's mandate to streamline conditionality, but rather as reflecting a growing emphasis on capacity-and institution-building in crucial structural areas, to help enhance program implementation. In hindsight, this emphasis should have come earlier.

34. **Policy implementation and performance under Fund-supported programs was mixed and uneven over the period. Some policy slippages occurred in recent years in the fiscal and structural reforms areas.** The frequent delays in completing program reviews, particularly under the third SBA and the PRGF arrangements, raise questions about ownership but also reveal institutional and administrative capacity and coordination issues. While overperformance relative to the program quantitative targets was the norm in the early years, the record deteriorated in recent years, owing to a combination of political and external shocks and policy slippages (Tables 3 and 5). This was reflected in a growing number of requests for waivers and delayed reviews under the PRGF arrangement.

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[10] PCs were introduced on net credit to the government, recurrent expenditure and overall fiscal surplus (in percent of GNP), while benchmarks were set on government wages and total revenue.

35. **There has been less compliance with structural than with quantitative conditionality.** In earlier arrangements, structural conditionality was less cognizant of Lesotho's institutional constraints and the need to better prioritize reforms. In some instances, a lack of adequate technical assistance, from either the Fund or other providers, hindered the timely implementation of structural conditionality. In recent programs, these shortcomings have been acknowledged. Similarly, the staff has become increasingly aware that the authorities need more time to build consensus around critical, but politically difficult, reforms as an essential precondition for success.

36. **Deficiencies in data quality and weaknesses of statistical systems hampered early detection of incipient problems and timely policy response.** Information on fiscal revenue and expenditure was often late, incomplete, and inaccurate, which undermined financial control in the public sector. Another example is that lack of timely integrated health information and survey instruments, necessary to monitor the development of the HIV/AIDS pandemic, delayed the government's policy response.

37. **Fund technical assistance was geared towards improving public expenditure and monetary policy management, supporting tax administration, strengthening banking supervision, and enhancing statistical capacity.** It was complementary to Fund programs and broadly effective. MFD provided extensive technical assistance that improved monetary policy management and banking supervision. FAD's technical assistance was instrumental for the establishment of the LRA and the introduction of VAT, but public expenditure management and budgetary processes remain inadequate despite recommendations from technical assistance missions. STA provided significant technical assistance in the areas of balance of payments and national accounts, but there are still major deficiencies in data quality and timeliness. More TA could have been offered, but (the lack of) absorption capacity needs to be carefully taken into consideration. Fund technical assistance must also be well coordinated with support provided by others.

D. Collaboration with the World Bank

38. **Cooperation with the World Bank has been close, and the two staffs have been in regular contact.** The World Bank has focused its advice on sectoral structural reforms, including privatization and private sector development, basic infrastructure, the education and health sectors, and HIV/AIDS and poverty monitoring and evaluation. The Fund has relied to a significant extent on the technical expertise of the World Bank staff in these areas. Areas of close collaboration include the PRSP, public sector reform, public expenditure management, and financial sector reform.

39. **However, there were areas in which a firmer and more systematic involvement of the World Bank would have improved the prospects for meeting program targets.** The main example is the Lesotho Public Sector Improvement and Reform Project (PSIRP), which is coordinated with World Bank assistance, covering financial management, governance, and human resource issues. As the PSIRP has not come off the ground as expected, Fund program targets have been difficult to reach and this has led to a tendency

for the Fund to introduce structural conditions of its own on some of these issues in the PRGF (which contributed to the expansion of structural conditionality noted above).[11]

IV. Lessons Learned

40. **Program monitoring and implementation are difficult when the authorities' implementation capacity is weak and ownership is lacking.** More attention could have been paid to this in earlier Fund-supported programs with Lesotho. Weak implementation capacity seriously hampered progress in many areas. Ministries lack technical skills—a situation that allowed political interest groups to interfere in the decision-making process to an excessive degree, even in areas such as the allocation of bank credit, civil service employment, and the selection of managers for parastatals.

41. **A lack of strong commitment at the highest political levels and inappropriate institutional arrangements made it difficult to build a consensus on reforms and coordinate the reform process.** A typical example is the reform and privatization of parastatals. After cabinet approval, these reforms were initially undertaken by each ministry responsible for the parastatal to be privatized. As a result, the reform process was fragmented, with little oversight. At the same time, seeking to minimize emerging divergences across ministries, the cabinet tended to get involved in detailed operational aspects, thereby reducing ownership of the reforms in the relevant ministries. In addition, the dominance of senior civil servants in the governing boards of most public corporations weakened the independence of management in carrying out its tasks.

42. **The fact that the privatization effort became successful after all** (see paragraph 25) **would suggest that reform policies can be effective when three key preconditions are fulfilled:** (i) the benefits of policies are widely explained to all stakeholders in order to build strong ownership; (ii) adequate technical assistance is provided to build institutional capacity; and (iii) institutional arrangements are improved.

43. **Better sequencing and a more appropriate pace of reforms could have enhanced ownership and strengthened performance.** Although there was generally a broad consensus among the Fund, the World Bank, and other development partners about the need for certain policy measures, insufficient attention was given to the implementation capacity issues. As a result, some structural reforms were delayed or stalled. Also, some reforms should have come earlier in the reform process, such as civil service restructuring, measures to improve governance, regulatory and judiciary reforms, and reform of land and property rights.

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[11] Building consensus on the reform program and coordination among various stakeholders, including the donors, contributed to delays.

44. **The Fund could have used more prior actions as a tool to ensure compliance with key program measures, and test the authorities' commitment**. The number of waivers granted increased in recent years, i.e., six waivers for the fifth review under the PRGF. The Fund should have taken a firmer position and request prior actions for completing the reviews as a way to strengthen compliance and to push ahead for difficult measures.

V. Policy Challenges for the Medium Term

45. **The main challenges facing Lesotho remain unchanged: to raise the real long-run economic growth rate, increase per capita income levels, reduce poverty, and improve social conditions, while strengthening the economy's resilience to exogenous shocks.** Achieving these goals will require pursuing sound macroeconomic policies to maintain a stable macroeconomic environment, accelerating and deepening structural and institutional reforms to remove current obstacles to growth, and creating an environment conducive to domestic and foreign private sector development.

46. **Drawing on past experience, future Fund programs should better address ownership and other political economy factors to avoid unduly slow progress in the implementation of reform, particularly in the areas of civil service reform and public expenditure management. Program design and monitoring should become a more integrated part of domestic policy formulation**. The authorities are tackling ownership issues in the context of the forthcoming PRSP, which is the result of a broad-based participatory process.

47. **Fostering ownership will also require further Fund staff involvement in the process of building consensus on a reform agenda and in coordinating the views among various stakeholders, including the donors**. Staff may, therefore, need to further broaden direct contacts and dialogue with different government institutions and social groups, and initiate poverty and social impact analyses in the case of potentially controversial reforms. The Resident Representative posted in South Africa has covered Lesotho since January 2004, and will play a vital role in an enhanced dialogue. In addition, more emphasis should be given to capacity constraints and adequate technical assistance to strengthen program implementation. To improve policy response to exogenous shocks, programs could include **alternative contingent scenarios**. Finally, to strengthen compliance and push ahead for difficult measures, future programs could use more **prior actions**.

48. Against this backdrop and consistent with the priorities being defined under the PRSP, the authorities will need to focus on the macroeconomic policies and structural reforms outlined below. Their design and implementation will require continued external support and technical assistance, including from the World Bank.

A. Macroeconomic Policies

49. Macroeconomic policy in Lesotho should focus on the following:

- **Developing a more ambitious and balanced approach to growth** through policies to enhance job creation and participation in economic activity for all segments of the population. The government of Lesotho should foster cooperation between small Basotho enterprises and the foreign-owned textile industry to further integrate this sector with the rest of the economy. It should also identify the current barriers to investment in agriculture, industry, tourism, and service sectors in order to diversify the economy. Moreover, with the planned reopening of the Letseng-la-Terae diamond mine, the prospects of diamond mining as a contributor to output, export earnings, and employment should be fully explored.
- **Ensuring medium-term fiscal sustainability through further fiscal consolidation.** Prudent fiscal policies should be focused on (i) making efforts to broaden the tax base and strengthen tax administration, particularly the performance of the newly established LRA to help compensate at least partially for the projected decline in SACU revenue (as a share of GDP) due to changes in the SACU revenue-sharing formula and trade liberalization;[12] (ii) reassessing expenditure priorities to allocate more resources to poverty-related and social sectors and to basic infrastructure in the context of a medium-term expenditure framework; and (iii) increasing the efficiency of government spending by improving public expenditure management and budget planning, execution, and reporting, as well as transparency and financial accountability. Controlling the wage bill and spending on scholarships and vehicle leases will be crucial to fiscal consolidation. This would help contain the domestic financing requirement and reduce pressures on domestic interest rates.
- **Maintaining the current peg to the South African rand**. The peg has served Lesotho well because of the financial discipline it entails and Lesotho's close economic integration with the South African economy. Prudent fiscal policies, combined with moderate credit policy, would help build up adequate international reserves to defend the peg. These policies would also help avoid inflationary pressures and preserve external competitiveness.
- **Pursuing prudent external and domestic debt management** to keep debt ratios at manageable levels. Borrowing should be used to finance productive activities that can enhance Lesotho's growth and diversification prospects and are able to generate the resources necessary to service the debt.

[12] Most of Lesotho's SACU revenues are linked to the collection of customs duties, which are expected to shrink because of new tariff-reducing trade agreements.

B. Structural and Institutional Reform Policies

50. **Substantial structural and institutional reforms are required to underpin macroeconomic stability and address structural impediments to productivity and economic growth, and ultimately to reduce poverty:**

- The investment climate should be improved to foster domestic and foreign private sector development. This would require reforms to (i) improve governance and reduce corruption, including by enhancing the judiciary; (ii) strengthen land acquisition and property rights; (iii) develop an equitable and efficient tax system; (iv) deepen financial intermediation and enhance access to credit and financial services, especially for the small and medium-sized enterprises (SMEs); and (v) improve basic infrastructure to increase productivity, as well as continuing efforts to sharpen human capital; employment and skill gaps in the economy could be better addressed by refocusing on vocational and skills-related education.

- **Trade liberalization policies should be pursued to help promote and diversify the economy.** To help address the challenge posed by the narrow export and production base, Lesotho's membership in various regional initiatives should be used to facilitate its integration into the regional and global economy. Lesotho has acceded to the Southern African Development Community (SADC) Trade Protocol, which could create a regional market for Lesotho's exports outside SACU over the long term. Access to developed countries' markets will also be important. Together with other SACU members, the authorities should press ahead with the proposed SACU-U.S. Free-Trade Agreement, which could overtake AGOA, and thus preserve Lesotho's access to the U.S. market. Lesotho should also gain from preferential access under the European Union's Everything-But-Arms initiative, once the rules of origin have been agreed. In addition, within existing trade agreements, Lesotho can promote trade by making current cross-border procedures easier.

- **Labor market regulations need to be more flexible and the investment and legal framework improved.** In particular, more flexibility in setting minimum wages without the use of centralized tripartite negotiations, and a relaxation of hiring and firing rules would be critical to maintaining competitiveness.[13]

51. **Lesotho needs to review and improve existing institutions to enhance the fight against the HIV/AIDS pandemic.** Given the already stretched government resources, donor support will be crucial. The capacity of the health system should be expanded to effectively utilize and monitor new resources, but HIV/AIDS is more than a health issue.

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[13] For further developments on the labor market, see Lesotho—Selected Issues and Statistical Appendix (IMF Country Report No. 04/23).

Recent gains in economic growth and human development could be eroded, as people will be forced to leave the labor force and the cost of managing the disease will further burden the finances of both households and the public sector. In turn, national savings and capital accumulation may decline as a proportion of GDP. The government should, therefore, develop an institutional framework covering a wide variety of HIV/AIDS programs related to specific health issues, as well as more general policies to support economic growth and poverty reduction. Finally, the provision of testing and antiretroviral medicines should continue.

52. Public services delivery should be improved, in line with the government's own agenda for economic and social development and poverty reduction. To this end, more resources should be allocated to undertake the necessary investment in health care, education and other social services, and basic infrastructure. Civil service reform and improvements in the public financial management system will be essential to bring spending in line with these priorities.

C. Technical Assistance and Relations with the World Bank

53. **In view of the existing administrative and institutional capacity constraints, technical assistance will continue to be required to strengthen economic policy formulation and implementation.** Further technical assistance from the Fund, the World Bank, and other partners would be needed to improve tax administration, budget preparation and execution, financial intermediation, governance, legal and judiciary frameworks, and statistical capacity building. As a participant of the GDDS, Lesotho is continuing to receive technical assistance for statistical improvement. Technical assistance recommendations should be integrated into program monitoring.

54. **Improved donor coordination is crucial to ensure an effective delivery of technical assistance.** Excessive or inconsistent advice should be avoided, coordination should be maximized on the sequencing and pace of reforms, and emphasis should be placed on institution and capacity building.

55. **The current division of labor between the World Bank and the Fund should continue.** The Fund would lead the dialogue on macroeconomic policy and structural reforms of fiscal management. The Bank would continue to lead the dialogue on most structural reforms, including employment generation through private sector development, civil service reform, infrastructure development, education, health, HIV/AIDS, and poverty monitoring and evaluation.[14] The two institutions would closely collaborate on, and share responsibility for public sector and financial sector reform.

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[14] The World Bank's overarching objectives for future lending to Lesotho are sustainable growth and the improvement of private sector competitiveness, in order to support job creation. The World Bank is preparing the Country Assistance Strategy (CAS) for the

(continued)

VI. FUTURE FUND RELATIONS WITH LESOTHO

56. **Despite progress made so far, Lesotho continues to face a challenging reform agenda and needs to preserve macroeconomic stability, which is key for raising long-term growth and reducing poverty.** A significant part of the reform agenda falls within the core areas of the Fund's expertise and responsibility. These include achieving medium-term fiscal sustainability through improving tax administration and public expenditure management, strengthening resilience to shocks by a further diversification of the economy, supporting financial sector reforms, and improving governance.

57. **Lesotho continues to be exposed to a number of exogenous shocks**, such as declining SACU revenues, the phasing out of the WTO quota regime in 2005, declining workers' remittances, and recurrent droughts. Furthermore, the HIV/AIDS pandemic imposes heavy social and economic costs, with almost one third of the adult population infected.

58. **Continued Fund program involvement would help strengthen commitment and add credibility to the authorities' reform efforts.** It would also help catalyze the necessary concessional resources from the international community, thus contributing to achieve the MDGs. Finally, it would also be consistent with the need to assist, over the long term, low-income countries in making the transition to market-based economies.[15]

59. For all the reasons, **there is a case for further use of Fund resources through a successor PRGF arrangement**. It should be noted that Lesotho's repayment record is excellent.

60. **Looking ahead, further program involvement will depend on progress in the reform agenda and a reduction in vulnerabilities to exogenous shocks, as well as in poverty reduction and the attainment of the MDGs**. Given the uncertainties involved, consideration of a possible exit strategy for Lesotho from Fund financial assistance will need to be reassessed at the end of the new possible PRGF arrangement.

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period 2004 to 2007, guided by the government's interim PRSP, the full PRSP that is expected to be finalized before the end of 2004, past development plans, and the Millennium Development Goals.

[15] "The Fund's Support of Low-Income Member Countries—Considerations on Instruments and Financing".

Table 1. Lesotho: Lending Arrangements as of June 30, 2004
(In thousands of SDRs)

	Date of Arrangement	Date of Expiration or Cancellation	Amount Agreed	Amount Drawn	Amount Outstanding
SAF	29-Jun-88	28-Jun-91	10,570	10,570	0
ESAF	22-May-91	1-Aug-94	18,120	18,120	0
Stand-By	23-Sep-94	31-Jul-95	8,365	0	0
Stand-By	31-Jul-95	30-Jul-96	7,170	0	0
Stand-By	23-Sep-96	22-Sep-97	7,170	0	0
PRGF	9-Mar-01	31-Oct-04	24,500	21,000	21,000
Total			75,895	49,690	21,000

Table 2. Lesotho: Selected Economic and Financial Indicators, 1991/92-2003/04 1/

	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04 Est.
	(Annual percentage change, unless otherwise specified)												
National income and prices													
Real GDP	4.1	4.6	3.7	3.7	5.9	9.5	4.8	-3.5	0.5	1.9	3.3	3.7	3.2
Real GNP	-0.6	1.6	-0.3	0.3	2.7	8.1	3.5	-6.5	-0.3	0.7	1.0	3.8	2.3
Consumer price index (average change)	17.0	17.7	8.4	9.4	9.4	8.8	8.0	8.6	7.1	6.2	9.2	9.3	6.4
Nominal GDP (in millions of maloti)	2,018	2,436	2,746	3,070	3,551	4,220	4,770	5,082	5,669	6,137	6,839	7,735	8,533
Nominal GNP (in millions of maloti)	3,148	3,669	3,800	4,266	4,796	5,631	6,311	6,492	7,183	7,685	8,374	9,477	10,361
External sector 2/													
Exports, f.o.b.	39.9	42.2	23.6	7.9	3.8	23.1	3.3	-3.0	-1.6	18.4	31.7	29.8	36.1
Imports, f.o.b.	42.6	2.0	-7.8	-2.9	24.5	-2.8	3.0	-23.3	1.9	-10.0	-7.7	21.9	31.1
Net labor income	0.8	-2.1	-18.2	4.3	3.3	-15.0	5.8	-25.1	2.5	-12.5	-22.7	8.2	44.8
Nominal effective exchange rate 3/	-4.6	-4.1	-8.4	-8.4	-4.8	-15.7	-0.1	-17.5	-3.2	-11.3	-20.3	-7.2	30.8
Real effective exchange rate 3/	6.7	8.3	-3.2	-4.2	0.6	-11.1	5.4	-12.2	2.4	-8.5	-15.7	1.0	34.3
Government budget													
Revenue (excluding grants)	30.5	24.3	23.9	13.9	17.2	20.7	10.4	-3.3	6.4	13.6	6.1	8.9	13.3
Total expenditure and net lending	17.8	10.9	14.6	14.2	18.1	22.5	14.1	4.1	38.3	-15.1	2.6	24.5	-2.9
Current expenditure	36.3	16.3	15.3	17.5	14.0	5.4	25.0	31.8	19.3	5.0	-5.0	23.6	2.5
Capital expenditure and net lending	-4.8	1.4	13.1	7.4	27.1	56.6	-0.6	-42.9	112.8	-59.2	45.5	28.2	-22.0
Money and credit													
Net foreign assets 4/	8.8	38.9	50.0	38.8	40.0	45.9	58.6	35.6	-9.8	5.1	85.5	-70.6	-11.1
Net domestic assets 4/	-10.9	-28.5	-15.1	-29.7	-33.0	-28.7	-34.9	-28.7	7.7	1.1	-68.5	73.4	16.5
Credit to the government 4/	-17.5	-34.8	-44.3	-30.4	-31.2	-47.4	-31.2	5.6	57.9	20.9	3.7	15.0	-5.9
Credit to the rest of the economy 5/	34.1	13.4	65.6	27.8	-5.2	17.8	27.1	-3.9	-7.5	1.2	-6.0	-45.8	15.2
Broad money	-2.1	10.3	34.9	9.1	7.0	17.2	23.7	6.9	-2.1	6.1	17.0	2.7	5.3
Velocity (GDP/average broad money)	3.1	3.5	3.0	3.0	3.3	3.3	3.2	3.0	3.3	3.5	3.5	3.6	3.8
	(In percent of GDP, unless otherwise specified)												
Investment and saving													
Investment	59.4	43.3	55.2	57.1	59.9	57.2	52.2	47.5	46.9	41.5	40.3	37.6	34.1
Public	17.6	14.8	14.9	14.3	15.7	20.7	18.2	9.8	8.5	7.7	12.1	9.7	7.6
Private	7.7	9.2	18.2	13.7	15.5	11.9	12.3	14.8	26.2	23.2	21.4	20.7	21.2
Lesotho Highlands Water Project	34.0	19.3	22.1	29.1	28.7	24.6	21.6	23.0	12.3	10.7	6.9	7.2	5.4
Gross national savings (including remittances)	13.5	12.6	27.8	31.5	25.4	26.9	21.2	22.5	24.1	23.3	27.0	20.9	24.0
Government budget													
Revenue	40.6	41.8	46.0	46.9	47.5	48.2	47.1	42.8	40.8	42.8	40.8	39.2	40.3
Total grants	7.4	5.8	5.0	4.7	4.6	4.8	3.7	2.4	2.3	2.0	2.8	3.8	2.1
Total expenditure and net lending 6/	48.5	44.5	45.3	46.2	47.2	48.6	49.1	48.0	59.5	46.7	43.0	47.3	41.7
Overall balance (before grants)	-7.9	-2.7	0.7	0.6	0.3	-0.4	-2.0	-5.2	-18.7	-3.9	-2.2	-8.1	-1.4
Overall balance (after grants)	-0.5	3.1	5.7	5.3	4.9	4.4	1.8	-2.8	-16.4	-1.8	0.6	-4.2	0.7
Domestic Primary balance	1.0	4.6	7.3	6.2	5.6	5.1	2.4	-2.2	-15.0	0.0	1.7	-2.8	2.2
Gross government debt 7/	...	64.4	75.1	70.8	66.1	67.2	63.0	83.9	89.6	88.9	89.8	87.5	59.8
Domestic debt	11.6	12.1	17.6	9.6	9.6	6.7	4.6	4.4	15.4	18.4	16.4	16.6	12.9
External debt 7/	...	52.3	57.6	61.2	56.4	60.4	58.4	79.5	74.3	70.5	73.4	71.0	47.0
External debt-service ratio 8/	...	...	...	...	...	...	...	...	24.0	27.9	12.9	12.0	8.2
External sector													
Current account balance (excluding official transfers)	-63.4	-51.3	-47.8	-47.2	-56.2	-49.7	-50.7	-40.7	-39.6	-33.1	-30.0	-33.2	-25.5
Current account balance (including official transfers)	-45.8	-30.8	-27.3	-25.6	-34.5	-30.2	-30.9	-25.0	-22.8	-18.2	-13.2	-17.0	-11.1
Gross official reserves (end of period)													
(In millions of U.S. dollars)	129.9	170.1	290.8	393.6	454.2	523.6	604.6	552.1	470.1	393.3	399.7	408.4	436.8
(In months of imports of goods and services) 9/	1.6	2.2	3.6	4.3	4.6	5.8	8.7	7.9	7.4	6.7	5.5	4.3	4.3

Sources: Lesotho authorities and Fund staff projections.

1/ Fiscal year beginning in April.
2/ In U.S. dollars.
3/ Based on partner-country data excluding South Africa. A minus sign indicates a depreciation.
4/ Change in percent of broad money at the beginning of the period.
5/ Credit to the rest of the economy affected by bad loans written-off in 2002/03.
6/ Recapitalization of the old Lesotho Bank raised expenditure in 1999/00.
7/ The appreciation of the loti versus the U.S. dollar has a significant effect on the debt to GDP ratio in 2003/04.
8/ In percent of exports of good and services.
9/ The stock of gross official reserves at the end of each fiscal year, measured in months of imports of goods and services during the following fiscal year.

Table 3. Lesotho: Programmed Targets and Outcomes of Key Macroeconomic Variables, 1991/92-2003/04 1/
(In percent of GDP, unless otherwise indicated)

	1991/92 2/		1992/93 2/		1993/94 2/		1994/95 2/		1995/96 2/		1996/97 2/	
	Prog. 3/	Act.	Prog. 4/	Act.	Prog. 5/	Act.	Prog. 6/	Act.	Prog. 7/	Act.	Prog. 8/	Act.
National income and prices												
Real GDP (annual percentage change)	7.1	4.1	1.6	4.6	7.0	3.7	11.8	3.7	7.4	5.9	13.1	9.5
Real GNP (annual percentage change)	0.9	-0.6	-2.9	1.6	6.5	-0.3	7.6	0.3	5.3	2.7	10.2	8.1
Gross savings	77.2	13.5	51.1	12.6	52.8	27.8	58.4	31.5	60.8	25.4	48.2	26.9
Gross investment	82.6	59.4	86.0	43.3	89.3	55.2	90.6	57.1	87.1	59.9	78.3	57.2
Inflation (end of period; annual percentage change)	13.3	16.5	14.0	15.3	13.0	6.1	8.0	10.7	7.8	9.3	10.0	8.8
Government budget												
Overall balance (including grants)	-1.2	-0.5	-0.6	3.1	3.6	5.7	4.3	5.3	2.9	4.9	1.8	4.4
Revenue	41.1	40.6	43.2	41.8	47.4	46.0	45.9	46.9	42.2	47.5	40.1	48.2
Grants	9.3	7.4	6.3	5.8	6.8	5.0	6.5	4.7	4.7	4.6	3.9	4.8
External sector												
Current account	-5.4	-45.8	-34.9	-30.8	-36.5	-27.3	-32.2	-25.6	-26.3	-34.5	-30.1	-30.2
Remittances	71.1	57.4	60.4	48.2	55.5	40.0	53.8	40.0	45.4	36.7	47.5	32.0
Exports (millions of U.S. dollars)	76	79	67	112	140	139	131	150	165	155	218	191
Imports (millions of U.S. dollars)	779	894	816	912	1,195	842	1,054	879	1,117	1,018	1,094	989
Gross official reserves (in millions of U.S. dollars)	...	130	...	170	271	291	352	394	448	454	478	524
Gross official reserves (in months of imports)	...	1.7	...	2.2	2.7	4.1	4.0	5.4	4.8	5.4	5.2	6.4
External debt	64.5	...	57.0	52.3	56.1	57.6	57.5	61.2	57.7	56.4	46.0	60.4

Table 3. Lesotho: Programmed Targets and Outcomes of Key Macroeconomic Variables, 1991/92-2003/04 (concluded)
(In percent of GDP, unless otherwise indicated)

	1997/98	1998/99	1999/00	2000/01		2001/02		2002/03		2003/04	
	Act.	Act.	Act.	Prog. 9/	Act.	Prog. 9/	Act.	Prog. 10/	Act.	Prog. 11/	Est.
				(In percent of GDP, unless otherwise indicated)							
National income and prices											
Real GDP (annual percentage change)	4.8	-3.5	0.5	2.4	1.9	2.8	3.3	2.8	3.7	4.2	3.2
Real GNP (annual percentage change)	3.5	-6.5	-0.3	0.7	0.7	1.7	1.0	1.3	3.8	3.5	2.3
Gross savings	21.2	22.5	24.1	7.9	23.3	10.6	27.0	26.5	20.9	24.3	24.0
Gross investment	52.2	47.5	46.9	26.3	41.5	24.4	40.3	32.5	37.6	37.2	34.1
Inflation (end of period; annual percentage change)	7.3	8.9	6.3	6.0	6.2	5.7	10.5	8.4	9.3	9.4	5.2
Government budget											
Overall balance (including grants)	1.8	-2.8	-16.4	-3.9	-1.8	-0.8	0.6	-0.8	-4.2	-3.8	0.7
Revenue	47.1	42.8	40.8	40.4	42.8	42.6	40.8	39.5	39.2	39.2	40.3
Grants	3.7	2.4	2.3	3.4	2.0	4.1	2.8	5.1	3.8	3.3	2.1
External sector											
Current account	-30.9	-25.0	-22.8	-18.4	-18.2	-13.9	-13.2	-6.0	-17.0	-12.9	-11.1
Remittances	31.5	27.3	26.6	24.4	25.5	22.6	23.0	20.4	22.4	21.3	21.4
Exports (millions of U.S. dollars)	197	191	188	200	223	201	294	249	381	563	519
Imports (millions of U.S. dollars)	1,019	781	796	687	717	640	661	565	806	1,048	1,057
Gross official reserves (in millions of U.S. dollars)	605	552	470	359	393	383	400	360	408	399	437
Gross official reserves (in months of imports)	7.1	8.5	7.1	6.3	6.6	7.2	7.3	7.7	6.1	4.6	5.0
External debt	58.4	79.5	74.3	67.2	70.5	63.6	73.4	75.0	71.0	50.1	47.0

Sources: Various staff reports.

1/ Fiscal year beginning in April.
2/ A comprehensive revision of statistical data in the late 1990s explains most of the deviation between programmed targets and actual outcomes.
For example, actual real GNP growth is now reported to have been -0.3 percent in 1993/94 but was first reported as a positive 8.6 percent.
3/ Based on projections in the economic program supported by a three-year arrangement under the ESAF, April 25, 1991.
4/ Based on projections in the economic program in the request for the second annual arrangement under the ESAF, June 9, 1992.
5/ Based on projections in the economic program in the request for the third annual arrangement under the ESAF, July 13, 1993.
6/ Based on projections in the economic program supported by a Stand-By Arrangement, August 26, 1994.
7/ Based on projections in the economic program by a Stand-By Arrangement, July 17, 1995.
8/ Based on projections in the economic program by a Stand-By Arrangement, September 9, 1996.
9/ Based on projections in the economic program supported by a three-year arrangement under the PRGF, February 15, 2001.
10/ Based on projections in the economic program in the second review of the three-year arrangement under the PRGF, March 4, 2002.
11/ Based on projections in the economic program in the fourth review of the three-year arrangement under the PRGF, May 23, 2003.

Table 4. Lesotho: Selected Social and Demographic Indicators, 1991-2001

	1991	1993	1995	1997	1999	2001
I. Population characteristics						
Life expectancy at birth (years):						
Total	...	...	52.4	48.4	44.6	43.3
Female	...	...	53.3	49.1	45.1	43.8
Male	...	...	51.5	47.8	44.1	42.9
Mortality rate, infant (per 1,000 live births)	...	...	97.0	95.0	...	91.0
Birth rate, crude (per 1,000 people)	...	...	35.7	35.3	...	31.8
Death rate, crude (per 1,000 people)	...	...	12.0	12.4	...	18.5
Fertility rate, total (births per woman)	...	...	4.9	4.8	...	4.3
II. Education						
Illiteracy rate (in percent):						
Adult total (of population 15+)	21.4	20.3	19.1	18.1	17.1	16.1
Young adult female (aged 15-24 years)	2.7	2.4	2.1	1.9	1.6	1.4
Young adult male (aged 15-24 years)	22.2	21.0	19.8	18.8	17.8	16.8
School enrollment (in percent):						
Primary, net enrollment	74.3	71.9	70.5	65.9	58.5	...
Female	82.7	79.1	76.2	71.0	62.3	...
Male	66.0	64.8	65.0	60.9	54.7	...
Secondary, net enrollment	14.9	17.5	...	15.1	18.8	...
Female	20.0	23.0	...	20.0	23.8	...
Male	9.8	12.0	...	10.3	13.8	...
Secondary, gross enrollment	24.7	26.8	30.8	...	33.2	...
Pupil-teacher ratio, primary education	54.0	48.6	47.7	...	44.4	...
III. Health						
Immunization (in percent of children under 12 months):						
DPT	78.0	83.0	88.0	88.0	85.4	85.0
Measles	80.0	81.0	83.0	80.0	77.0	77.0
IV. Land use						
Arable land (in percent of total land area)	10.5	10.9	10.5	10.7	10.7	...
V. Labor force						
Total (in thousands)	691	723	759	794	824	852
Female (in percent of total)	36.5	36.6	36.7	36.8	36.9	37.0

Source: World Bank, *World Development Indicators.*

Table 5: Lesotho: Quantitative Performance Criteria Under Fund Arrangements, 1991-2004

	ESAF (1991-94)			Stand-By Arrangements (1994-1997) 1/												PRGF (2001-04) 2/				
	9/91	9/92	9/93	9/94	12/94	3/95	6/95	9/95	12/95	3/96	6/96	9/96	12/96	3/97	6/97	3/01	9/01	3/02	9/02	6/03
Type of condition																				
Net domestic assets	M															M	M	M	M	M
Net domestic credit		M	M	NM	M	M	M	M	M	M	M	M	M	M	M					
Net credit to government	M	M	M	NM	M	M														
Net bank credit to government							M	M	M	M	M	M	M	M	M					
Domestic financing requirement of central government																M	M	NM	NM	NM
Recurrent expenditure	NM																			
Overall fiscal surplus	M	M	M																	
Contracting or guaranteeing of nonconcessional loans by government 3/																				
0-1 year				M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M	M
1-15 years	M	M	M	M	M	M	M	M	M	M	M					M	M	M	M	M
1-5 years												M	M	M	M					
5 years or more												NM	NM	NM	NM					
External payment arrears 3/																M	M	M	M	M
Net external reserves	M	M	M				M	M	M	M	M	NM	M	M	M	M	M	M	M	M
Cumulative increase of net external reserves				NM	M	M														
Total number of conditions	6	5	5	4	4	4	4	4	4	4	4	4	4	4	4	5	5	5	5	5
Share not met (in percent)	17	0	0	75	0	0	0	0	0	0	0	50	25	25	25	0	0	20	20	20

Sources: Various staff reports.

1/ Due to delays in implementation of structural reforms, the midterm review of the third annual arrangement could not be completed before it lapsed on September 22, 1997. For each criterion, M indicates that the criterion was met and NM that it was not met.
2/ Excluding the sixth review, which has yet to be held.
3/ Continuous zero ceilings.

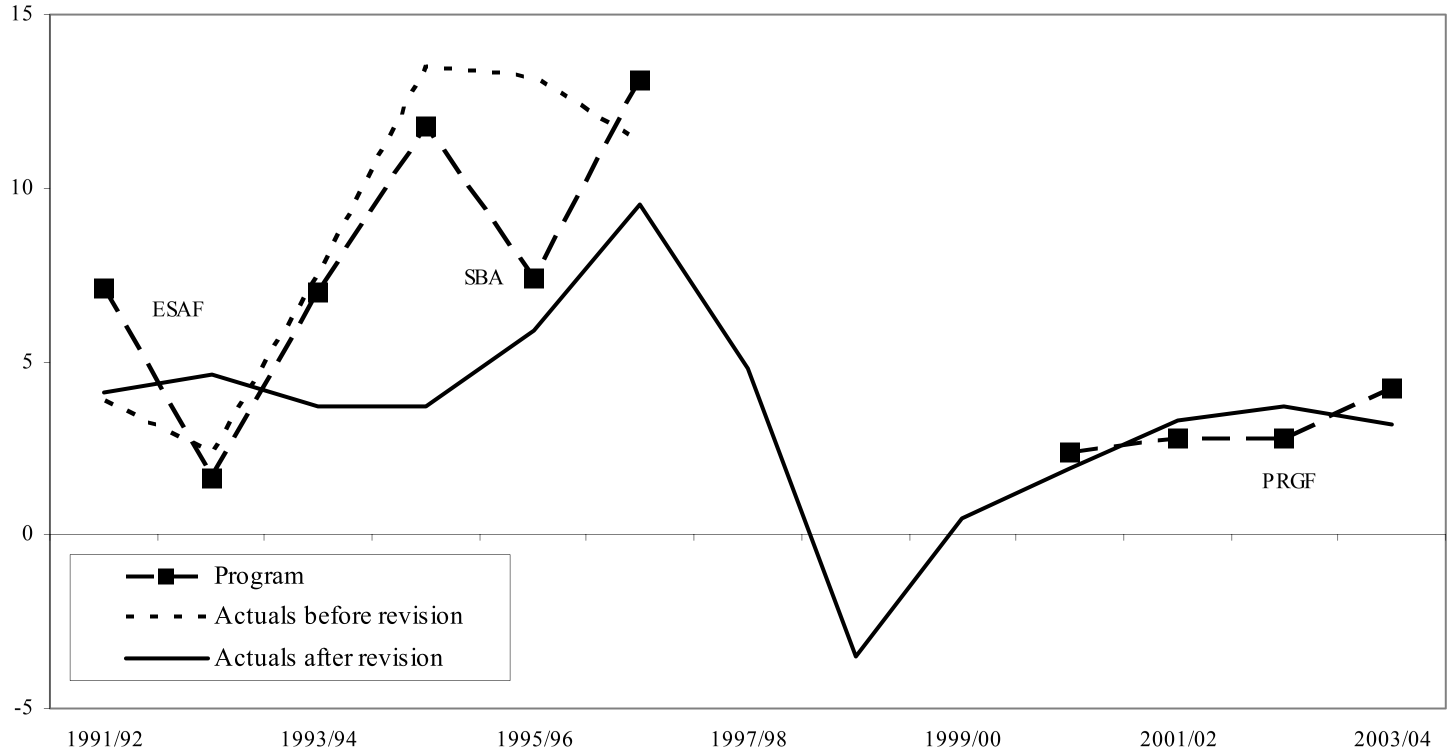
Table 6: Lesotho: Structural Conditionality Under Fund Arrangements, 1991-2004 1/

	ESAF (1991-94)		SBA (1994-1997) 2/		PRGF (2001-04) 3/	
	Met	Not met	Met	Not met	Met	Not met
Number and type of condition						
Tax policy and administration	1 PA	1 PC	1 SB	1 PC; 1 SB	5 PC; 6 SB	
Fiscal management incl. expenditure policy	1 PA; 1 PC			4 SB	4 PC; 9 SB	7 PC; 4 SB
Monetary policy			1 SB			
Financial sector reform	1 PC; 3 SB	1 SB	1 PC		2 PC; 4 SB	2 PC; 4 SB
Statistics					4 SB	1 SB
Public enterprise reform incl. privatization	1 PA; 1 PC; 1 SB	1 PC; 3 SB	2 PC; 3 SB	2 PC; 9 SB		
Civil service reform	1 PA			1 SB	1 SB	
Sectoral policy	2 PA	1 SB	1 PC			1 SB
Social safety net	2 SB					
Total number of conditions						
PA	6		0		0	
PC	5		7		20	
SB	11		20		34	
Share of conditions (in percent)						
PA	100	--	...	...	...	...
PC	60	40	57	43	55	45
SB	55	45	25	75	71	29

Sources: Various staff reports.

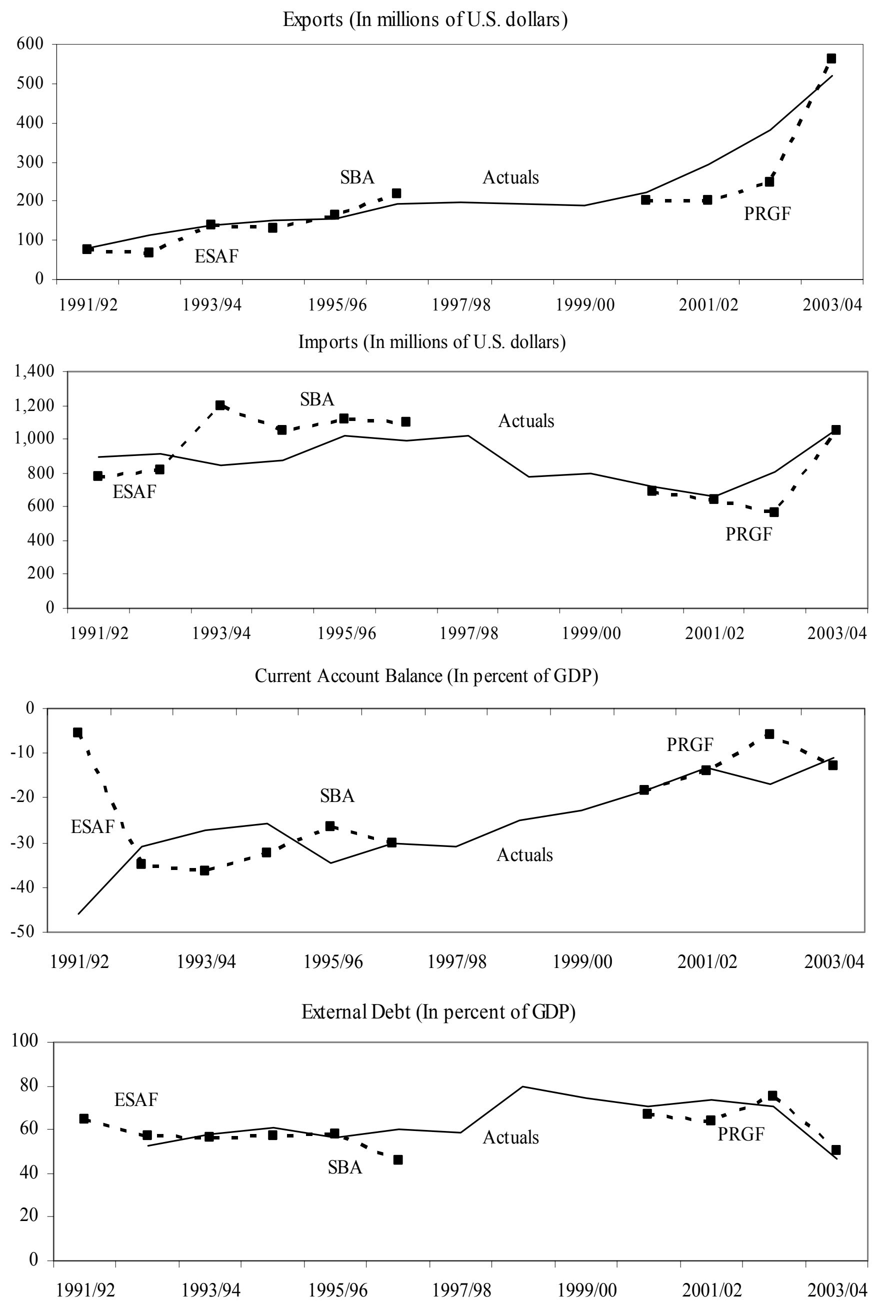
1/ The abbreviations are as follows: PA=prior action, PC=performance criteria, and SB=structural benchmark.
2/ Due to delays in implementation of structural reforms, the midterm review of the third annual arrangement could not be completed before it lapsed on September 22, 1997.
3/ Excluding the sixth review, which has yet to be held.

Figure 1. Lesotho: Real GDP, 1991/92-2003/04
(Annual percentage change)



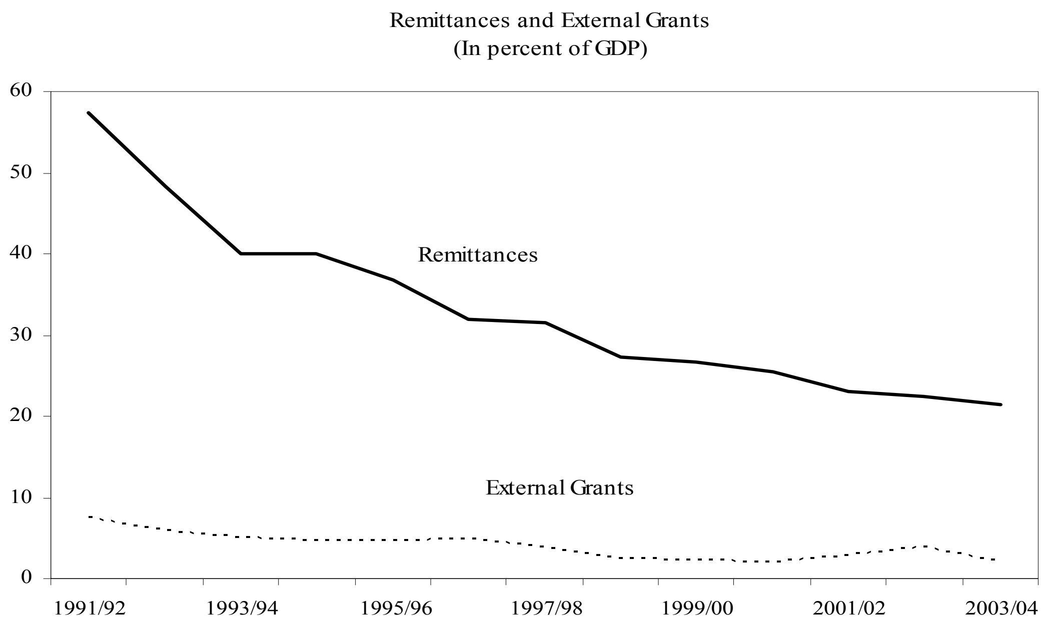
Sources: Lesotho authorities; and Fund staff estimates.

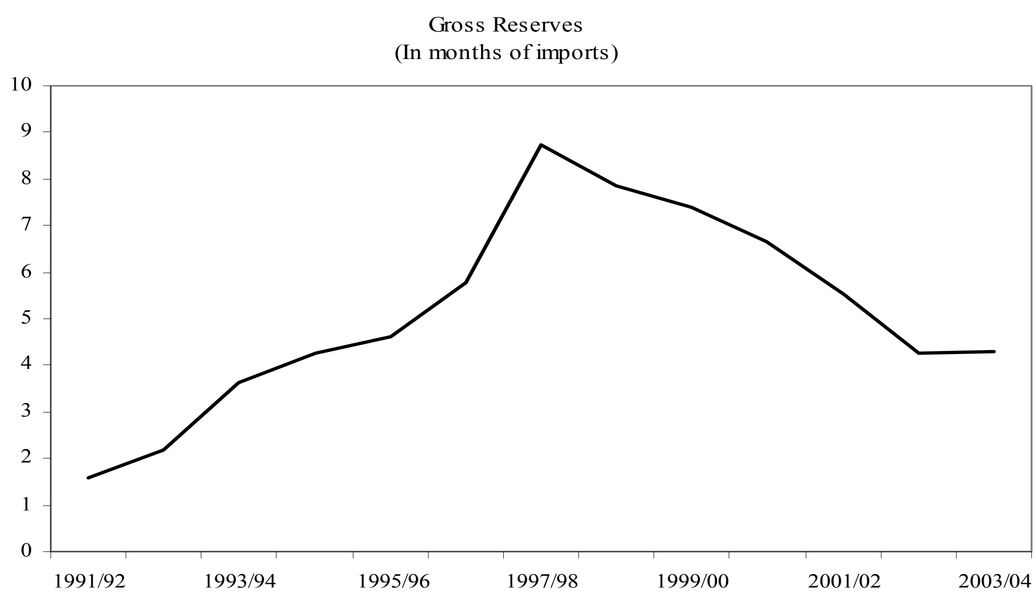
Figure 2. Lesotho: Exports, Imports, Current Account Balance, and External Debt, 1991/92-2003/04



Sources: Lesotho authorities; and Fund staff estimates.

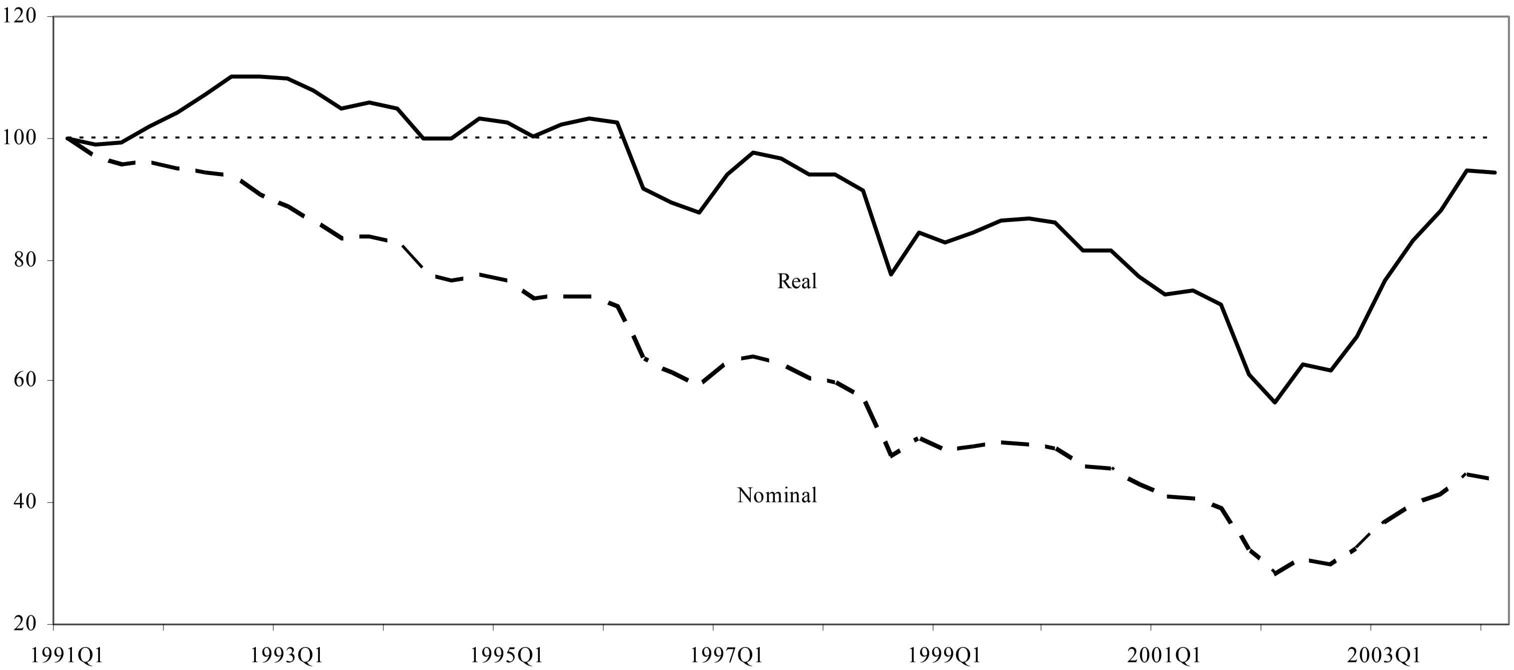
Figure 3. Lesotho: Remittances, External Grants, and Gross Reserves, 1991/92-2003/04





Sources: Lesotho authorities; and Fund staff estimates.

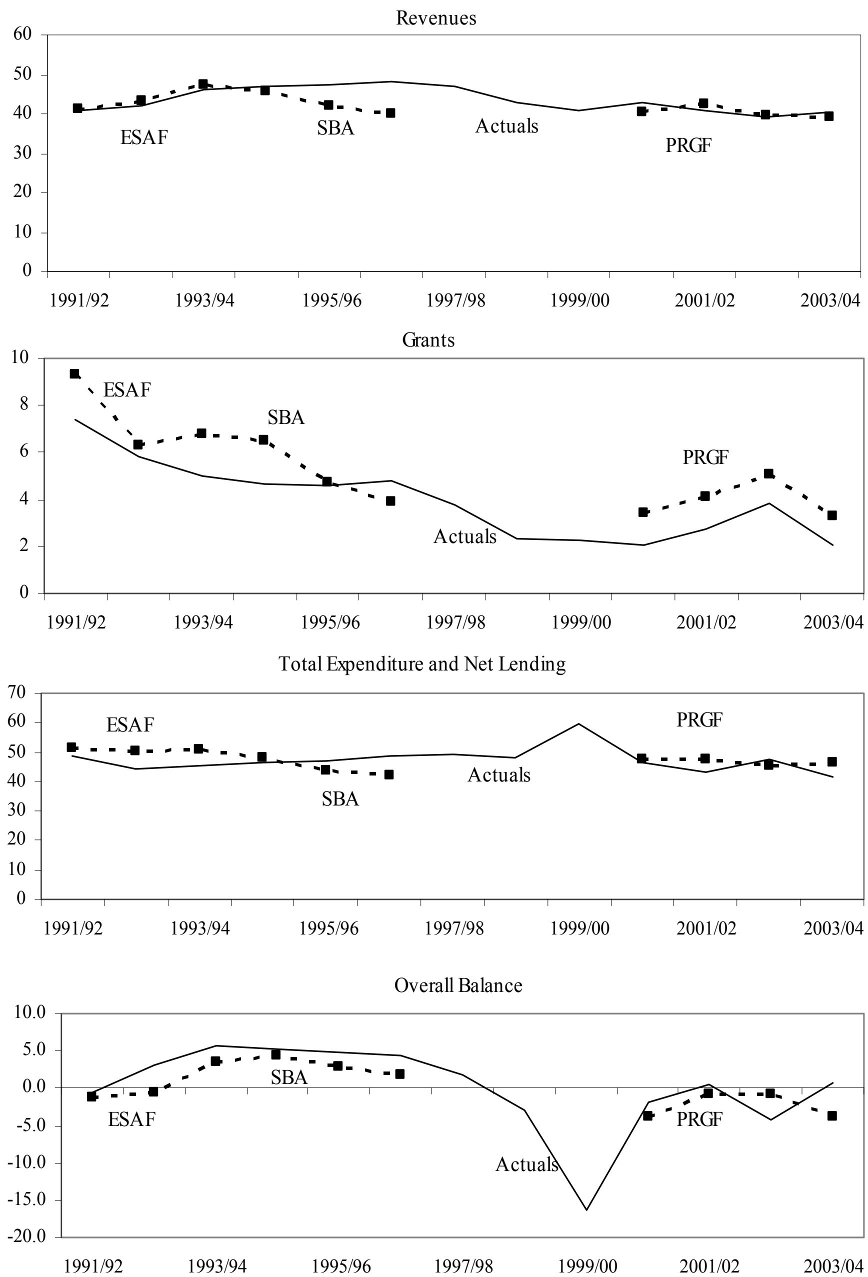
Figure 4. Lesotho: Nominal and Real Effective Exchange Rates, 1991:Q1-2004:Q1 1/
(Index, 1991:Q1=100)



Source: IMF *International Financial Statistics* .

1/ Lesotho's trading partners excluding South Africa.

Figure 5. Lesotho: Fiscal Revenues, Grants, Expenditures, and Balance, 1991/92-2003/04
(In percent of GDP)



Sources: Lesotho authorities; and Fund staff estimates.