

KINGDOM OF LESOTHO



Lesotho Development Finance Assessment 2021



INFF

Integrated National
Financing Frameworks

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ABBREVIATIONS/ACRONYMS



ABC	All Basotho Convention
ADF	African Development Fund
AfDB	African Development Bank
AfDB	African Development Bank Group
AU	African Union
BCL	Business Council of Lesotho
BEDCO	Basotho Enterprises Development Corporation
BFP	Budget Framework Paper
BNP	Basotho National Party
BOS	Bureau of Statistics
BSP	Budget Strategy Paper
CBL	Central Bank of Lesotho
CBMS	Central Budget Management System
CBO	Community-based Organisation
COVID-19	(or C-19) Corona Virus 2019 (Severe Acute Respiratory Syndrome)
CPA	Corporate Political Activity
CSO	Civil Society Organisations
CSR	Corporate Social Responsibility
DAC	Development Assistance Committee
DC	Democratic Congress
DCR	Development Cooperation Report
DCEO	Directorate of Corruption and Economic Offences
DFA	Development Finance Assessment
DfID	Department for International Development
DSSI	Debt Service Suspension Initiative
EDP	Entrepreneurship Development Programme
EPM	Economic Planners' Manual
EPPCF	Ethiopian Public-Private Consultative Forum
ETL	Econet Telecom Lesotho
EU	European Union
FBO	Faith-based Organisation
FDIs	Foreign Direct Investments
FSDS	Financial Sector Development Strategy

ABBREVIATIONS/ACRONYMS



GCF	Green Climate Fund
GDP	Gender and Development Policy
GDP	Gross Domestic Product
GEF	Global Environmental Facility
GRB	Gender-Responsive Budgeting
HLCC	High-Level Consultative Council
HIV and AIDS	Human Immunodeficiency Virus and Acquired Immunodeficiency Syndrome
IATF	Inter-Agency Task Force on Financing for Development
IDA	International Development Association
IDP	International Development Partner
IFIs	International Financial Institutions
IFMIS	Integrated Financial Management Information System
IICPSD	UNDP Istanbul International Centre for Private Sector in Development
IMF	International Monetary Fund
INFF	Integrated National Financial Framework
IoD	Institute of Directors
IRMS	Integrated Revenue Management System
ITC	International Trade Centre
KPA	Key Priority Area
LEC	Lesotho Electricity Company
LEWA	Lesotho Electricity and Water Authority
LHDA	Lesotho Highlands Water Authority
LHWP	Lesotho Highlands Water Project
LIPAM	Lesotho Institute of Public Administration and Management
LLWDP	Lesotho Lowlands Water Development Project
LMIC	Lower-Middle-Income Country
LNDC	Lesotho National Development Corporation
LNOB	Leave No One Behind
LRA	Lesotho Revenue Authority
LTDC	Lesotho Tourism Development Corporation
MCC	Maseru City Council
MDAs	Ministries, Districts and Agencies
MEC	Movement for Economic Change
MoDP	Ministry of Development Planning
MoEM	Ministry of Energy and Meteorology

ABBREVIATIONS/ACRONYMS



MoEMWA	Ministry of Energy, Meteorology and Water Affairs
MoF	Ministry of Finance
MoFA	Ministry of Foreign Affairs (and International Relations)
MoFDP	Ministry of Finance and Development Planning
MoGYSR	Ministry of Gender, Youth, Sport and Recreation
MoJHR&CS	Ministry of Justice, Human Rights and Correctional Services
MoLG&PA	Ministry of Local Government and Chieftainship Affairs
MoLGC&PA	Ministry of Local Government, Chieftainship and Parliamentary Affairs (now defunct)
MoPS	Ministry of Public Service
MoSD	Ministry of Social Development
MoTI	Ministry of Trade and Industry
MSM	Maseru Securities Markets
MSMEs	Micro, Small and Medium Enterprises
MSND	Multi-Stakeholder National Dialogue
MTBF	Medium-Term Budgetary Framework
MTDS	Medium-term Debt Strategy
NCFM	National Climate Change Financing Mechanism
NDA	National Designated Authority
NDPC	National Dialogue Preparation Committee
NOC	National Oversight Committee
NPB	National Planning Board
NPC	National Planning Commission
NRA	National Reforms Authority
NRF	National Resource Fund
NSA	Non-state Actor
NSDP	National Strategic Development Plan
OBFC	One-stop Business Facilitation Centre
ODA	Official Development Assistance
ODF	Official Development Finance
OOF	Other Official Flows
OECD	Organisation for Economic Cooperation and Development
PCGF	Partial Credit Guarantee Fund
PDMD	Public Debt Management Department
PFM	Public Financial Management
PFMR	Public Financial Management Reform
PFP	Popular Front for Democracy

ABBREVIATIONS/ACRONYMS



PPP	Public-Private Partnerships
PPPP	Public-Private Partnerships Policy
PSID	Public Sector Investment Database
R&D	Research and Development
RIDMP	Regional Infrastructure Development Master Plan
RoA Africa	Reality of Aid Africa Network
RSA	Republic of South Africa
SADC	Southern African Development Community
SACU	Southern African Customs Union
SLB	Standard Lesotho Bank
SSC	South-South Cooperation
SSTC	South-South and Triangular Cooperation
STAP	Short-term Action Plan
STIP	Science, Technology and Innovation for Development Programme
TWG	Technical Working Group
UN	United Nations
UNGA	United Nations General Assembly
UNCDF	United Nations Capital Development Fund
UNCTAD	United National Conference on Trade and Development
UNDESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
USD	United States Dollar
VAT	Value Added Tax
VfM	Value for Money
VNR	Voluntary National Review
WASCO	Water and Sewerage Company
WB	World Bank
WBG	World Bank Group
ZAR	South African Rand

EXECUTIVE SUMMARY



LESOTHO IS A SMALL, LANDLOCKED COUNTRY, with inextricable ties to the Republic of South Africa (RSA). The country's economy, which is one of the smallest in Southern Africa, has experienced a drop in GDP over the last few years. This trend has been accelerated by the COVID-19 pandemic that has hit it hard. The issues of troubling economic growth have also been accompanied by political instability, experienced in the mid-2010s. The country also exhibits a high prevalence of HIV and AIDS and tuberculosis, which drains the already limited health resources.

With support of the Southern African Development Community (SADC), Lesotho has introduced comprehensive societal reforms, aimed at bringing about major changes in the constitutional, legal, economic, political and cultural spheres. The process should strengthen democracy, accountability and transparency through multi-stakeholder dialogues, and other consultative initiatives meant to build a consensus on the nation's future. The national dialogue culminated in the adoption of the National Plenary II Report, which is a set of reform statements presenting a national consensus on the immediate future towards social, economic, and political development. The management of the reform processes, triggered through the national dialogue, has been entrusted to an autonomous statutory body, the National Reforms Authority (NRA).

Lesotho is committed to the UN 2030 Agenda for Sustainable Development and AU Agenda 2063: *The Africa We Want*, and this is reflected in the current National Strategic Development Plan II (2018-2023), henceforth NSDP II.

Lesotho's economy is small. Textile, manufacturing and mining industries dominate it, alongside the buoyant informal, unrecorded economy. The country's budget is funded through tax and non-tax revenue, grants and Southern African Customs Union (SACU) revenues. SACU revenues make up the largest contribution. However, these resources often fall short of development needs and priorities, resulting in low development results, increasing poverty and economic vulnerability. This further risks the prospects for achieving national development priorities and the respective global and regional development targets. Learning from the experience with NSDP I, the Government has developed a comprehensive NSDP II Financing Strategy, which outlines the main principles of financing the NSDP II. The Financing Strategy focuses on the domestic and international, as well as public and private investment flows. Domestic public finance includes tax and non-tax revenues, revenues from public entities, and Government borrowing, whilst international public finance flows come from Official Development Assistance (ODA), other official flows (OOFs) and South-South and Triangular Cooperation (SSTC). Domestic private finance flows come from private investment, credit to the private sector, domestic third sector and other forms of institutional investment, while international private flows are made of Foreign Direct Investments (FDIs), portfolio investment and international third sector finance. However, the challenge of mobilising sufficient financing for development remains critical.

The Addis Ababa Action Agenda (AAAA) has recommended a set of tools aimed at supporting countries to implement more integrated approaches to financing development, by implementing the Integrated National Financing Frameworks (INFFs). INFF help countries to strengthen their planning processes and overcome existing impediments to financing national priorities and the Sustainable Development Goals (SDGs) at the country level. It does this by facilitating alignment between short-term and medium-term finance policies, and the longer-term aspirations of national strategic plans. It also develops more holistic approaches to financing that mobilize impactful investments from public and private sources

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according to their characteristics. In this context, the Government, with the support from the development partners, has commissioned a Development Finance Assessment (DFA) study to map the major development finance resources and outline INFF.

The DFA, a conceptual model and methodology developed by UNDP, provides a snapshot of development finance, looking over a longer period of time. It assesses the development support infrastructure in the country and, ultimately, leads to the development of INFF, which in turn should contribute to the better mobilisation of development finance, while also pointing and outlining areas where the Government and development community may achieve best results effectively and efficiently.

Main findings

Lesotho experiences volatile financing flows, regardless of whether domestic or international. The country has, until now, had a low level of Government/public debt, a relatively high level of tax revenues, a very high level of workers' remittances, and a moderately low level of ODA grants. Currently, concessional loans dominate the debt composition, accounting for approximately 82 per cent of total public debt (MoF, 2021), even though it is expected that their share in the total public debt will decrease, and the country will have to borrow more in the financial markets, under commercial terms. Migrant workers employed in South Africa and a few other SADC states, represent a significant portion of the labour force, but COVID-19 and the resultant lockdown measures have affected their mobility. Resultantly, revenues from remittances are also on a decline.

Domestic public financial sources are a major source of development finance, and they were just below 39.51 per cent of GDP for the observed period (2005-2019). In the same period, taxes have contributed 39.47 per cent to the total public revenues, whilst the SACU revenues accounted for 43.66 of the public revenues. Other revenues represented 9.63 per cent of the aggregate public revenues, whilst the remaining 7.26 per cent were the grants (mainly from the development partners through the budget support programmes). SACU revenues are the most volatile. In the observed period, they have varied between 28.6 and 59 per cent of total revenues. Taxes in nominal terms have been growing, although their contribution to the total public revenues has varied (mainly influenced by the relative size of SACU receipts). Increases in the domestic revenues have significantly contributed to the ability of the country to finance NSDP II and, ultimately, towards achieving the SDGs, albeit with mixed results and alignment. Health and education sectors have had the highest budget allocation.

² Customs and trade taxes are collected by each individual member state and transferred to the Common Revenue Pool, on a quarterly basis; based on the Part 6 of the SACU Agreement 2002. The allocations are made based on the formula stipulated in the Part 7 of the SACU Agreement 2002. The national allocation is based on three elements: 1) customs component; 2) excise component and 3) development component. The former two components are based on the collections made by a member state, whilst the development component favours less developed member states (Article 34 of the Southern African Customs Union Agreement, 2002).

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Lesotho's public debt has been volatile and has ranged between USD0.75 and USD1.2 billion (between 2005 and 2019); and, varied between 40 to 50 per cent of GDP. Servicing of the public debt has been on the rise since 2014. It is expected that it will grow in the next few years as the country addresses the adverse impact of COVID-19. At present, Lesotho still has some space for attracting more public debt. However, it must be managed carefully and be used with stronger SDG aligned productive purposes to achieve sustainable development.

Domestic private investment is very low, partly due to the weak financial capacity of the sector and partly due to the lack of access to credit, especially for Micro, Small, and Medium Enterprises (MSMEs). Access to finance remains one of the major challenges in promoting the private economic initiative in the country, despite the Government's initiatives such as credit guarantee schemes. Many small non-bank financial intermediaries, including microfinance institutions, are important segments of the financial sector, but they cannot provide large-scale support. Bank Asset to GDP ratio in Lesotho was 19.03 per cent in 2017, putting the country in 149th place globally. Private sector capital is also constrained due to the underdeveloped domestic capital market and limited regulatory instruments. The Maseru Securities Market (MSM) was only created in 2014 and is still in a nascent phase, with a narrow offering (only debt instruments) and low liquidity.

Lesotho has developed the **Public-Private Partnership Policy (PPPP)** to encourage and manage private-public partnerships (PPPs). Although the experience on the PPP projects has not been that positive (for instance, the Queen 'Mamohato Memorial Hospital), the potential is there and should be explored. For a more aggressive PPP approach, it is necessary to enact PPP law and supporting regulations. NSDP II Financing Strategy also favours PPP as a source of alternative finance. Domestic Corporate Social Responsibility (CSR), impact investing and third sector finance are still new to Lesotho, hence contribute marginally to the overall development efforts. Domestic NGOs do not have the financial capacity and are largely dependent on foreign support. Building the capacity of the third sector is a priority, both for further democratisation of the society and for improving the domestic development institutional portfolio.

FDIs inflows have been moderate and do not fully reflect Lesotho's potential as an investment destination. Despite being a small market, with relatively high transport costs and limited infrastructure, Lesotho has been successful in attracting investments in a few sectors: garment industry, manufacturing, mining and energy (water). Portfolio investments have been of marginal importance for Lesotho. However, the Government would like to explore this source of finance, as well as venture capital. This must be approached with utmost caution, as these sources are very mobile and volatile, hence why a (financial) crisis can complicate the situation even more.

Remittances are not only the major private international finance flow, but also a major development finance source and a lifeline for almost 20 per cent of households in Lesotho. Remittance revenues have been volatile and have reflected the global and SADC economic situation. As the global demand falls and SADC economies (especially South Africa) experience contraction – remittances fall. Moreover, remittances have suffered in 2020 because of the COVID-19 restrictions and lockdowns. Facilitating remittance transfers and access through effective financial corridors with SADC countries should be a priority, as well as investing and supporting the development of innovative and digital finance platforms including digital remittances. The Government has realised the potential of diaspora and has prepared the Diaspora Strategy, which

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should yield results in the next few years. Diaspora bonds and a Diaspora Fund will be some of the initiatives to be explored.

International third sector finance has been seriously underutilised, where just a few USD million were mobilised annually, despite the obvious needs, especially in the health and education sectors. Providing a conducive working environment and enhanced local capacities for the international foundations to explore blended finance (through partnering and coproduction) may be necessary to increase the flows in this area.

Development in Lesotho has to be inclusive, be based on national consensus, address equity and quality, and ensure more equal, equitable and just society. All the strata of society have been mobilised and invited to contribute to the societal debate. In SDG-aligned planning and financing processes, there will be a need for an institutional overhaul and creation of new coordination and monitoring mechanisms and instruments, to ensure not only accountability and responsibility for the policy implementation but also actively monitor progress made in mobilising enabling finance for growth.

Public Sector and Public Financial Management (PFM) reforms were the first to be introduced, and based on their experiences, other reforms should be instigated. Further automation and digitalisation in the public sector should improve the access and quality of services rendered to the populace, ensuring value-for-money (VfM) and leaving no one behind (LNOB) principles are observed. Following the assessment of the current financial portfolio and policies, an INFF Roadmap was developed, which has made major recommendations for improvement in the mobilization of development finance (domestic and international; public and private); Monitoring and Review systems; Governance and Coordination mechanisms; as well as suggesting the areas for the further analysis and improvement. Each recommendation is based on a particular finding and over sixty recommendations, in total, have been made.

Summary of the key recommendations:

1. Establishing the annual targets for each of the development finance revenues with requisite institutional and SDG-target alignment.
2. Ensuring the alignment of the short-, medium- and long-term financing policies to the national development priorities, through integrated development planning, financing strategies, and implementation strategies, including the MTEFs.
3. Developing a centralised database for all the financing flows (both public and private) to enable integrated planning and financing of national priorities and facilitate monitoring and accountability.
4. Building internal capacities and institutional alignment to attract the untapped climate finance funds and leveraging opportunities for blended finance.

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5. Analysing and streamlining tax incentives in SDG-related sectors to attract international and domestic private finance and investments in the identified priority economic and social sectors and ensure that the foreign-owned firms are appropriately subjected to taxes and social contributions, in line with the domestic laws and regulations.
6. Strengthening the linkages between planning and budgeting (in the spirit of the Budget Strategy Paper, jointly presented by MoF and MoDP) by ensuring that budgeting and planning modules of IFMIS are complementary and operational.
7. Promoting gender inclusivity by introducing gender-responsive budgeting (GRB) and expenditure reporting to facilitate gender equality in the distribution of resources and attainment of development results.
8. Mobilising civil society organisations (CSOs) and the private sector to effectively participate in development efforts in the country and contribute to budget transparency, accountability, and SDGs aligned investments; with a special focus on cross-cutting issues, such as gender and climate change.
9. Undertake a comprehensive gender audit ■



1.1 Introduction

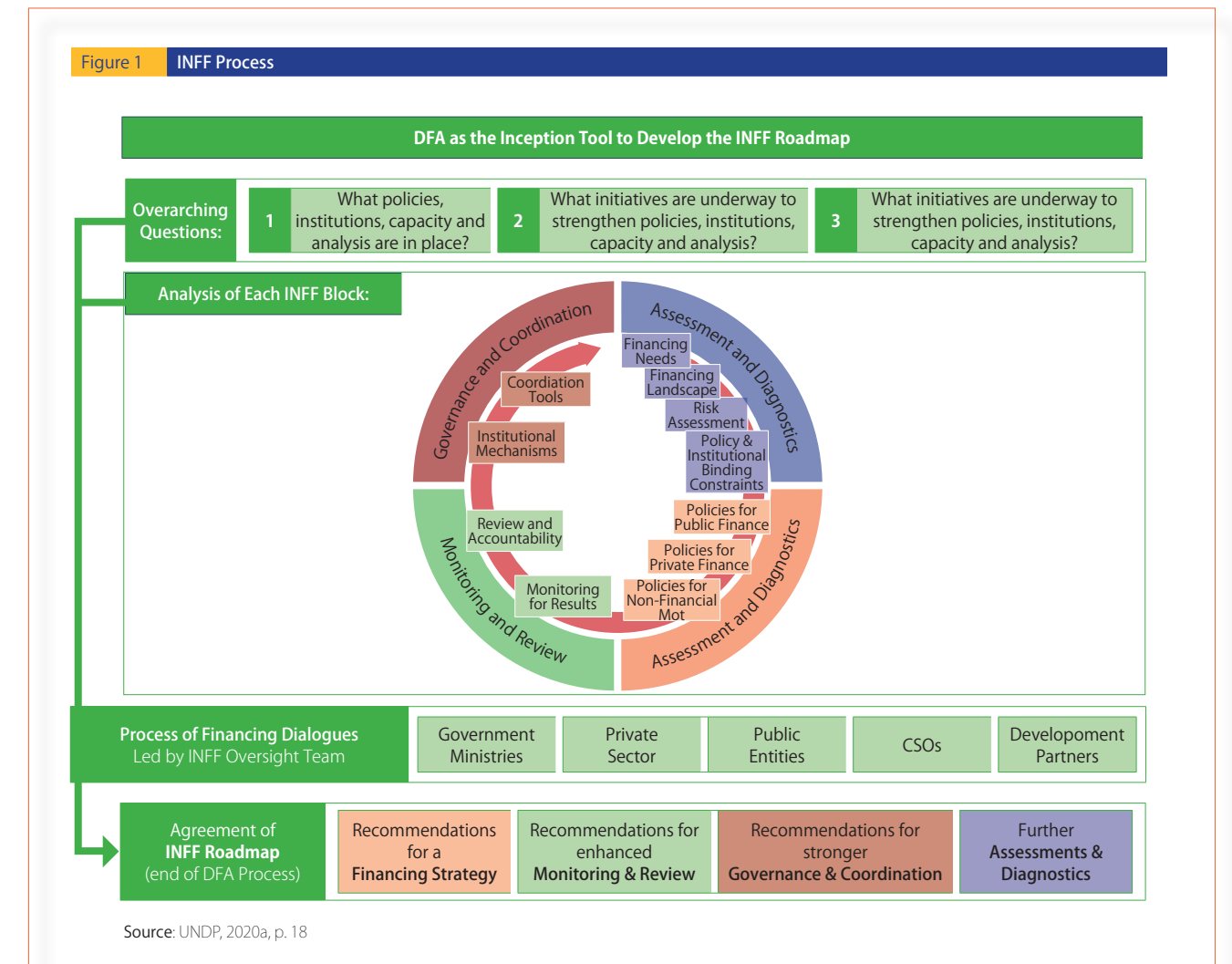
LESOTHO IS A SMALL COUNTRY, encircled by RSA, hereafter South Africa. It has just over two million citizens, primarily engaged in agriculture, mining, manufacturing or migrant work in South Africa. Since her independence in 1966, it has experienced periods of political instability and varying economic performance. Over the last decade, the political situation has stabilised and the economy has performed relatively well, despite many challenges. Poverty, high Gini coefficient, and extreme HIV and AIDS prevalence are significant societal challenges that have not been addressed effectively. These challenges have remained, even though it has grown to become a lower-middle-income country (LMIC).

Lesotho's economy has been in decline over the last few years, due to both internal and external factors. The economy is largely dependent on South Africa which is a major economic partner in terms of exports and imports as well as a destination country for most migrant workers. The real economic growth rate has been about 1.6 per cent over the last 5 years (2015-2019), and, due to COVID-19, the economy contracted another 5.3 per cent in 2020 (World Bank, 2020a). The economy had already experienced a slowdown and recession by March 2020, when the first cases of COVID-19 were reported, and the Government introduced a national lockdown, recording a decline of about 20 per cent, except for agriculture.

As an open economy, Lesotho is prone to external shocks, especially the remittances which have accounted for almost 26 per cent of GDP, on average, for period under review (2005-2019). The country has experienced a drop in international private finance revenues, as FDIs are declining and most likely will be very low in 2021. International development assistance has been volatile, and in decline. Domestic public revenues have been improving in nominal terms, although the ongoing reforms in public financial management have not yielded the expected improvements. Against this backdrop, the Government of Lesotho, through the Ministry of Development Planning (MoDP) and with the assistance of the UNDP, has initiated the preparation of the DFA, together with the development of an Integrated National Financing Framework (INFF) Roadmap. DFA is an inception tool developed by UNDP to support governments in establishing INFFs and managing better the development finance flows necessary in achieving the SDGs.

The DFA Guidebook (UNDP, 2020a) outlines the process of conducting the development finance assessment and ultimately building an effective INFF. DFA provides a broad picture of the development efforts and especially the development finance landscape, outlines the main trends, points out shortcomings and bottlenecks and contributes to the enhancement of development finance and ensuing strategies, focusing on supporting the national development efforts. In this process, various stakeholders must be engaged, i.e., public and private, domestic and international, to promote the SDG financing dialogue on three levels of integration: (1) between planning and financing systems; (2) between public and private actors; and (3) from a whole of society perspective.

DFA is finalised through the dialogue between the stakeholders, whose active participation is needed to ensure Government ownership of it. Figure 1 outlines the INFF process and four building blocks, which ideally should be a product of the consensus amongst all the development stakeholders.



PART I: THE CURRENT CONTEXT



Chapter 1: Assessing the Financing Context

1.1 Economic and Political Context

THE ECONOMY OF LESOTHO is based on agriculture, mining, and manufacturing, with tourism, touted as a potential growth driver. Agriculture is based on subsistence farming, which is the main source of revenue for half of the population; whilst it represents only roughly 4.7 per cent of the country's GDP (BoS, 2020). Much of the population (over 70 per cent) live in rural areas. Women are mainly employed in light manufacturing (textile industry), whereas males are either employed in a relatively small and focused domestic mining industry or they form part of migrant workers who spend 6 to 9 months working in South Africa - and to some extent, in other SACU countries (mainly in the mining industry). Unsurprisingly, the country is heavily dependent on remittances, mainly from SACU countries² (especially South Africa).

Manufacturing is almost entirely focused on the textile industry, where the major international brands have contracted factories in Lesotho. The country has utilised advantages offered by the US African Growth and Opportunity Act, 2000 (AGOA)³, which enables sub-Saharan African nations to engage easier with the US and gain access to the US market. The textile industry currently employs around 50,000 workers⁴, a number similar to the roughly 50,000 employed at the peak in 2004⁵. From 1990 when the sector employed some 7,400 workers, the focus on garment manufacturing has paid off, and about 20 per cent of the formal labour force is engaged in the industry, where the workers (mainly female) have found gainful employment.

Lesotho has a fairly large public sector. Due to this, the Government is usually the most important employer in the country (World Bank, 2020a)⁶. Economic growth in Lesotho generally exhibited a positive trend until 1998, when the political instability and conflict had an adverse effect, and over 80 per cent of the economic/commercial infrastructure was destroyed. Government efforts in the 1990s and the early 2000s saw a return of macroeconomic stability and a resumption of economic growth.

However, in the last half-a-decade, Lesotho has experienced serious economic challenges. This has mainly been on account of the economic slowdown in the US (the major export partner), South Africa (second most important export partner) and the EU (third most important export partner). These destinations are responsible for roughly 99 per cent of the country's exports, giving very little space for adjustment in challenging times. At the same time, all these economies are subjected

² SACU members are: Botswana, Eswatini (formerly Swaziland), Lesotho, Namibia and South Africa.

³ Title I, Trade and Development Act of 2000 (PL 106-200), initially was to last until 2015, but it was extended until 2025.

⁴ The number of employees in the textile industry in the quarter ending December 2020 was roughly 50,107 (CBL, 2021). https://www.centralbank.org.ls/images/Publications/Research/Reports/QuarterlyReviews/2020/Dec_2020_QER.pdf Some sources claim around 36,000 (https://theodora.com/wfbcurrent/lesotho/lesotho_economy.html).

⁵ IFC Smart lesson – Africa Can Compete! The Miracle of Tiny Lesotho—Sub-Saharan Africa's Largest Garment Exporter (<http://smartlessons.ifc.org/smartlessons/lesson.html?id=1342>).

⁶ Historically the public sector has been exchanging the first place with the manufacturing industry, especially in the years where there were challenges in the major economic partners.

PART I: THE CURRENT CONTEXT



to fairly similar business cycle trends. This synchronicity has recently been reflected in a slowdown in diamond mining in the domestic economy, coupled with less than favourable prices in the global diamond market. Moreover, a slowdown in the South African economy has resulted in a drop in remittance transfers, which have usually contributed over 25 per cent of the country's GDP in the most recent years.

Government economic reform attempts aimed at stimulating alternative forms of economic activity, other than basic subsistence farming, have had some success. However, diversification is still limited. The country has recently graduated as a LMIC, and although the per centage of the population living below the poverty line dropped from 58 per cent in 2002 to about 49.2 per cent in late 2017 (World Bank, 2019a), poverty remains a major challenge in Lesotho, as evidenced by a low Human Development Index, listed 165th out of 189 countries⁷ (UN, 2020). It is expected that the level of poverty will worsen due to the COVID-19 socio-economic challenges and the lockdown measures, which had immense adverse effects, especially on the Micro, Small, and Medium-sized Enterprises (MSMEs)⁸.

Lesotho's economic performance on a longer-term trend has been noticeable, despite numerous challenges. For instance, GDP per head has grown seven-fold between 1980 and 2017, from USD512 to USD3,581, respectively. Inflation (measured through GDP deflator) has been volatile, varying from -5.374 to 12.86 per cent and averaging 5.63 per cent, in the last 15 years. GDP growth averaged 3.4 per cent between 1980 and 2017 before experiencing a significant decline of -11.06 per cent in 2020⁹. Real GDP growth averaged 1.6 per cent between 2015 and 2019 and is projected to average 0.6 per cent between 2019 and 2021, chiefly due to the impact of the COVID-19 pandemic¹⁰.

⁷ A drop of 10 places compared to 2009 (155th out of 192 countries). See: UN, 2009.

⁸ In 2016 MSME sector had 76,000 firms, employing over 118,000 workers. Some 32 per cent of MSMEs owners in the sector are 35 years or younger and employ around 37,000 employees who are 30 years of age and younger (FinScope, 2016).

⁹ <https://data.worldbank.org/indicator/NY.GDPMKTRPKD.ZG?locations=LS>.

¹⁰ All data from the World Bank Open Data (Development Indicators).

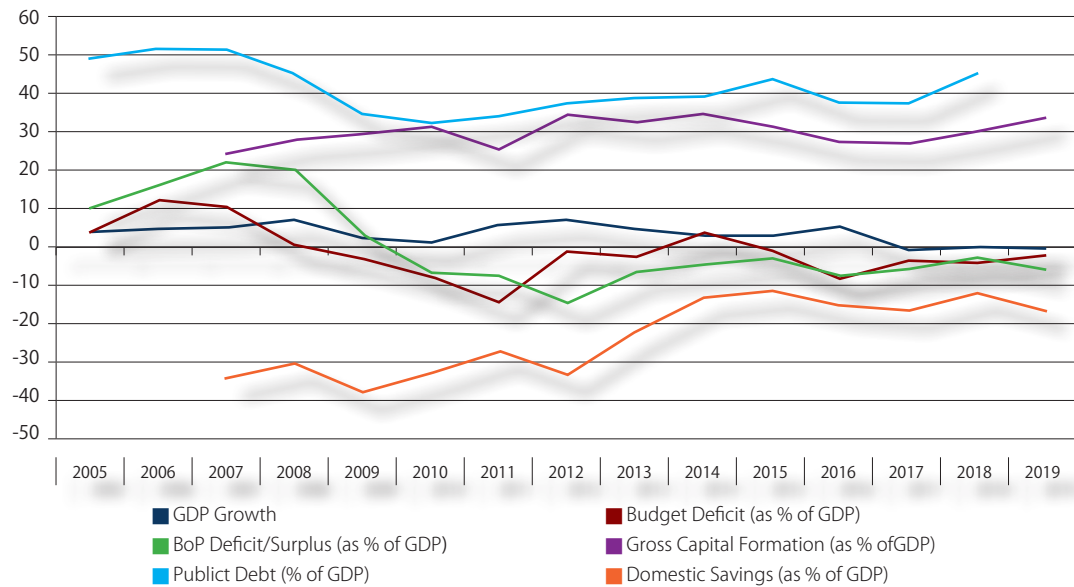
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Figure 2 Selected Development Economic Indicators for Lesotho (% of GDP), 2005-2019



Source: World Bank Open Data, Countryeconomy.com (for Budget Deficit), Gross Domestic Savings, Author's calculations based on the World Bank Open Data

Unemployment remains a major challenge for Lesotho, as it was reported at 22.5 per cent in 2019 (BOS, 2019a¹¹; MoF and MoDP, 2020¹²), a negligible drop from 23.6 per cent recorded a year earlier¹³. Overall, in the last ten years, unemployment averaged about 26 per cent, despite all the Government's efforts. The recent economic growth has been supported by the expansion in the mining and financial sectors, which collectively had relatively little impact on job creation. In the medium term, it is expected that construction will spur growth, including the building of the second phase of the Lesotho highlands and lowlands water projects and public roads. Lesotho Highlands Water Project¹⁴ (LHWP) and Lesotho Lowlands Water Development Project II¹⁵ (LLWDP II) should ensure that Lesotho is energy independent (in terms of electrical energy) and that the planned surpluses will be passed on to RSA.

Water and electricity sectors should accelerate green projects to open new avenues for investment. Government inclusion initiatives should have a positive impact on the tertiary sector. Services accounted for more than 60 per cent of GDP in 2019, followed by manufacturing which contributed 34 per cent. During the same year, agriculture accounted for only

¹¹ For major current statistical indicators (<http://www.bos.gov.ls/>).
¹² Although, BSP reports unemployment slightly lower; 22.4 per cent (MoF and MoDP, 2020, p. 10).
¹³ <https://www.worldbank.org/en/country/lesotho/overview>
¹⁴ <http://www.lhda.org.ls/lhdaweb/projectphases/phaseii>
¹⁵ <https://projects.worldbank.org/en/projects-operations/project-detail/PI60672>

4.7 per cent of GDP¹⁶, which is very low (although just over a per cent higher than the world average – 3.27 per cent)¹⁷ considering that over 80 per cent of Lesotho's population is reliant on subsistence farming. This generally leads to the conclusion that the productivity in Lesotho's agricultural sector is very low.

Political instability, large public sector, cumbersome regulations, lack of access to finance for MSMEs and entrepreneurs, along with the challenges to the traditional industries (garment, mining), have stalled Lesotho's growth. Over 23 per cent of GDP is spent on salaries in the public sector, making it one of the highest pay bills in the world¹⁸. The growth in spending was not due to the growth of the sector, but rather the increases in public servants' salaries when SACU revenues were buoyant. With the economic challenges in South Africa, recorded after 2014, the Government experienced challenges in meeting obligations, which led to significant arrears recorded in 2018 and 2019, because of delayed payments.

Lesotho's economic recovery started to pick up in 2019 but has been stopped by the COVID-19 pandemic. Resultantly, many of the benefits of the increased diamond and textile garment exports (supported by weaker rand to which the local currency – *loti*¹⁹ – is pegged) were all but annulled. Continuing lower SACU revenues and ongoing fiscal spending rigidities will create fiscal challenges for the Government, and significantly narrow its policy space²⁰. Since the fiscal year 2018/2019, the Government has amended value-added tax (VAT) rates annually on selected commodities, bringing them in line with the countries in the region and attempting to improve the overall level of VAT revenues. VAT on electricity and telecommunications has been adjusted annually from 2018/19 to date²¹. The standard VAT rate was increased from 14 to 15 per cent in 2018. The Government has increased levies on alcohol and tobacco and increased the levy on petrol²². However, the introduction of the petrol levy also shows the Government's commitment to address the issue of climate change.

The Government's efforts to sell Treasury bonds in the domestic market have fallen through, as they were not fully subscribed, leading ultimately to a widening of the fiscal deficit²³. It is expected that the Government's accumulated arrears and the limited ability to finance deficit through debt, will harm the overall economy. The decline of the fiscal discipline remains a major concern in the short to medium-term. Also, external debt distress has been raised from low to moderate, because of these actions (IMF, 2019). The domestic bond market is shallow and needs further investment, as the country will have limited access to concessional financing in the future.

¹⁶ World Bank Open Data at <https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS?locations=LS>. Agriculture value added has been on average 4.93 per cent of GDP during the observed period (2005-2019).
¹⁷ See: World Bank Open data at <https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS>.
¹⁸ As a rule of thumb, everything approaching 10 per cent would be considered high.
¹⁹ Lesotho loti – LSL, maloti is plural.
²⁰ This is in line with the CBL forecasts. CBL, 2020.
²¹ Legal Notice 30 of 2021, Value Added Tax (Amendments) Regulations, 2021, Lesotho Government Gazette, Extraordinary, No. 66, Issue 25 of 12th March 2021
²² IMF staff estimates that it may account to 1.8 per cent of GDP, leaving the deficit of 3.4 per cent (IMF, 2019)
²³ In March 2020, only LSL19,568,000 was raised against the total amount offered of LSL200,000,000. The situation improved in September, October and December; although in both cases the raised sum has been below the target (<https://www.centralbank.org.ls/index.php/financial-markets/142-auctions/results/608-treasury-bonds>)

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Access to finance remains a major problem for the private sector's development even though Lesotho's financial sector is liquid and robust. Interestingly, the banking sector plays a minor role in supporting the local entrepreneurial efforts. Many aspiring entrepreneurs would consider engaging informal lenders and the alternative non-bank sources of finance²⁴. Focus on strengthening the private sector remains a challenge for Lesotho, and to address the economic challenges, these issues also have to be addressed. Lesotho is ranked 122nd in the most recent World Bank 'Doing Business' Report (World Bank, 2020b). Red tape and cumbersome bureaucracy are listed as major impediments to private sector development.

It is expected that Lesotho will recover from the negative impact of COVID-19 not sooner than 2022/2023, although some improvement should be noted in 2021. However, it is questionable whether there will be any noticeable recovery recorded in 2021. This owes to the fact that the global efforts to introduce COVID-19 vaccinations have been delayed, and it is likely that only by mid to late 2021 will the global vaccination programmes be in place.

1.1.1 SDGs and Financing Needs

The Government is strongly committed to towards achieving the SDGs. Through a consultative process, the country decided to focus on all 17 SDGs²⁵ and selected 152 SDG indicators (MoDP, 2016a). In 2016, it was able to report on 84 of them, where 31 were customised (MoDP, 2016a). In the case of reported indicators, there was some missing information, notably those related to disabilities, employment and wealth status. In many cases, data are simply missing. It was reported (in 2016) that 71 out of 152 indicators cannot competently be reported on, due to the lack of data. This problem has been more pronounced in SDGs 6, 10, 11, 12, 16 and 17, where over 50 per cent of data could not be provided (MoDP, 2016a²⁷). Lesotho has developed four nationally specific indicators. Some indicators (such as for SDG 4: Education) have also been decentralised/localised. The National Strategic Development Plan II, 2018-2023 (NSDP II) has to a large extent, integrated the SDGs (MoDP, 2019a).

A recent report on SDG integration (MoDP, 2020c) states that 98 per cent of NSDP II targets are aligned to the SDGs. Fully aligned with NSDP II are 38 per cent of SDG targets, whilst 61 per cent are partially aligned. This is a fairly high level of alignment that demonstrates the Lesotho Government's commitment to reducing poverty through inclusive growth and employment creation, which is in line with the AAAA and 2030 Agenda. However, there are two goals under SDG 12²⁸ that are not addressed in the development documents, although they are important for Lesotho (Goals 12.3 and 12.6). SDG 17: *Partnerships*, despite their obvious importance for a developing nation, have been only partially integrated. In the section analysing SDG Goal 17, the major development finance trends have been outlined together with the analysis

²⁴ On the problem of access to finance in SADC member-states (SADC, 2019).

²⁵ The SDGs are: Goal 1: No Poverty; Goal 2: Zero Hunger; Goal 3: Good Health and Well-being; Goal 4: Quality Education; Goal 5: Gender Equality; Goal 6: Clean Water and Sanitation; Goal 7: Affordable and Clean Energy; Goal 8: Decent Work and Economic Growth; GOAL 9: Industry, Innovation and Infrastructure; Goal 10: Reduced Inequality; Goal 11: Sustainable Cities and Communities; Goal 12: Responsible Consumption and Production; Goal 13: Climate Action; GOAL 14: Life Below Water; Goal 15: Life on Land; Goal 16: Peace and Justice Strong Institutions, and GOAL 17: Partnerships to achieve the Goal (<https://www.un.org/development/desa/disabilities/envision2030.html>).

²⁶ The situation has not improved between 2016 and 2019, as the same was reported in VNR (MoDP, 2019a, p. 111).

²⁷ Figure 1 in MoDP, 2016a.

²⁸ Responsible Consumption and Production.

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of data management issues. Most of the targets under this SDG do not have corresponding targets in the NSDP II M&E Framework, except 17.1 (Tax mobilisation). It has been reported that the highest level of integration is found in four goals, namely: Goal 2: Zero Hunger, Goal 4: Quality Education, Goal 6: Clean Water and Sanitation, and Goal 13: Climate Action, with the majority of their targets fully integrated into the NSDP II (MoDP, 2020c)²⁹.

In 2019, Lesotho underwent a Voluntary National Review (VNR) of the Implementation of the 2030 Agenda (MoDP, 2019a), focusing on SDGs 1, 2, 4, 8, 10, 13, 16 and 17. There was noticeable progress with these SDGs, compared to the initial commitment document (MoDP, 2016a). The Government has looked at the development partnership broadly and has focused on a few areas/initiatives; namely the National Dialogue and Reform agenda, as well as combating climate change and building health and protection systems to address HIV/AIDS (MoDP, 2019a, p. 104). Overall, it was concluded that revenues have been less volatile, if not stable since 2010, with the challenging period being between 2005 and 2010 (MoDP, 2019a).

NSDP II is a comprehensive document that outlines the main development goals and ambitions of the Government. In contrast to NSDP I, the Government has developed a Financing Strategy for NSDP II (2018-2023), with lessons learned from the implementation of NSDP I³⁰. The Financing Strategy (Government of Lesotho, n.d.), focuses primarily on the existing sources of development finance (Official Development Assistance – ODA, remittances, FDIs, public revenues), and relatively little on the financing needs, as such (Government of Lesotho, n.d.)³¹. However, the Financing Strategy has also attempted to address some of the possible new finance streams, such as venture capital, Corporate Social Responsibility (CSR), climate change funding, and so on (Government of Lesotho, n.d.)³². The Financial Strategy states '*NSDP II Investment Plan has four key investment priority areas with a total of 118 ongoing capital projects as of 2018/19 with an estimated total cost of about M29.6 billion to be spent in the next five years of the Plan period (see the Lesotho Medium Term Expenditure Framework (MTEF)*³³ (Government of Lesotho, n.d., p. 13). The Financing Strategy may be developed further by incorporating a long-term strategic approach, going beyond the single planning cycle by aligning it to the long-term development plans rather than the medium-term strategy, as defined through the NSDP II.

The Government's Medium-Term Fiscal Framework (MTFF) has planned that LSL26.3 billion will be available for the five years (2018-2023), against the projected needs of LSL29.6 billion, making the shortfall of LSL3.3 billion, creating the development finance gap. NSDP II aims to meet SDGs, and the SDGs are aligned with the NSDP, although the sectoral level plans are not consistent. The financial plan has included ongoing projects and not much space is left for new projects that might address emerging development needs.

²⁹ Following VNR, UNDP has assisted MoDP in preparation of a study looking at the alignment of NSDP II and SDGs in Lesotho. (MoDP, 2020c).

³⁰ The main reasons for limited results of NSDP I, are: 1) chronic political uncertainty and bringing with it politicization of civil service management; 2) Institutional fragmentation and lack of coordination; 3) NSDP design flaws concerning poverty reduction and employment generation, 4) weak link between NSDP priorities and spending patterns; 5) the fall of donor support, and 6) untimely Monitoring and Evaluation and Weak Implementation Management (Government of Lesotho, 2017c).

³¹ A major criticism of NSDP I has been that it did not have an appropriate financing strategy, as it has been outlined in NSDP II (Government of Lesotho, n.d.).

³² Section 4.4. Non-traditional/Innovative Sources of Finance (Government of Lesotho, n.d.)

³³ Italics were not used in the original text.



Box 1 Gender and the National Planning and Budgeting System

Lesotho is committed to achieving gender equality and inclusivity, parity in education, and health and survival indicators under the Global Gender Gap Index (2020). The Government adopted the Gender and Development Policy (GADP) in 2018 to strengthen national efforts towards gender equality and women’s empowerment. The Policy is progressive and is based on 12 pillars, where the 4th pillar is devoted to the economic empowerment of women. The Government has promulgated several laws aimed at improving the status of women and their voice, in social, economic, and political spheres. The Department of Gender at MoGYSR is charged with overseeing the implementation of the Gender and Development Policy and related laws. However, the capacity within the department is limited to deliver cross-government gender advocacy, both in terms of financial and human resource adequacy, as well as the instruments at their disposal to influence other MDAs for implementation.

Gender equality and women’s empowerment, together with climate have been mainstreamed as cross-cutting issues in the NSDP II (Government of Lesotho, 2017b). Gender has also been formally integrated into the planning process. The recently developed Economic Planner’s Manual (Government of Lesotho, 2020b) outlines the requirement to consider gender dimension within the planning process. As with cascading down SDG goals from NSDP II to the sectoral plans, sectoral plans are still to fully endorse the gender dimension and ensure that gender has been considered in the sectoral planning process.

While there is progress on the compilation of gender statistics, there are significant gaps in finance statistics indicators. For instance, there is no reporting on gender-related budget allocations and expenditures. This information is vital to ascertain how much has been allocated to achieving gender-related NSDP II and SDG goals. Further capacity building within MDAs, especially MoF and BOS, is required to close gaps in data disaggregation and trigger reporting on gender expenditures.

Lesotho has been considering the introduction of Gender Responsive Budgeting (GRB) for some time. It is expected that from FY 2022-2023, the Government will launch GRB in a few pilot MDAs. The approach and methodology, as well as the training of all the involved, are expected to take place in 2021. The introduction of GRB will also improve the situation, as more data will be gender-sensitive from the very outset of the process, and hence gender data tagging will be implemented. At present, the gender-related regulatory framework is in place, but it lacks serious implementation. Strengthening the policy capacity and enforcement powers of MoGYSR should also be high on the Government’s agenda if the (political) commitment to gender equality and inclusion is to be delivered.

1.2 Financing Trends

1.2.1 Domestic Public Finance

1.2.1.1 Government Revenues

Total public sector revenues (*excluding grants*) registered an average of 39.51 per cent of GDP, for the observed period (2005-2019)³⁴. At the same time, taxes accounted for 33.62 per cent of GDP³⁵. In most recent years, the tax participation in aggregate public revenues has stabilised at about 31.6 per cent (in 2017 and 2018). This is fairly high for a developing African country and significantly higher than sub-Saharan countries³⁶.

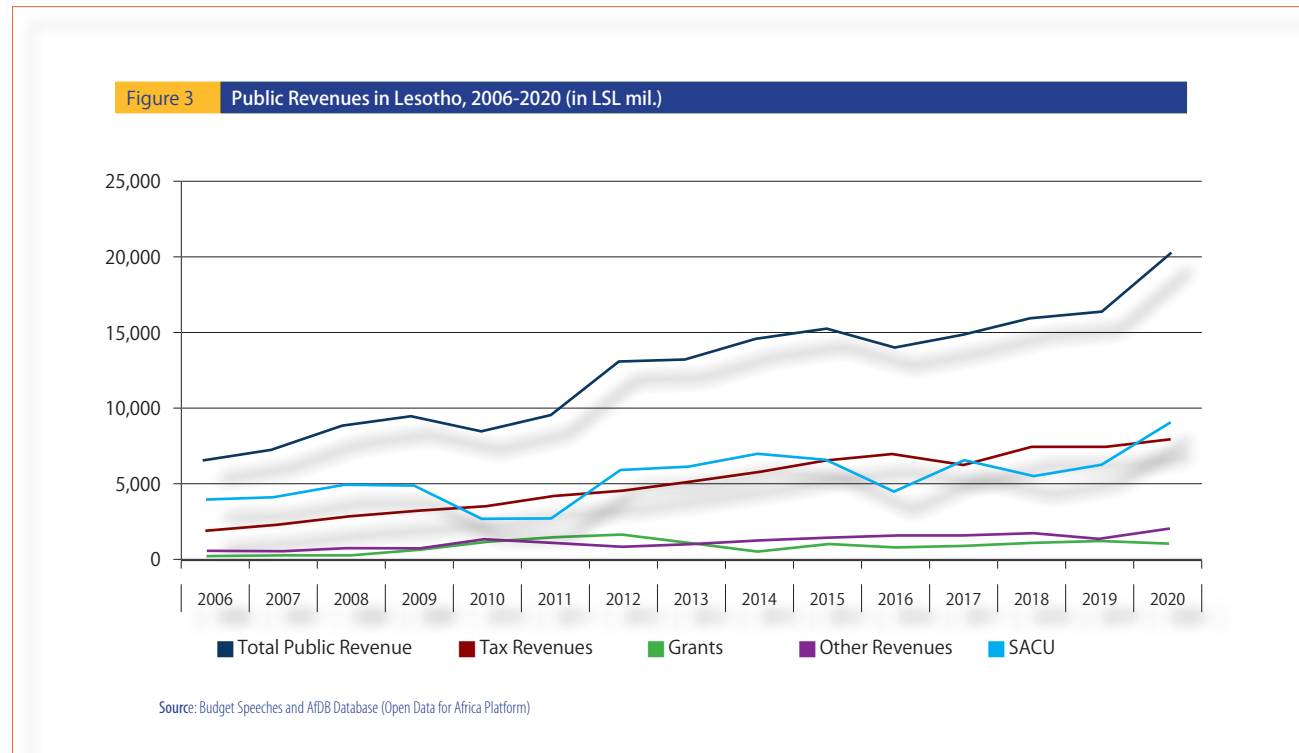
Public revenues in Lesotho come from various sources, with taxes being a major contributor. Other sources are grants (mainly from international sources), other revenues and SACU revenues. SACU revenues have been the major source of public revenues in the period 2005-2020, contributing approximately 43.66 per cent. In the same period, taxes contributed about 39.47 per cent of the Total Public Revenues, followed by the ‘Other revenues’ (property income, dividends, rents, fees and charges, and other miscellaneous revenues). Other revenues usually contributed just below 10 per cent of the Total Public Revenues. Grants, as a form of the general budget support, are reported as a public revenue stream and have accounted for about 6-7 per cent of the Total Public Revenues in recent years³⁷. Tax collection has improved over time, whilst other categories have had somewhat mixed performance. SACU revenues have been volatile, reflecting on the situation in South Africa, and its economic performance, as Lesotho’s economy is well integrated into the South African economy, and experiences, ipso facto, the same business cycles.

³⁴ <https://data.worldbank.org/indicator/GC.REV.XGRT.GD.ZS?locations=LS>

³⁵ <https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS?locations=LS>

³⁶ For more comparative information, especially for developed countries: <https://www.taxpolicycenter.org/statistics/oecd-taxes-share-gdp>. For developing countries consult: <https://www.indexmundi.com/facts/indicators/GC.REV.XGRT.GD.ZS> and <https://www.indexmundi.com/facts/indicators/GC.TAX.TOTL.GD.ZS>

³⁷ Grants as a revenue stream are looked at in more details under the ODA section.



Lesotho has a fairly developed taxation system, with several taxes targeting various classes of taxpayers and economic activities. Since 2003, the public revenues have been entrusted to the Lesotho Revenue Authority (LRA)³⁸. The main piece of tax legislation is the Income Tax Act 1993 with all the subsequent amendments. The main tax sources are: 1) Taxes on Income, Profits and Capital Gains (consisting of Individual Income Tax, Corporate Tax and Income Tax-Unallowable); 2) Tax on Property; 3) Taxes on Goods and Services (Value-Added Tax – VAT and Excise Taxes); 4) Taxes on Specific Services; 5) Taxes on the Use of Goods and on Permissions to Use or Perform Activities; 6) Taxes on International Trade and Transactions and 7) Other Taxes³⁹.

Each of the tax categories consists of several taxes. For instance, Taxes on Income, Profits, and Capital Gains consist of Income-tax paid by the individual, corporations, and other income tax. Personal taxation is progressive, but not very fair, as there are only two taxation brackets: 1) up to LSL61,080 (approx. USD4,255 in July 2021) tax rate was 20 per cent and over LSL61,080 – 30 per cent⁴⁰. There is tax credit, for which one has to apply, of LSL10,080 (approx. USD702.00 in July 2021). Although the Tax Law requires every person drawing any revenue to register with the LRA, the enforcement is still an issue, despite the improvement in tax collection, year-on-year⁴¹. Taxes on Property play a negligible role, contributing

³⁸ <http://lra.org.ls/>
³⁹ Source: Budget Speech to the Parliament for the various fiscal years (Parliament of the Kingdom of Lesotho, 2004-2019; 2020a)
⁴⁰ <http://lra.org.ls/individual-income-tax-iit#:~:text=An%20individual%20who%20derives%20income,How%20is%20Individual%20Income%20taxed%3F&text=Any%20chargeable%20income%20from%20M,at%20the%20rate%20of%2030%25> <http://lra.org.ls/individual-income-tax-iit#:~:text=An%20individual%20who%20derives%20income,How%20is%20Individual%20Income%20taxed%3F&text=Any%20chargeable%20income%20from%20M,at%20the%20rate%20of%2030%25>
⁴¹ <https://www.lra.org.ls/individual-income-tax-iit>

on average about 2 per cent to the aggregate tax revenues⁴². Taxes on Goods and Services comes primarily from VAT, with other taxes contributing up to 10 per cent of the total Taxes on Goods and Services revenues collected. Interestingly, VAT contributes to 10-15 per cent of the aggregate tax revenues, which seems rather low and may suggest that there are issues with the enforcement. VAT threshold in Lesotho is fairly high (LSL 0.5. mil.⁴³), which is the highest in Africa (Foreign Investment Advisory Service, 2006).

Lesotho’s informal economy is estimated to be more than 20 per cent of GDP (Medina, Jonelis, and Cangul, 2017). This is a fairly low per centage compared to the rest of the continent, where for instance, in Nigeria, the informal economy accounts for up to 60 per cent. Lesotho has tried to address the taxation of the informal sector by inviting street sellers to register with the tax authorities. Despite the efforts by the LRA, the results have been limited as the public opinion is that the informal sector taxation will mainly hurt the poorest in the society⁴⁴. LRA is considering the registration of primarily informal vendors and the introduction of a lump sum tax for the informal economic agents⁴⁵.

The NSDP II Financing Strategy (Government of Lesotho, n.d.) makes some suggestions as to the improvement in the taxation system. For instance, increasing levy on alcohol and tobacco, modifying the VAT rate on electricity and mobile phones services, raising the petrol levy and improving the tax enforcement (Government of Lesotho, n.d.). Lesotho is in the very early stages of fiscal decentralisation, hence the country’s districts have, at present, low capacity to raise public revenues of some significance and their financing is almost entirely dependent on the central Government transfers as per the Local Government Act (1997). Districts should be able to raise their revenues, support private sector development, deliver public services to the citizens more effectively and take the responsibility for the development on their territory, including delivery of cascaded SDG targets. In the process of fiscal decentralisation, the Government may consider devolving significant local revenue-raising powers to the Local Government units, including those that are related to environmental conservation. As fiscal decentralisation is still in the very early stages, there are many opportunities to be innovative and ensure that the local fiscal base is widened, relative to the central collection of tax revenues.

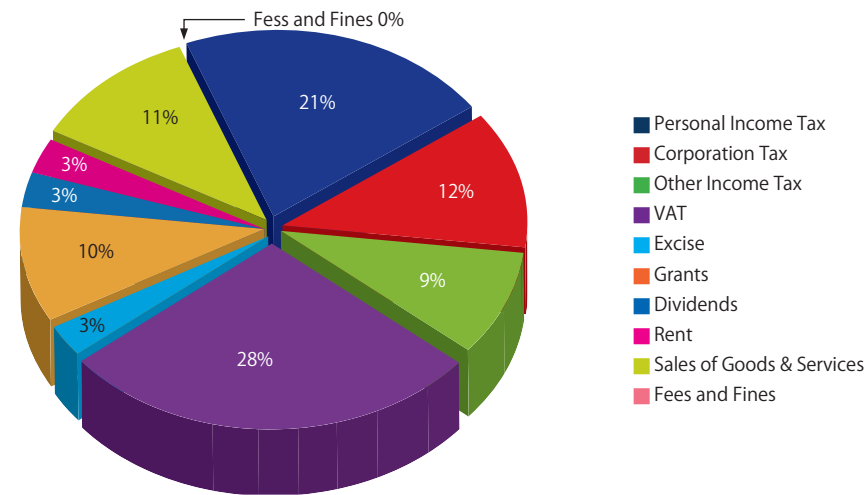
Most of the public revenues are volatile and seem difficult to project. In the last 15 years, for almost all years, the projections and budgeted revenues were not achieved⁴⁶. This may suggest that there is either a problem with planning or with execution or a combination of both. Execution lacked an effective management system and the presence of rampant corruption in the Civil Service has also contributed to the systemic underperformance.

SACU revenues contributed almost 60 per cent of the Total Public Revenues in 2006, and then suddenly dropped to about 30 per cent in the period 2010-2012. They have recovered from 2013, and now contributing about 40 per cent. Projections for 2020 and beyond suggest the growth to just below 50 per cent⁴⁷. Grants have contributed about 6-7 per

⁴² In 2007 tax amounted to M0.01 million, indicating that the tax was not probably administered.
⁴³ Approx. USD 34,835.00 at the time of writing (July 2021).
⁴⁴ <https://www.thepost.co.ls/insight/taxing-informal-sector-will-antagonise-the-poor/>
⁴⁵ Information disclosed during the consultation process, when the issue of business taxation was discussed.
⁴⁶ Parliament of the Kingdom of Lesotho, *Budget Speeches*, 2004-2020.
⁴⁷ IMF, 2019, although these projections have been made before COVID-19 pandemic.



Figure 4 Structure of the Public Revenues for FY 2018/2019



Source: Author's calculations based on: Parliament of Lesotho, 2018, Annex I⁵⁰

cent of the total⁴⁸, except in the years when SACU revenues have dropped, where grants contributed between 12 and 14⁴⁹ per cent to the Total Public Revenues.

Amongst other revenues, sales of goods and services contribute over 2/3, followed by the water royalties (LHDA), which have shown growth over the period, in contrast to the decline recorded in previous decades. Incidental sales by the public bodies have been growing as an item, contributing more than any other fees and charges imposed by the public authorities, suggesting that the traditional non-tax revenue sources (fees, charges and fines) are not widely used in Lesotho. Often these items alone contribute to over 2 per cent of the Total Public Revenues in other countries. In Lesotho, in 2018, they accounted for 0.55 per cent⁵¹.

The volatility of dividend revenues and their relatively small participation in the total revenues opens the issue of public (state-owned) enterprises in Lesotho, which have been criticised for underperformance. However, the problem goes beyond the traditional SOEs issues, as the Government owns many traditional businesses which are not necessarily providing 'public goods', either through the proxy agency (Lesotho National Development Corporation – LNDC) or –

⁴⁸ Grants contribution ranged between lowest 3.25 per cent recorded in 2008 and 14.94 per cent recorded in 2011. Average for the period 2006-2020 was 7.26 per cent of the Total Public Revenues.

⁴⁹ This jump was recorded in 2010 – 14.04 per cent, 2011 – 14.94 per cent and 2012 – 12.96 per cent.

⁵⁰ Fees and Fines item consists of Administrative fees amounting to LSL22.3 million and Fines and forfeits amounting to LSL0.5 million. They are projections to increase collection of fees and fines in the subsequent budget years, with growth planned over 100 per cent in the period 2019-2021⁵¹. Information disclosed during the consultation process, when the issue of business taxation was discussed.

⁵¹ Parliament of Lesotho, 2020, Annex X Government Budget Operationsemic.

directly. Often both types of ownership (direct and indirect) will be in combination, pointing out the ultimate owner – the Government (MoF, 2020a). Some of the state-owned corporations have not prepared the financial reports on time, and some have not reported regularly, or have not had their accounts audited. However, the top five state-owned enterprises account for over 18 per cent of the country's GDP⁵². Many public and state-owned enterprises operate in traditionally competitive industries. In the medium- to long-term, a question may be raised as to why the Government is directly involved in the activities that can reasonably be done by the private sector (domestic and/or international).

LHDA water royalties have emerged as an important revenue stream, which, in many years, have been equal to the corporate tax. However, even this fairly straightforward revenue stream has exhibited a certain level of volatility, but overall, it has shown growth.

VAT revenues⁵³ have been rising showing the efforts to improve the collection and introduce a new *modus operandi*, including digitalisation. At present, the annual growth rate of VAT collection is set at 2-3 per cent, which is a low target, compared to many developing countries, where the targets are more ambitious⁵⁴. Having annual growth, of at least 5 per cent (in the post-COVID-19 times) would be more appropriate. Excises are also relatively on the low side, subject to increase with changes to taxation of alcohol and tobacco announced in 2020 (Parliament of Lesotho, 2020). However, trends in the collection of public revenue have shown that Government agencies delay introducing taxes and taking the appropriate measures to effectuate collection. Non-tax revenues have not been closely managed, though they have been growing over time, and through better management, their collection may improve further. Standard non-tax revenues (user charges and fees) are not fully explored in Lesotho and require the attention of Government (i.e. MoF). Overall, the Lesotho tax base is narrow and could be expanded and some new taxes may be considered, as well as the current rates and reach (i.e. tax base) modified.

1.2.1.2 Government Borrowings⁵⁵

Lesotho has experienced the growth of public debt⁵⁶ in recent years, which may accelerate further, primarily due to the adverse impact of the COVID-19 pandemic on the economy. The Government introduced the Public Debt Management Policy Framework in 2019, outlining its position on the public debt (MoF, 2019a). The document outlines that the Government takes debt to meet its financial dues on time, at the lowest possible cost, with acceptable levels of risk. As the domestic debt market is institutionally underdeveloped, without needed depth, the Government is committed to using the Public Debt instruments to develop local financial markets.

⁵² Five major companies which the government has a stake are: Letšeng Diamond Mining, Standard Lesotho Bank, Maluti Mountain Brewery (Pty) Ltd, Lesotho Electricity Company Pty Ltd and Lesotho Flour Mills Ltd.

⁵³ Although a major source of revenues, VAT and other sales taxes are not equitable in their very core, as they tax all the strata of society equally, without regard for their economic power and ability to pay.

⁵⁴ Author's calculations based on the annual Budget Speeches (Parliament of the Kingdom of Lesotho, 2004-2020).

⁵⁵ We have used term 'Government borrowing' rather than the 'Public debt'. And, hence borrowing is treated in the domestic finance section of the study, although Lesotho's public debt is primarily external, and the domestic debt amounts only to about LSL950 million (USD64.3 mil. in March 2021). External debt exposure is primarily towards IFIs.

⁵⁶ Often referred to as National Debt or (Total) Government Debt.

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Debt is defined broadly as financial instruments, guarantees and the resources used to mitigate the risk. The government has provided guarantees for the public sector entities in the past and often these obligations do not appear in the financial statements until they are activated. Often their activation may find Government not prepared. It stems from the Public Debt Management Policy Framework that the borrowing has to be used to finance development objectives spelt out in the national planning documents. Although it has not been explicitly stated, it seems that borrowing as such cannot be used for covering recurrent expenditures⁵⁷. When looking for external sources, the Government will ultimately seek to optimise the use of grants and concessional loans, in line with the Lesotho Partnership Policy (MoDP, 2013). An international bond issue may be considered only when the country is given an investment-grade rating, ensuring that the costs are low. The ensuing document is the Medium-Term Debt Strategy (MTDS), which considers debt in the medium-term, rather than in a strategical manner, as does the Public Debt Management Policy Framework.

The Public Debt Management Policy Framework establishes the ceilings that must be observed by the Government in committing to debt. It is stated that ceilings on total public debt, including guarantees, will be 60 per cent of GDP and public external debt will be limited to 40 per cent of GDP. Government guarantees are subjected to an overall limit of 5 per cent of GDP (7.2. Policy Framework). To enable more dynamic management of debt, a trigger level of the debt limit is being established for the public debt, excluding guarantees, at 50 per cent of GDP, for the public external debt at 35 per cent of GDP, and for Government guarantees at 3 per cent of GDP (7.3. Policy Framework). The Government is obliged to develop the MTDS, which is to be updated annually, reflecting on the most recent development.

Making the MTDS a living document enables active management of debt and empowers MoF to react in time to any eventual economic changes. The MTDS is implemented through the Annual Borrowing Plan that MoF will develop on an annual basis and revise semi-annually. External borrowing will be primarily in the hands of MoDP, which will assist the line ministries in the process of negotiation. Priority will be given to borrowing with a higher grant element (11.2. Policy Framework).

The Public Debt Management Policy Framework has introduced the Risk assessment requirements in deciding on the level and forms of debt. It links benefits and costs, adding the probabilities of certain outcomes. In doing so, the Government should be able to make the best decision at the time, ensuring that the costs will be commensurate with the risk and not excessive. Cash Management and Contingency Liability Management are also outlined in the Policy Framework.

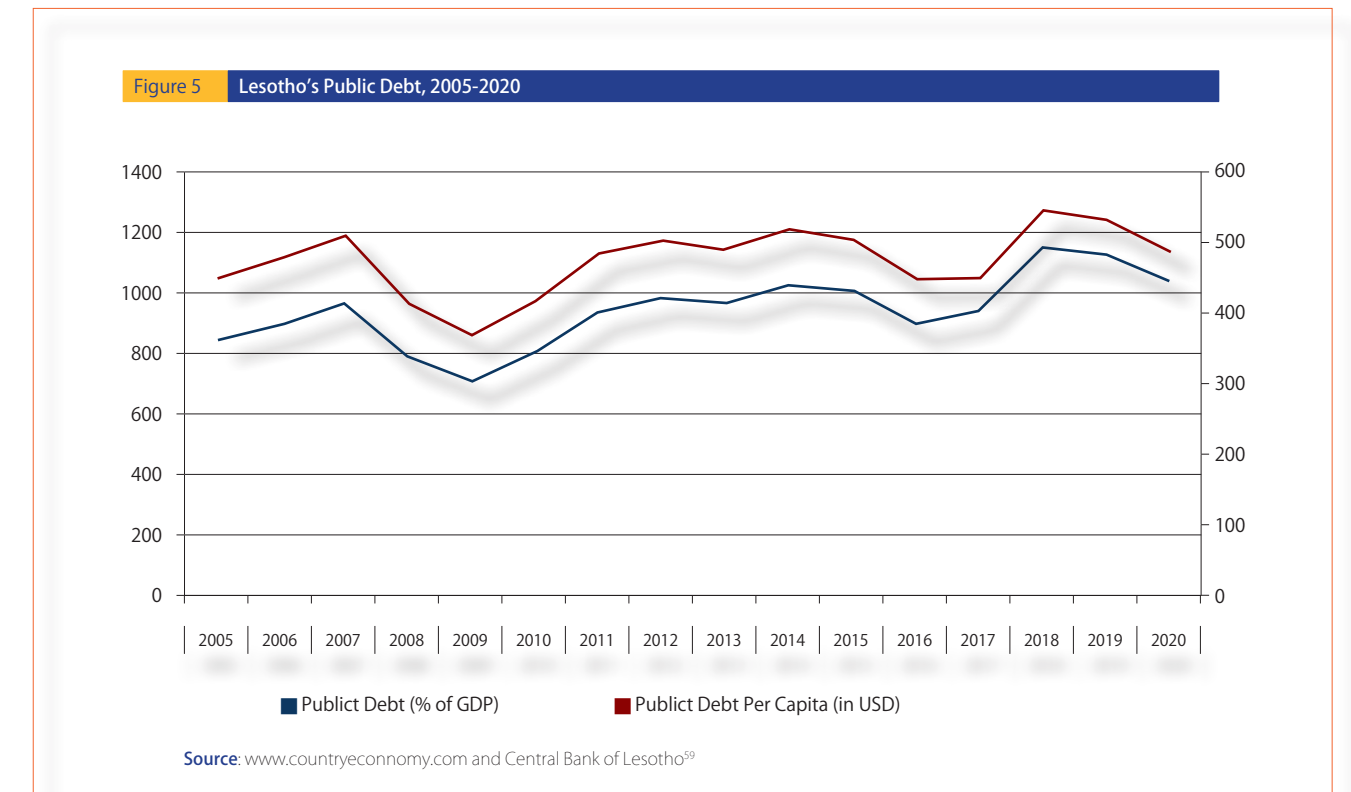
During the last Debt Management Performance Assessment in 2012, the Government was criticised for poor cash management. In response, the Public Debt Management Policy Framework has addressed some of the noted shortcomings (World Bank, 2012). However, the current COVID-19 pandemic has had a serious adverse effect on Lesotho's economy. It has significantly narrowed the external financing channels. When this is coupled with the Government's challenges to

⁵⁷ The Policy Framework states the purposes, and stricto sensu, they are not necessarily linked with the recurrent expenditures. *The Government will borrow to finance its development projects, balance the fiscal deficit, refinance repayment obligations on existing debt, meet cash management requirements, build cash buffers, pre-finance, prepay loans, implement buybacks or switches on Government securities, support monetary policy operations, build foreign exchange reserves of the country, meet any contingent liabilities which may materialise; and respond to any national exigencies.* (Policy Framework, 3.2).

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raise the additional funds locally (undersubscribed bond issues) and the relatively lax fiscal discipline of local Government bodies (which may exhibit hidden debt), this may increase the Government's credit and other associated risks⁵⁸.



Lesotho's Public Debt has been dynamic in the last 15 years, oscillating between USD750 million and USD1.2 billion. However, it is set to grow (IMF, 2019). Due to the COVID-19 pandemic, the overall level of debt is expected to rise in the next few years and at least until 2023, if the major sectors of the economy will recover reasonably quick. Debt servicing has been usually below 3 per cent of the total export of goods and services. For instance, it was 4.1 per cent in 2007, dropping to 1.2. per cent in 2011, and then growing to 2.8 per cent in 2019. The growth in service burden can be explained by the fall in the value of South African Rand (ZAR) to which the national currency (LSL) is pegged at par (MoDP, 2019a).

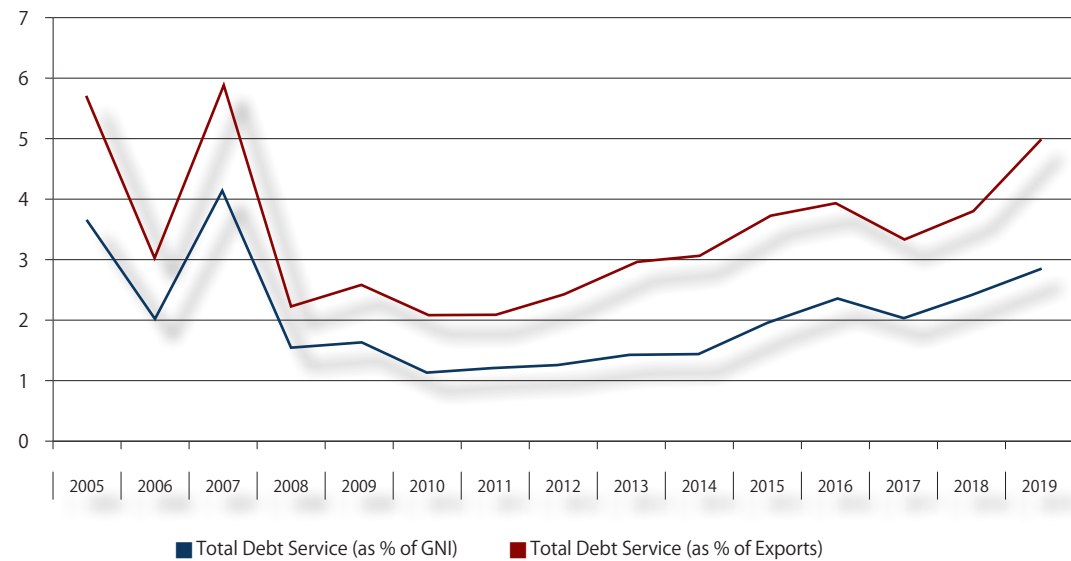
Debt servicing was high in the period 2005-2008, then stabilised, and, from 2011 to 2016, it has been on the steady rise, falling in 2017 and then rising again. Overall, the debt is still manageable, and the outlook is moderate (IMF, 2019). It is suggested by IFIs (IMF and World Bank) that the present value of public debt to GDP ratio should be below 40 per cent, and its debt service to exports and debt service to revenue be less than 20 per cent (MoF, 2016; IMF, 2019). At present, the debt is reaching over 40 per cent and the IMF projects that Lesotho's public debt to GDP will reach 47 per cent in 2022 (IMF, 2019).

⁵⁸ This point was raised by the Government colleagues during the consultations on the working versions of this document.

⁵⁹ <https://countryeconomy.com/national-debt/lesotho> and <https://www.centralbank.org.ls/index.php/statistics/macroeconomic-statistics>.



Figure 6 Lesotho Total Debt Service, 2005-2019



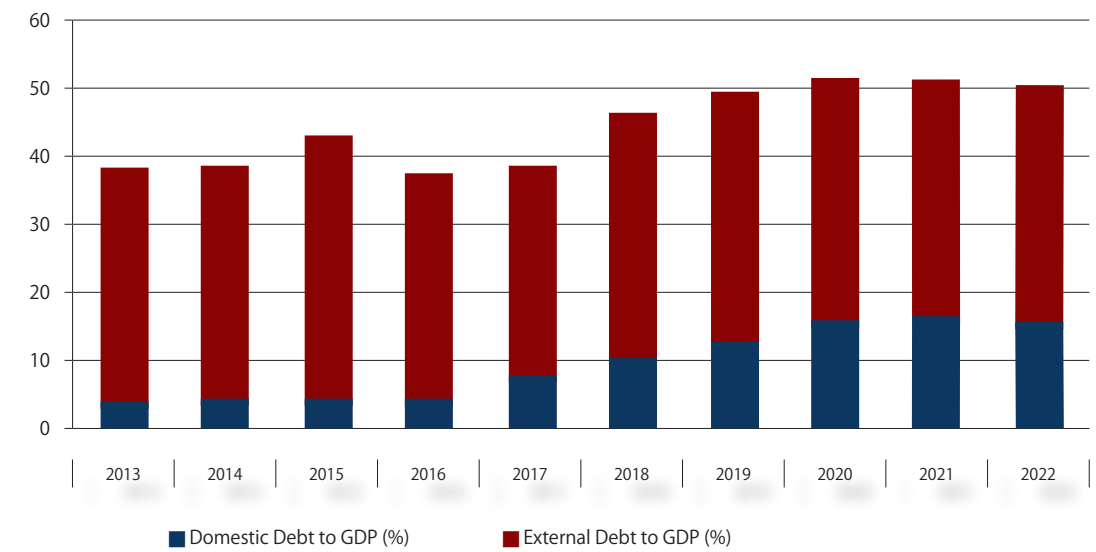
Source: World Bank Open Data (Development Indicators)

Debt was set to grow for the period 2017-2020, with a peak in 2020. However, given the COVID-19 pandemic, it is expected that the public debt is set to grow more to support the extraordinary public health spending and to address the resultant socio-economic challenges. Despite the increase and surpassing of the recommended level of public debt, it is expected that the country will be able to service its debt and remain within the current rating. The GDP has been experiencing a slowdown since the mid-2010s and though there were concerns, they were not listed as major (IDA-IMF, 2018).

Lesotho may benefit from the World Bank's Debt Service Suspension Initiative (DSSI), with possible estimated savings of USD9.8 million from May to December 2020, and further USD5.9 million in January-May 2021, i.e., 0.6 per cent of GDP cumulatively⁶⁰. Lesotho may consider reprogramming its current debt by reducing the service burden, even though not by much, since the vast majority of debt is extended by the international financial organisations rather than the private creditors.

⁶⁰ <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative>

Figure 7 Total Debt to GDP, 2013-2022⁶¹



Source: IDA-IMF, 2018; Government of Lesotho, n.d.

Most of Lesotho's public debt comes from external sources, and in most cases from the institutional multilateral creditors. About 20 per cent come from the bilateral partners⁶² (Government of Lesotho, n.d.) and only about 0.6 per cent from the commercial loans (IMF, 2018a). Lesotho has been advised to borrow about USD50 million annually to support the implementation of NSDP II.

Domestic public debt has been on the rise since 2016 and consists of Treasury Bills and Treasury Bonds. At present, the majority of debt is held by banking institutions (51.4 per cent) and the rest is held by non-banking entities (MoF, 2021). Bonds account for 73.4 per cent of the total domestic public debt. CBL acts as a fiscal agent of the state and organises regular auctions for the treasury instruments. Treasury bills for up to LSL99,900 are sold at predetermined prices, whilst in the competitive market (over LSL100,000), the tendered yield rate must be specified and securities are sold to those with the lowest yields⁶³. Although Lesotho's domestic public debt has been on the rise, the local market is fairly limited and there are cases where there was not enough interest in the Government securities (IMF, 2020).

Orientation towards raising finance in the domestic markets has been a consequence of the Government's intention to pay out accumulated arrears and to address the challenges posed by the COVID-19 pandemic. Payment of the domestic

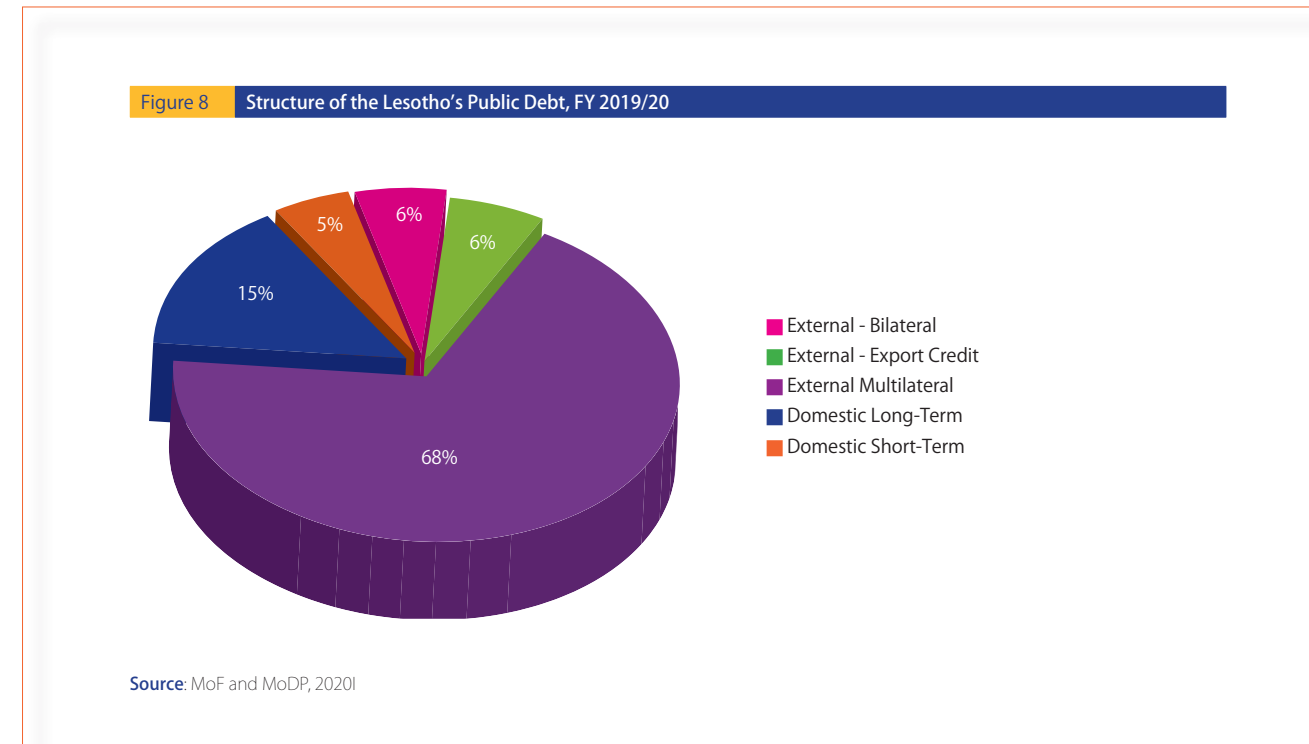
⁶¹ Public Debt projections for 2021 and 2022 are based on NSDP II Financing Strategy (Government of Lesotho, n.d.).

⁶² Mainly: The Abu Dhabi Fund, China Exim Bank, India Exim Bank, Kuwait Fund, and Saudi Fund.

⁶³ <https://www.centralbank.org.ls/index.php/financial-markets-about/599-government-domestic-debt>



arrears may provide additional liquidity to the private sector (IMF, 2020). Further development of the domestic financial markets is a mid-term commitment of the Government, and it is necessary as the country attracts less concessional finance (presently over 82 per cent of the public debt is concessional)⁶⁴. However, the development and growth of the local capital market may be seriously limited by the currently low markets' absorptive capacity. This also entails strengthening further the regulatory and supervisory elements of the (financial) market dynamics.



Lesotho's debt situation has been sustainable, although recently the international rating agencies have marked prospective as 'negative', warning that there may be issues with servicing the obligations in the future. However, this should not raise any immediate concerns, though international rating agency Fitch has reduced the country rating in 2019 and 2020⁶⁵.

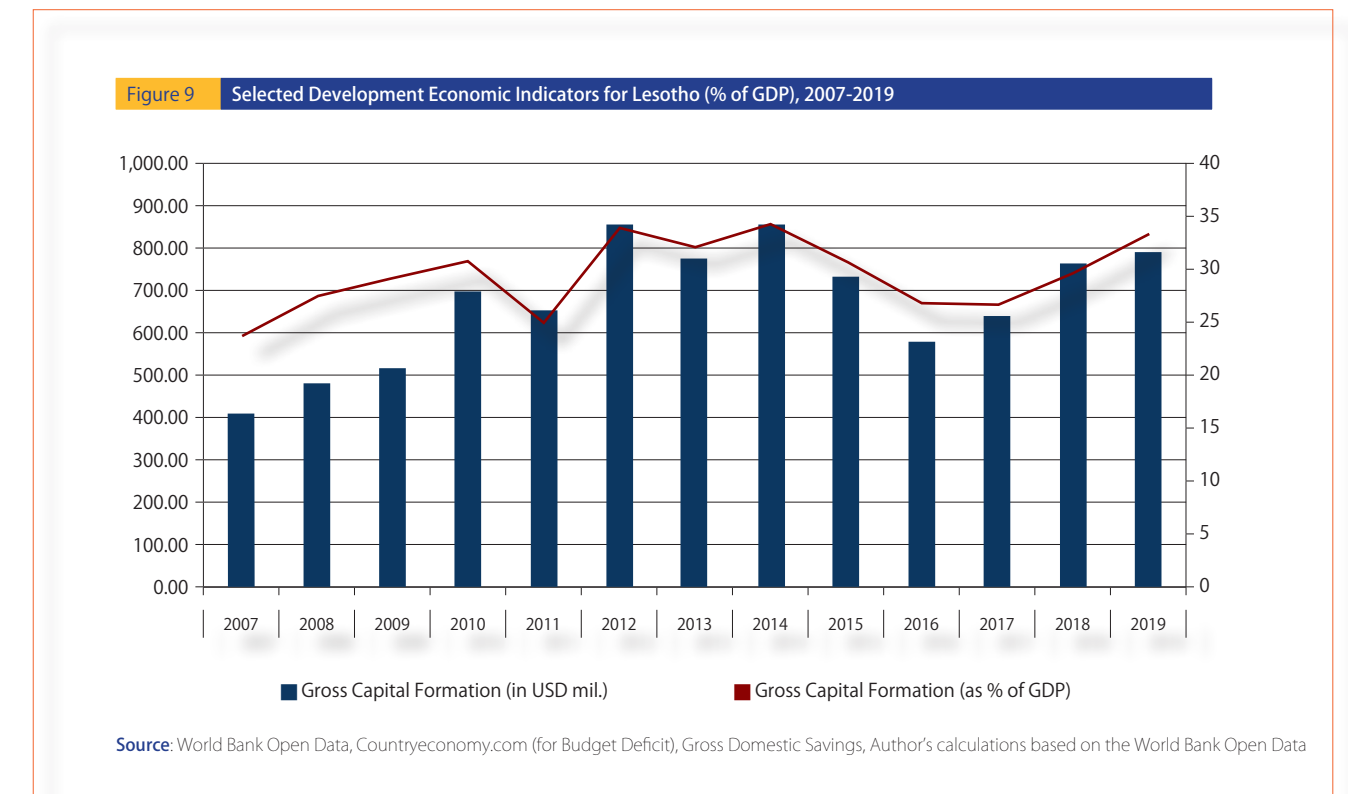
⁶⁴ MoF, 2021.
⁶⁵ <https://tradingeconomics.com/lesotho/rating>; In 2019 the rating was downgraded from B+ to B stable and in 2020 from B stable to B negative. It is very likely that the rating will go down in August 2021, if not sooner.



1.2.2 Domestic Private Finance

1.2.2.1 Domestic Sector Investment and Credit

Domestic investment plays a prominent role in securing sustainable development and growth in the country. In developing countries with a lack of capital, the private sector should play a more prominent role in investing capital to the best possible uses. Gross Capital Formation captures⁶⁶, at least in part, private investments into the country and outlines the development ambitions. In the case of Lesotho, the Gross Capital Formation indicator has been on a higher side, especially after 2010, with some variations, reflecting some ongoing challenges. It has been on a constant growth path⁶⁷, with a few drops, in the years when SACU revenues underperformed and/or when ZAR was weaker. In 2019, Gross Capital Formation recorded an investment of USD790.5 million, which represented 33.26 per cent of GDP.



Bank (or broad financial sector) credit is usually used as a proxy for the private sector investment in development. It is very difficult to capture the company's investment in new ventures and hence the credit to the private entities is used assuming that the companies borrow to invest into a new entrepreneurial venture. Lesotho, due to its size, has a small and

⁶⁶ However, Gross Capital Formation includes both private and public investment and it should be noted that it may overestimate the contribution of the private sector in the countries where the public sector is strong.
⁶⁷ <https://data.worldbank.org/indicator/NE.GDI.TOTL.CN?end=2019&locations=LS&start=2007>
⁶⁸ <https://www.centralbank.org.ls/index.php/financial-stability/95-supervision/615-banks>

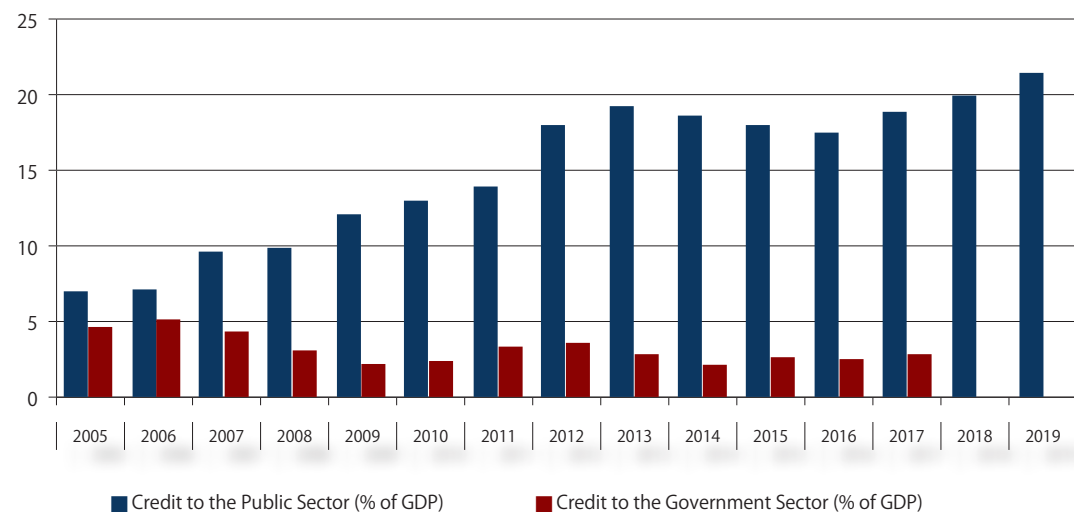
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compact banking sector, with only four commercial banks, which have South African ties⁶⁸. At present, the Government has a controlling stake in one bank, Lesotho Post Bank and interest in another, Standard Lesotho Bank.

Lesotho's financial system is bank-based⁶⁹. Consequently, banks play a prominent role, with growing importance of insurance companies and pension funds (IMF, 2019). Banks control over 50 per cent of assets, whilst insurance companies control about 20 per cent of assets and the remaining 30 per cent is shared by other financial intermediaries⁷⁰. The main banking clients are households, and up to 40 per cent of the credit activities are oriented towards the business sector (IMF, 2019)⁷¹. The majority of the sector's assets is in foreign hands, whereas the Lesotho Post Bank controls 4.5 per cent of the sector's assets. The microfinance sector has recently been growing and the established banks are also offering microfinance products. In 2017, microfinance institutions controlled about 2.6 per cent of total assets (IMF, 2018b).

Figure 10 Credit Extended as Percentage of GDP, 2005-2019⁷²



Source: World Bank Open Data

Despite the strong foreign presence in the banking sector, Lesotho's loan to deposit ratio has been below 60 per cent, which is low compared to the countries of similar economic strength and size (IMF, 2018b). Similarly, the interest rates are inversely correlated with the interest rate spread between loans and deposits, a measure of the efficiency of financial intermediation (higher spreads signal higher costs of credit).

⁶⁹ On a typology of financial systems, see: Allen, 2001.

⁷⁰ Based on CBL online statistical database.

⁷¹ IMF Financial Soundness Indicators for Lesotho. Also available on Open Data Africa at: <http://cb.lesotho.opendataforafrica.org/pqdyae/> financial-soundness-indicators

⁷² Data for the public sector credit are available only up to 2017 (World Bank Open Data).

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Lesotho's banks have very high foreign asset holdings, which may suggest that there are not enough bankable products, although another explanation may be their need to keep foreign liquid balances limits the credit growth. Bank capital to asset ratio has been on a lower side, ranging from 8.93 per cent in 2009 to 12.56 per cent in 2019, averaging 9.65 per cent for the period under consideration (2009-2019)⁷³.

There was a significant increase in credit line use from 18.7 per cent in 2016 to 32.2 per cent in 2020⁷⁴. In terms of access to banking services, Lesotho presents an interesting picture – while 46 per cent of the adult population (over 15 years of age) have a bank account, only 14 per cent have received a transfer to the bank account in a year before the report (Demirgüç-Kunt, et al., 2017⁷⁵).

*FinScope MSME Survey Lesotho 2016*⁷⁶ shows that far fewer MSMEs borrowed from the bank, only nine per cent. Further on, 49 per cent of MSMEs' owners reported that access to finance is a major problem, with 35 per cent claiming that poor access to finance limits their operations and further 20 per cent claim that it inhibits their growth (FinScope, 2016). Only two per cent of MSMEs accessed credit from the commercial banking sector in 2016⁷⁷. The Government reports that only two per cent of MSMEs have used the bank credit, whereas seven per cent resorted to informal lenders, whilst 91 per cent refrained from any borrowings (MoF and MoDP, 2020). With the anticipated growth of the currently small microfinance sector, individual entrepreneurs may have better options to attract external finance (IMF, 2019)⁷⁸.

Nevertheless, at present, it seems that households are a major customer to the microfinance institutions, as well. Although households are not seen as risky customers, that may change, as it has been reported that the public sector workers are experiencing payment delays. At present, it may be concluded that the financial sector could serve the business clients better, especially MSMEs and individual entrepreneurs.

1.2.2.2 Public-Private Partnerships

Public-Private Partnership (PPP) assumes a form of collaboration between the entities operating in the public and private sectors, respectively⁷⁹. Lesotho's Public-Private Partnership Policy provides the following definition: 'A PPP is defined as a contractual arrangement between a Procurement Unit and Private Partner whereby the private investor and/or operator designs, finances, constructs, operates, maintains and/or rehabilitates a public asset or service in whole or in part and in accordance with pre- defined output specifications on behalf of the Procuring Unit.' (Government of Lesotho, 2017a, p. 8). The collaboration may take many forms and hence the general definition of PPP may differ from country to country.

⁷³ World Bank Open Data (<https://data.worldbank.org/indicator/FB.BNK.CAPA.ZS?locations=LS>)

⁷⁴ World Bank Databank, at <https://databank.worldbank.org/reports.aspx?source=enterprise-surveys#>

⁷⁵ <https://globalfindex.worldbank.org/> (Most recent data reported in 2017)

⁷⁶ The Government is planning to organise another FinScope survey in 2021 (MoF and MoDP, 2020). The results are expected to be published in late 2021.

⁷⁷ Similarly, almost no MSME uses insurance and does not hedge the risks (FinScope, 2016).

⁷⁸ 2021 UNCDF Making Access Possible (MAP) Refresh Diagnostic is expected to be released in late 2021, providing the newest market data..

⁷⁹ Public-Private Partnership (PPP) is a strategy for procurement which involves a long-term contract between a Government and a private entity for the provision of a public service (or asset).

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Nevertheless, PPPs have emerged as a very attractive form of addressing the infrastructure needs and knowledge gaps in developing and transitional economies worldwide. PPPs have an expansive growth and now represent one of the major modes of attractive finance for both domestic and foreign investment in major infrastructure projects.

PPP is still a relatively new instrument in Lesotho and will require careful management to deliver to expectations. It features strongly in the NSDP II Financing Strategy (Government of Lesotho, n.d.), where it is seen as an innovative way of attracting additional finance. Lesotho has developed the Public-Private Partnership Policy Framework (PPPPF) in 2017 (Government of Lesotho, 2017a), which outlines the main principles of PPP collaboration. However, the full regulatory framework has not been developed. Even though there were attempts to develop PPP projects, the experience has been mixed. The modern hospital was developed using a PPP model and the experience has been negative. The Queen 'Mamohato Memorial Hospital project has exhibited all the challenges of an ill-designed PPP model. The Hospital that has become operational in 2011, accounts for the large share of the scarce national health budget, with many other priority areas being underinvested (Oxfam, 2014; Government of Lesotho, n.d.). The government's contractual (pre)commitments have hurt the health budget, as the magnitude of accepted obligations has not been fully assessed. PPP Knowledge Lab that usually has an up-to-date list of PPP projects worldwide, provides very limited information on PPP development in Lesotho, as can be seen from the table below (Table 1)⁸⁰.

Table 1 Ongoing PPP Projects in Lesotho (PPP Knowledge Lab)			
Project	Sector	Final Closure	Investment/Fees
Econet Telecom Lesotho	ICT	2001	USD27 mil. (fees to the Government USD10 mil., and USD17 mil. investment in the physical assets).
Lesotho Electricity Corporation (LEC)	Energy	2002	n/a

Source: PPP Knowledge Lab (<https://pppknowledgelab.org/countries/lesotho>).

It should also be noted that PPPs are complex to manage, and they often lack transparency and accountability. It is seldom easy to assess the Government's financial exposure, which may down the line, adversely affect the Government's fiscal stability. Often the Government might accept the obligations and guarantees that might be activated later and increase a financial burden.

Management of PPPs is centralised at MoF, where a PPP Unit deals with PPP requests and facilitates the process. This centralised approach is considered the best practice and has been adopted in most developing countries. At present, the PPP Policy does not provide a link between PPP projects and priority development sectors and targets. It may be advisable to use the next PPP Policy review to establish these links and ensure that PPP projects contribute to the national development efforts and the country's commitment on SDGs. PPP projects can be utilised across all sectors, including infrastructure, social services and other areas of socio-economic life. Value-for-money, affordability and fair risk requirements should also be met to approve projects.

PPPs should be seen as just one type of mobilising private finance to deliver development goals. Other forms involving different modes of blended finance should be explored.

⁸⁰ <https://pppknowledgelab.org/countries/south-africa> and <https://pppknowledgelab.org/countries/botswana> for more information on framework, PPP Units and current regulation.

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1.2.2.3 Other Domestic Private Finance

Corporate Social Responsibility (CSR), and domestic charitable and religious finance can be valuable sources of domestic development finance mobilisation. CSR is a broad self-regulating business model where business entities engage in the projects and activities that benefit the society by showing their commitment to the communities in which they operate⁸¹. SDG 12 encourages companies to adopt sustainable practices and sustainability reporting. CSR and sustainability reporting are the same type of responsibility reporting and are often used interchangeably.

NSDP II Financing Strategy outlines CSR as a potentially important development flow that has already been practiced in the country (Government of Lesotho, n.d.). There were attempts to understand the motivation of CSR in Lesotho undertaken by scholars (Okyere, 2019). However, despite all the efforts, it seems they are still sporadic and not well-reported. NSDP II Financing Strategy singles out two companies that are owned by the Government as good examples of CSR (Letšeng Diamond Mining and Maluti Mountain Brewery).

Box 2 Example of CSR Activities in Lesotho: Standard Lesotho Bank

Standard Lesotho Bank (SLB) runs its own CSR programme, under the banner of 'Corporate Social Investment' which enables the 'bank to take its rightful position as a good corporate citizen by way of contributing to the betterment of the society and ploughing back to the communities'⁸³ in which it operates. SLB supports entrepreneurship and small business development and in 2018, it launched the Entrepreneurship Development Programme (EDP). Enterprise Hub is one of the initiatives supported by EDP. The bank opened the hub as a physical facility within the Business Banking at the Maseru Mall. The Hub provides office space, facilities, and market information for aspiring entrepreneurs and offers training programmes. SLB hosts the 'Lioness of Africa' women empowerment programme and sponsors the Entrepreneurship Network and Bacha Entrepreneurship Project. It endeavours to support local entrepreneurs through the Supplier Development Project by enhancing the capacity of local companies to be credible suppliers of choice. The Bank itself leads by example and wants to increase its domestic suppliers from the current 55 per cent to 70 per cent. The Local Supplier Development Project has UNDP and LNDC as partners⁸³.

The CSR of the mining companies has been subjected to external oversight since 2013, as the Policy Analysis and Research Institute of Lesotho has monitored them *vis-à-vis* corporate social responsibility. The Lesotho's Consumer Protection Association and the Media Institute of Southern Africa (MISA) have also developed comprehensive monitoring programs that will assess corporate social responsibility in a variety of economic sectors. However, the latter initiative is still to produce tangible results.

CSR has potential as a development finance flow to support the delivery of NSDP II and SDGs for Lesotho. However, it will require a better regulatory framework, where socially responsible companies may have an appropriate tax treatment, be

⁸¹ Refer to Saïd, Sevic and Phillips (2019), for CSR and CPA of a pharmaceutical company in an emerging market. Also, (Chattu, 2015).

⁸² <https://www.standardlesothobank.co.ls/lesotho/personal/About-us/corporate-social-investment>

⁸³ <https://www.standardlesothobank.co.ls/lesotho/personal/About-us/corporate-social-investment>; For a similar initiative (World Bank, 2019c)

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invited to coordinate their activities with the Government or coordinate their activities with other development actors to avoid duplication or unnecessary competition. At present, it is difficult to estimate the value of CSR in Lesotho, partly because there is no formal reporting requirement, and some CSR activities are delivered in-kind. The Government and the civil society may influence businesses and their associations to align their CSR activities with the national development plans for wider societal development. In the case of Lesotho, the development actors may promote impact investing as a dominant form of CSR.

Lesotho has a buoyant civic sector though fragmented, poorly coordinated (RoA Africa, 2014) and reportedly struggling financially⁸⁴. The sector consists of NGOs, Community-based organisations (CBOs), Faith-based organisations (FBOs) and Non-state actors (NSAs) (Johnson, 2016). Trade Unions and Cooperatives are sometimes referred to as being a part of the civil society/third sector (Johnson, 2016).

At national level, there is an umbrella body established to coordinate the NGO sector – the Lesotho Council of NGOs⁸⁵, but its effectiveness has been questioned because its social dialogue with the Government and other political players have been limited. The Council lists 140 organisations as its members⁸⁶ in 2021, whilst the Commonwealth⁸⁷ provides information on 33 major NGOs established in Lesotho. However, it is difficult to establish as to how many international NGOs are operating in Lesotho. In principle, the legal framework does not require them to register within the country. For instance, it is claimed that 143 UK registered charities operate in Lesotho, but no information on spending and size of operations is provided⁸⁸.

In the case of the US, the Foundation Center reported that 26 per cent of total charitable giving in the US was given to Africa in 2015, amounting to USD376 million. Lesotho received only 0.02 per cent, or USD86,000 (Foundation Center, 2015).

It is difficult to assess to what extent the domestic civic sector has the financial power to support development to a greater extent. NGOs are operating on a project basis supported by international donors (both public and private) and seem to act as a conduit for channelling the external funds to the domestic end-users. However, by building their capacity, NGOs may be able to play a more prominent role in development finance by mobilising the emerging domestic philanthropic and established international charitable financial resources.

⁸⁴ <https://www.globalpolicy.org/component/content/article/176/31489.html>

⁸⁵ <http://www.lcn.org.ls/home/default.php>

⁸⁶ <http://www.lcn.org.ls/member/LIST.pdf> (as of January 2021)

⁸⁷ https://www.commonwealthofnations.org/sectors-lesotho/civil_society/national_ngos_civil_society/

⁸⁸ <https://ngoexplorer.org/country/ls/show-charities>

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1.2.3 International Public Finance

1.2.3.1 Official Development Assistance

Official Development Assistance (ODA) is broadly defined as government assistance to promote the economic and social development of developing countries. Lesotho has received ODA mainly from DAC countries and multilateral organisations, with some inflows from other development partners. DAC countries have been more active in recent years, supporting primarily the ‘softer’ sectors, whilst international organisations were more active in infrastructure (as well as China, as a bilateral donor). ODA has grown steadily until 2014, when it dropped significantly, and then since 2016 has shown some signs of recovery. The top major development partner countries in the last 15 years are the US (USD837.87 mil.), Ireland (USD132.44 mil.), Japan (USD81.21 mil.), Germany (USD65.78 mil.), and the UK (USD65.05 mil.)⁸⁹. Amongst the multilaterals, the EU is the largest with USD 351.41 mil., followed by the WBG with USD243.59 mil. and the UN with USD147.99 mil. in the period 2015-2019. Other multilaterals have committed USD344.83 mil. Amongst the Non-DAC reporting countries, Kuwait and UAE are the biggest partners with the spent of USD16.7 million and USD14.01 million, respectively.

NSDP II Financing Strategy pays considerable attention to ODA. Based on past performance, it lists 16 major development partners: the European Union (EU), World Bank Group (WBG), China, African Development Bank (AfDB), International Monetary Fund (IMF), the United Nations (UN), Global Fund, OPEC Fund International Development (OFID), International Fund for Agricultural Development (IFAD), Japan, South Africa, GIZ, EIB, FAO, USAID, and the UK (Government of Lesotho, n.d.). It states that Lesotho needs to source about LSL11.3 billion (40.8 per cent) of the total costs of projects from the Development Partners; in the form of loans LSL6.3 bn. (22.7 per cent) and grants LSL4.99 bn. (18.1 per cent), over the next five years⁹⁰. The World Bank and China are the major IDPs in the infrastructure projects, whilst the EU member states are, either bilaterally or multilaterally through the EU support, more active in the social (‘soft’) sectors where democracy, rule of law, and governance feature at the top. USAID projects are more focused on enhancing economic capacity, while also active in democratic governance and related areas.

⁸⁹ China is listed as the second most important bilateral donor (DCR, 2018; 2019; 2020), but it is difficult to establish the magnitude of ODA support for the entire period under observation (2005-2019). In 2018 China cancelled Lesotho’s debt, and offered a new aid package, including emergency food aid. (<http://lestimes.com/china-cancels-lesotho-debts-gives-more-aid/>).

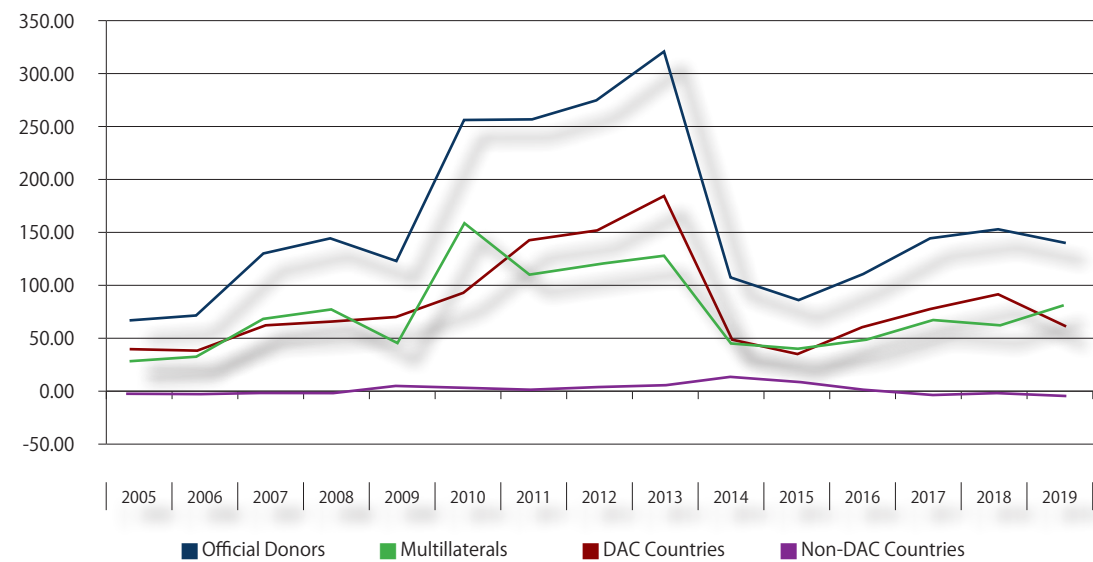
⁹⁰ NSDP II Financing Strategy provides the full listing of the commitments showing that World Bank will support 11 areas, whilst the EU will support five areas. There are also commitments by USAID, China and other traditional IDPs.

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Figure 11 Lesotho Net ODA, 2005-2019 (in USD mil.)

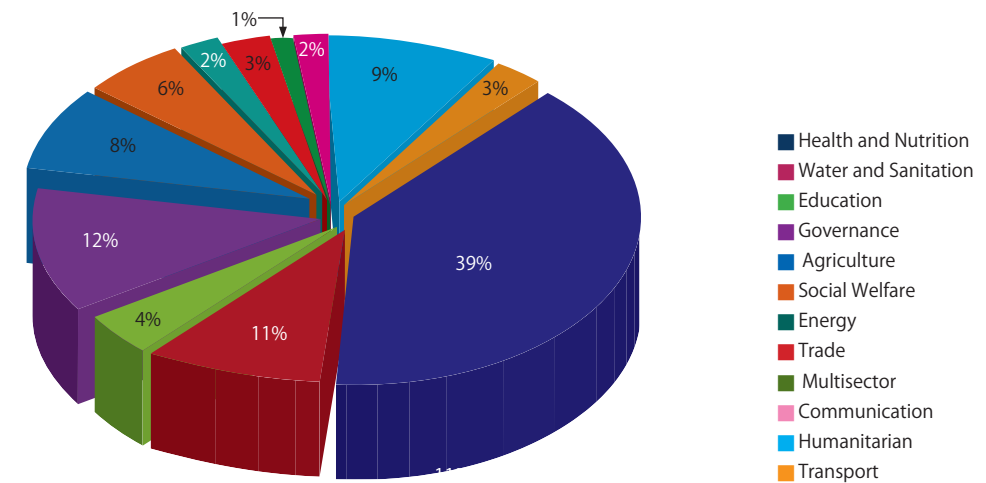


Source: OECD Database

The Government reports ODA as grants and they are treated as a separate item in the Central Government Operation statements⁹¹. Grants have represented on average, 7.26 per cent of Lesotho’s Government Budget. They have ranged between 3.25 per cent in 2008 and 14.94 in 2011. The integration of ODAs in the budget suggests that there is a good alignment of ODA spending on the priorities stated in the national development planning documents. However, there has been some shift in the focus of ODA allocations in Lesotho.

⁹¹ In many African countries ODA grants are reported in the national budget as a source of Non-Tax revenues.

Figure 12 Lesotho, ODA by Sectors, 2016-2020



Source: MoDP, 2016b, 2018a; 2019b and 2020a

As expected, the health-related programmes have accounted for 1/3 of the total ODA spending in Lesotho, followed by governance and water and sanitation. Interest in governance-related projects is on the increase in the last two years and this growth alone has ensured that governance is the second most important sector for ODA spending. This also may be interpreted as a sign of clear international support for the wide-range societal reforms that the Government of Lesotho is pursuing in the political sphere – parliamentary, judicial, and constitutional.

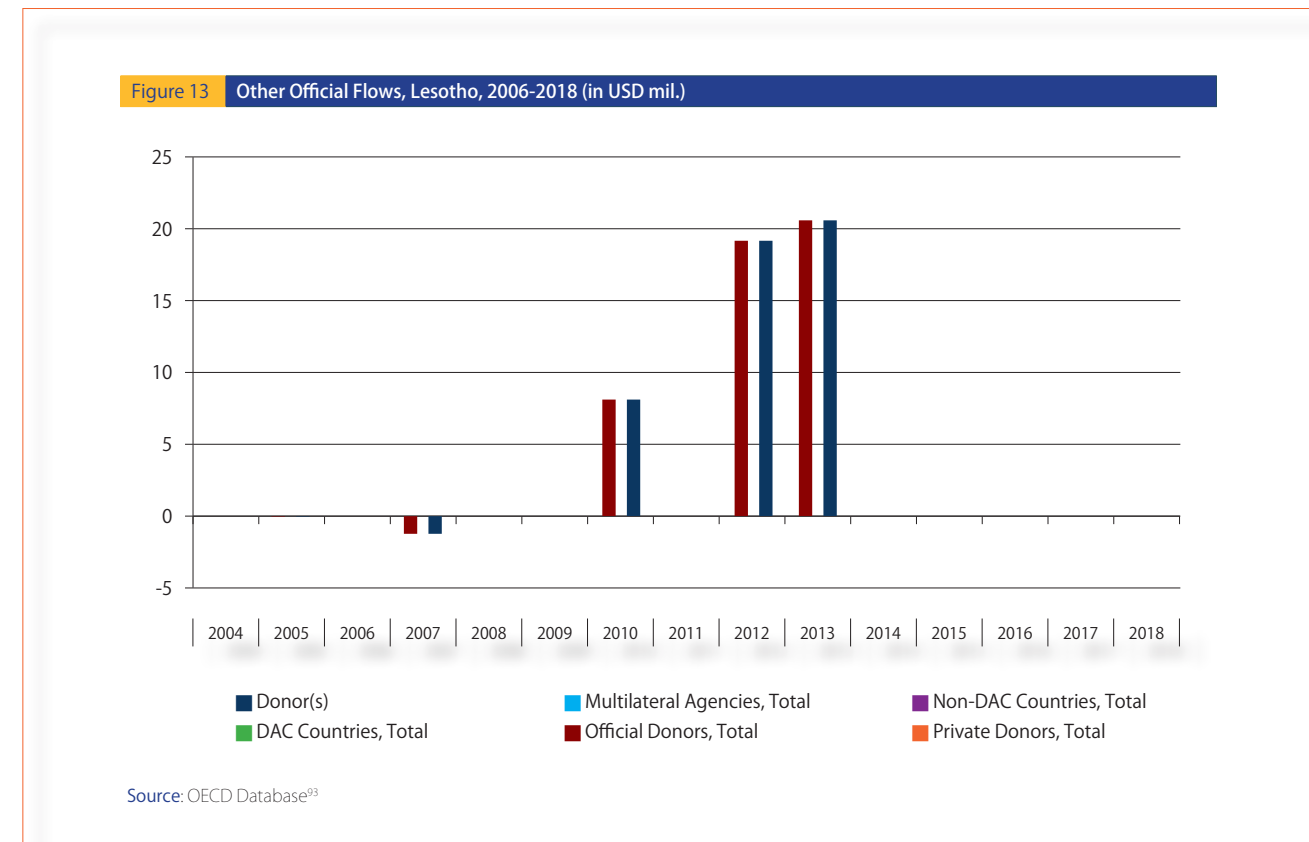
ODA has had a fairly stable influence on development finance flows, despite the drop in certain years as a response to the political instability. As Lesotho is now a LMIC, it is expected that ODA will slowly fall, as other forms of collaboration and supports may take place including OOF.

1.2.3.2 Other Official Flows

Other Official Flows (OOF) are a development resource flow and type of the Official Development Finance (ODF) that cannot be classified as ODA. However, the development finance flows still have to be official, i.e., from the government (i.e., public sector) of one country to another. As the country becomes more developed, ODA usually drops in volume and is replaced by OOF. OOF includes official export credit, net acquisition by Government and central monetary authorities of securities issued by multilateral development banks at market terms, subsidies to the private sector to soften its credits



to developing countries, and funds in support of private investments⁹². OECD reports that over 1/3 of all development finance flows have been in OOF and since the mid-1990s the relative importance of ODA has been declining and OOF is becoming an important development finance flow (OECD, 2014).



However, in the case of Lesotho, the situation is different. As it can be seen from the Figure above (Figure 13) in the period 2005-2018, Lesotho received (net) OOF in four years only – 2007, 2010, 2012, and 2013. One possible explanation is that the drop in OOFs in 2014, was due to political instability, which suggests that OOFs are politically sensitive, while economically driven. OOFs are not yet fully explored either by the Government and/or IDP. DAC countries, as the world’s most advanced economies, are the major source of OOF but in the case of Lesotho, this is not the case, as the primary source of OOF was multilateral institutions. Other IDPs have not featured at all. NSDP II Financing Strategy recognises, however, that OOF may be a source to be explored in the future, despite reservations of their direct contribution to development (Government of Lesotho, n.d.).

The issue is that NSDP II Financing Strategy has a fairly negative view of some forms of OOF, particularly export credit facilities, stating: *‘Caution is especially warranted with loans from export-import agencies, whose primary objective is not to support*

⁹² <https://www.oecd-ilibrary.org/development/other-official-flows-oof/>

⁹³ Term ‘Official donors’ covers all the categories of public sector donors, notably DAC countries, Non-DAC countries and multilateral agencies



international development but, instead, to expand market access for their domestic firms. The procurement arrangements with credits from these agencies are usually highly restrictive and non-transparent and, in some circumstances, may not represent good value for money.’ (Government of Lesotho, n.d., p. 24⁹⁴). NSDP II Financing Strategy overemphasises the relative importance of ODA, especially grants for budget stability and sustainability, neglecting other forms of ODF, which may not be the best possible strategy in the competitive world, where competition for limited official development resources is becoming stiffer day-by-day.

1.2.4 International Private Finance

1.2.4.1 Foreign Direct Investments and Portfolio Investment

Foreign Direct Investments (FDIs) are usually the first or second international private finance flow, not only in developing but also in developed economies. Following the remittances, FDI flows are the second most important international private finance flow in most LDCs and LMICs. FDIs support not only physical growth but also enable the transfer of technology, knowledge, and know-how. As with all other international flows, the global competition is fierce, and the attractiveness of unregulated and low-paid labour force may not be so attractive. Instead, the proximity of the (growing) markets and the regional integration of an FDI recipient country may be more attractive nowadays. In 2019, Lesotho attracted USD118 mil. in FDIs, whilst the FDI stock in the country has grown to USD732 mil. The textile industry and small-scale manufacturing are the main industries that attract FDIs in the country (UNCTAD, 2020a).

Performance in *‘Doing Business’* ranking is usually directly correlated with the success in attracting FDIs, and Lesotho’s performance as of late has been declining. In the most recent 2020 report (World Bank, 2020b), Lesotho slipped 18 places from the previous year’s ranking. Investors usually list the high port authority expenses (as Lesotho is a landlocked country), low quality of infrastructure, and the recent political instability as the main impediments to investment. The Government recently introduced an automated customs system to expedite the customs procedure. The good quality labour force is usually listed as Lesotho’s advantage, although it has not been independently documented. Textile industry has traditionally been the most attractive, especially due to the access it has to the US market, as over 80 per cent of its production was placed into the US market. However, political challenges may lead to non-extension of privileges beyond 2025, which may have a major adverse effect, besides the current troubles that the textile industry is facing globally.

FDIs contribution in Lesotho has not ever exceeded 8.7 per cent of GDP (as recorded in 2015) when the inflow was at its the highest – USD206.514 million. The lowest level of FDI was in 2008 when only USD11 million was invested in the country. Compared to the other fast-growing African economies, Lesotho’s share of FDIs is extremely low. Moreover, there is an issue with diversification, as only two industries (manufacturing⁹⁵ and mining), attract FDIs. It is expected that the tourism sector will attract additional investment as Lesotho has a high potential to attract foreign investment in tourist facilities of different quality (from the mass market to an upper-end market).

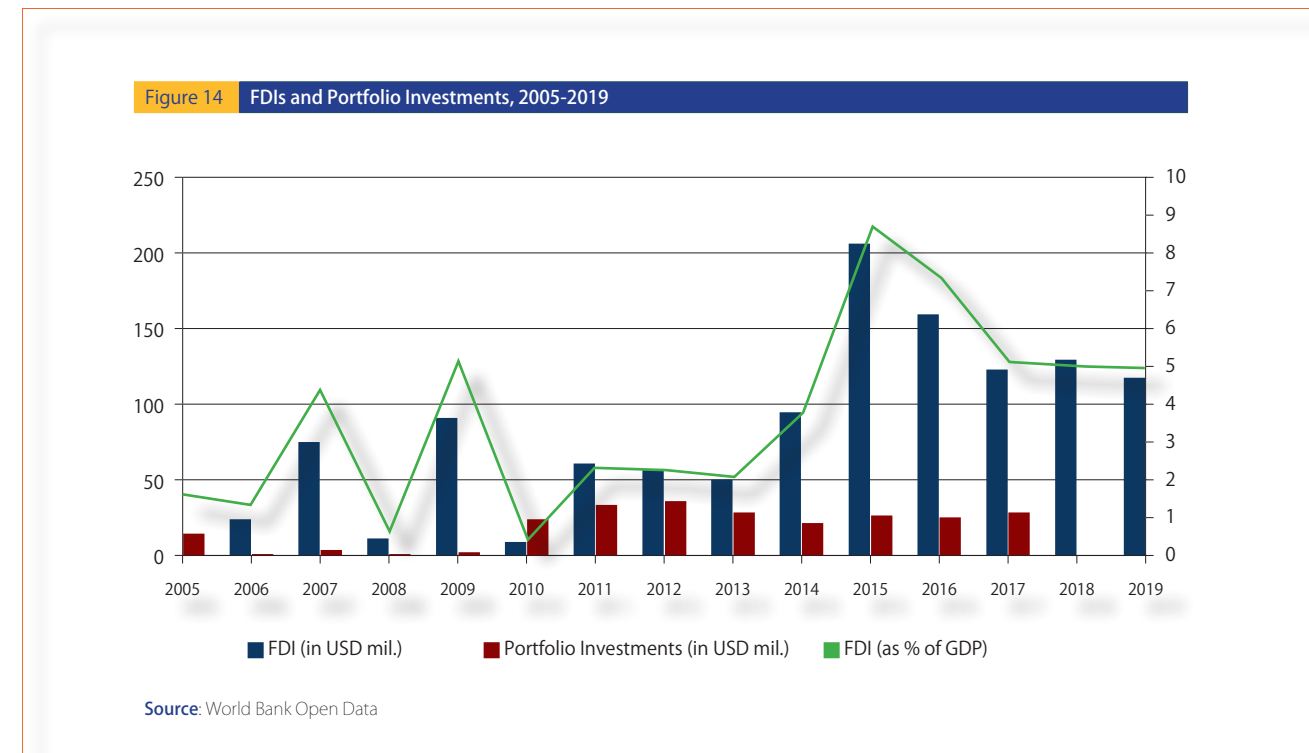
⁹⁴ Author’s italics.

⁹⁵ Predominantly garment/textile industry.

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Portfolio investments in Lesotho have been very modest in years that recorded positive results and, in most years, the outflow, rather than inflow, has been reported. Only between 2005 and 2009 were portfolio investment inflow values positive. Portfolio investments are usually volatile and are linked closely with the political business cycles. In situations of political instability, capital outflow is expected and recorded. To that extent, Lesotho's portfolio investment performance comes as no surprise.



Lesotho has played its advantages rather well, and UNCTAD has commended the country on being successful in attracting foreign capital⁹⁶, especially in the export-oriented sectors (UNCTAD, 2003⁹⁷). The country has introduced several tax incentives to attract foreign investors, such as 1) 10 per cent corporate income tax on manufacturing profits; 2) No withholding tax on dividends distributed by manufacturing firms to local or foreign shareholders, and 3) Training costs are allowable at 125 per cent for tax purposes⁹⁸. Other measures that are used are access to land and prepared facilities, assistance with the permits and licenses, etc⁹⁹. At the same time, the country has presented other advantages well, such as a good labour force, access to the developed markets (such as the US, Australia, Canada, MEROSCUR, EFTA, etc.), and access to SADC and SACU markets (i.e., ability to serve the larger markets – 55 million and 260 million consumers markets, respectively). However, despite a positive assessment by UNCTAD, the attracted international investments, and new job

⁹⁶ <https://unctad.org/webflyer/investment-policy-review-lesotho> <https://unctad.org/webflyer/investment-policy-review-lesotho>
⁹⁷ With the support and funding provided by AfDB Lesotho has initiated a review of the Investment Policy and creation of supporting legal framework, in the year 2020. The results are still pending: <https://www.afdb.org/en/documents/eoi-lesotho-review-investment-policy-and-development-associated-legal-framework>
⁹⁸ <https://www.lndc.org.ls/content/investment-incentives-why-invest-lesotho> <https://www.lndc.org.ls/content/investment-incentives-why-invest-lesotho>
⁹⁹ Measures will be presented in more details and analysed in the section 2.2.1 (see below).

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opportunities created for Basotho, are difficult to ascertain or whether the implemented policy measures have delivered value-for-money and societal impact.

Lesotho has been successful in attracting foreign investment in the past, particularly in the industries that do not require a highly skilled labour force¹⁰⁰, like the garment industry. To ensure consistency to development objectives outlined in the NSDP II and the Government's strong commitment to delivering on SDGs, it is necessary to undertake the SDG investor mapping exercise. SDG investor mapping brings together national development aims and private interests, ensuring that the private investors contribute to the delivery of the development, i.e., SDG goals¹⁰¹. In the case of India for instance, mapping conducted in 2020, identified 'the overlaps and gaps between public sector priorities and private sector interests'. The NSDP II Financing Strategy (Government of Lesotho, n.d.) has paid attention to FDIs, outlining the possible FDIs in the pipeline. Given the shortcomings of the current FDI policy, the following actions are proposed to improve management and out-turn of FDI in Lesotho: 1) reviewing a possibility to have an FDI law; 2) increasing the number of and efficiently utilising opportunities offered through Bilateral Investment Treaties (BITs) with strategic partners; 3) reviewing the Labour Laws to meet international standards; 4) developing and ensuring stable guidelines for investment incentives; 5) ensuring the stable and predictable macroeconomic environment and fiscal regime; 6) establishing the proposed Landbank for large investments, and; 7) and working on implementing NSDP II Governance Strategies to reduce corruption (Government of Lesotho, n.d., p. 32). It is necessary to address issues of red tape, political stability, and infrastructure, as these were the critical negative issues raised by the investors.

1.2.4.2 Remittances

Remittances are the most important international development inflow¹⁰² in Lesotho for a number of years. The Labour force in Lesotho can make about four choices: to work in the textile industry, the public sector, become an entrepreneur (either in a formal or increasingly in an informal sector¹⁰³) or to become an economic migrant and leave for work, primarily, to South Africa. It is estimated that Lesotho has over 46,000 migrant workers¹⁰⁴ who spend most of the year working in the South African mines. However, the total migration stock, as per the UN Department of Economic and Social

¹⁰⁰ i.e. the highly trained, educated, or experienced segments of the workforce
¹⁰¹ For the most recent position on SDG Impact and SDG Investor Mapping, (SDG Impact, 2021|202)
¹⁰² UNCDF states that remittances may contribute to reaching the SDGs in a variety of ways: 1) Household level: by recognizing the positive socioeconomic impact of remittances on families and communities; 2) Community level: Benefits associated at sub-national or municipal levels including reduced rural poverty, lower income inequality, increased micro small and medium enterprises (MSME) activity, and strengthen resilience to adverse effects of climate change or disaster risks; 3) Government level: Benefits for public sector institutions including greater transparency, better communication with citizens, and increased private sector development and entrepreneurship as a result of access to capital and domestic credit; 4) Macro level: At macro-economic level, remittances can foster much needed foreign currency exchange, stabilise Balance of Payments (BOP), reduce dependency on government aid, and re-allocate capital resources into more productive investments and other financial services – moving money from international to domestic, consumption to investment, and from urban to rural.
¹⁰³ It is estimated that 22 per cent of the Lesotho's labour force is employed in the informal sector (MoLE, 2018). And, more importantly, if the informal workers in agriculture are excluded it is possible that the informal economy in the urban areas employs as much as 30-35 per cent of the labour force (if one takes into consideration the contribution of the agriculture to GDP). [https://unstats.un.org/unsd/demographic/meetings/wshops/Tanzania_28Sep09/Exercise%20IV%20ILO%20IndicatorCalcResults\(FINAL\).pdf](https://unstats.un.org/unsd/demographic/meetings/wshops/Tanzania_28Sep09/Exercise%20IV%20ILO%20IndicatorCalcResults(FINAL).pdf). Although the per centage is high, it is still significantly lower than in many other East and Southern African Countries.
¹⁰⁴ In the 1990 there were over 100,000 migrant miners, but these numbers have been decreasing due to the structural changes in the South African mining industry. <https://southafrica.co.za/changes-migrant-labour-lesotho.html>

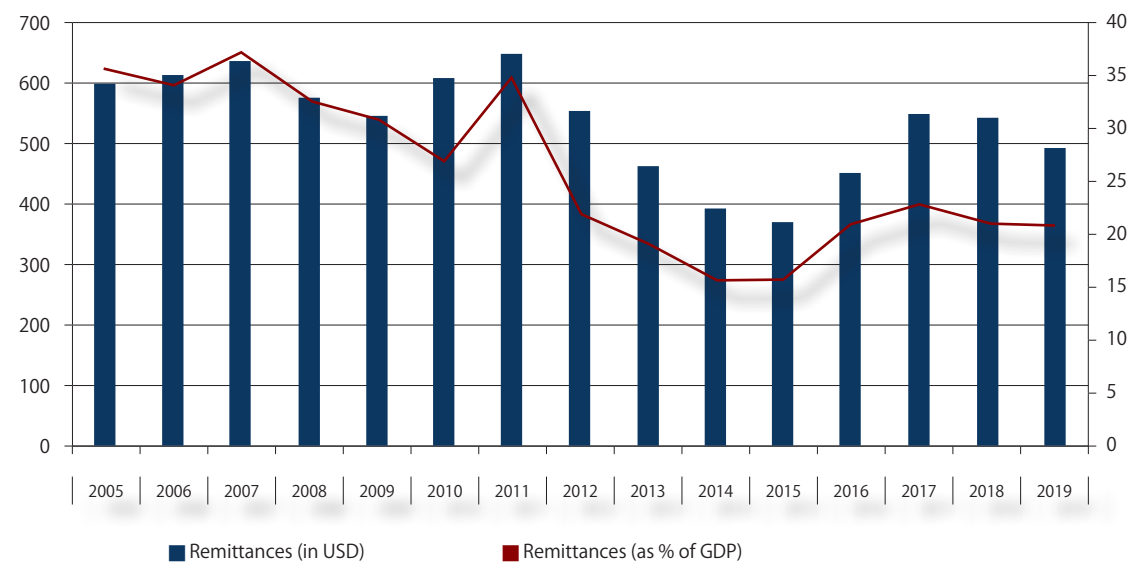
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Affairs (UNDESA), is 112,597 migrants¹⁰⁵. Over 17 per cent of households in Lesotho are almost entirely dependent on remittances income (UNDP, 2020b).

Female labour outward migration has decreased, primarily due to the FDIs in the textile manufacturing and garment industry (Botea, Chakravarty and Compennolle, 2018). However, there is significant movement within the country and it has been proposed that the following measures be introduced to support female migrants and their families: 1) lower the barriers to secondary education in rural areas: 2) diversify and expand employment opportunities for men and women, and 3) provide HIV/AIDS prevention and treatment services to garment factory workers, as well as migrants working in the informal sector (Botea, Chakravarty and Compennolle, 2018). IOM points out that regional integration (SADC and SACU) continues to have an impact on migrations, as SACU and SADC migrants continue to gravitate towards South Africa (IOM, 2020).

Figure 15 Remittances, 2005-2019



Source: World Bank Open Data

Lesotho is the top country in Africa in terms of remittances as a percentage of GDP (AfDB, 2020). The overall situation has improved since the mid-1990s when the remittances vis-à-vis GDP had been much higher. From the late 1980s to the mid-1990s remittances, were higher than the country's GDP, and in 1987 alone they were 236 per cent of Lesotho's GDP. With the growth of investments and opportunities in the country, as well as the country's better economic performance, the relative importance of remittances has been slowly decreasing until 2016 when again they grew slowly, before stabilising

¹⁰⁵ <https://www.un.org/development/desa/pd/content/international-migrant-stock>

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in the last two years (2018 and 2019). It is expected that in 2020, remittances will drop significantly due to the COVID-19 pandemic and lesser labour mobility and the reduced economic activity due to the frequent lockdowns, both in Lesotho and South Africa (and other SADC countries).

A certain amount of migrant workers' salaries may also be brought into the country in cash, and it is difficult to estimate how much as there is no compulsory cash declaration threshold stipulated upon entry into the country¹⁰⁶. In fact, it is believed that significant amounts are brought back in cash, and the total sum is very difficult to ascertain. There is a room to explore further the case of digital remittances, as it is reasonable to expect that the classical transfers will drop over time, and other more technically advanced channels will be utilised. UNCDF is currently exploring the issues of digital remittances in Africa, but the work is still in a very nascent phase¹⁰⁷. However, Lesotho's migrant workers in South Africa already enjoy some benefits of a digital corridor between the two countries. The Shoprite cross-border money transfer services allow the citizens of Lesotho in South Africa to send money to Lesotho (AFI, 2018).

Mobile network operators in Lesotho have explored the inbound cross-border remittance services in partnership with licensed international money transfer service providers. Econet Telecom Lesotho (ETL) partnered with WorldRemit¹⁰⁸ in June 2015 to enable mobile transfers from the UK and US. ETL was a pioneer of mobile cash in Lesotho, launching the service in 2012¹⁰⁹, and the partnership with WorldRemit has broadened the offer for its customers. WorldRemit charges senders four per cent of the transfer, whilst ETL charges the recipients from ZAR1 to ZAR11.50 depending on the amount received. ETL also partnered with Flash South Africa, launching the inbound cross-border remittance transfers from South Africa to Lesotho in December 2017 (AFI, 2018). Vodacom Lesotho has partnered with Mukuru, to provide competitive remittance transfer, especially from South Africa to Lesotho (World Bank, 2018b). Given Lesotho's topography and distribution of financial access points, interoperability between the service providers is recommended to promote access and reduce costs to recipients. There are opportunities to engage with well-established remittance transfer platforms and operators, such as Western Union, MoneyGram, Wise, etc¹¹⁰.

In the case of the cost of remittance transfers to Lesotho, the average cost of transfer is still higher than the global average (6.51 per cent and 8.03 per cent at the end of 2020, respectively). The introduction of digital options should reduce the costs and at present, Shoprite transfers are the cheapest with the 1.46 per cent total cost, whilst WorldRemit transfers are around five per cent¹¹¹. Further, innovative channels may be considered, taking advantage of the SADC – level regional integration and the financial technologies. It may be advisable to offer more financial education, promote digital skills among migrants, and promote access and effective use of available remittance transfer channels and financial services. This will improve financial inclusion and reduce illegal financial flows.

¹⁰⁶ South Africa requires all the entrants to report any money on them (either in cash or financial instruments) in excess of ZAR25,000 or USD 10,000 to be declared to Customs Authorities.

¹⁰⁷ <https://www.uncdf.org/article/5660/request-for-applications-inclusive-digital-solutions-to-support-migrants-and-remittances>

¹⁰⁸ WorldRemit is a digital money transfer company that enables migrants and expatriates to send money to over 100 countries. The average total fee is 4.5 per cent of the total value transferred (shared by the sender and recipient) (AFI, 2018). In the meantime, the total cost has increased for about 10 per cent, as per World Bank Remittance cost data (<https://emittanceprices.worldbank.org>)

¹⁰⁹ More on mobile money transfers in Lesotho's context, (Sekantši and Motelle, 2016 and World Bank, 2017; (World Bank, 2018b and to some extent, TechnoServe, 2016)

¹¹⁰ <https://moneytransfers.com/guides/top-10-money-transfer-companies>

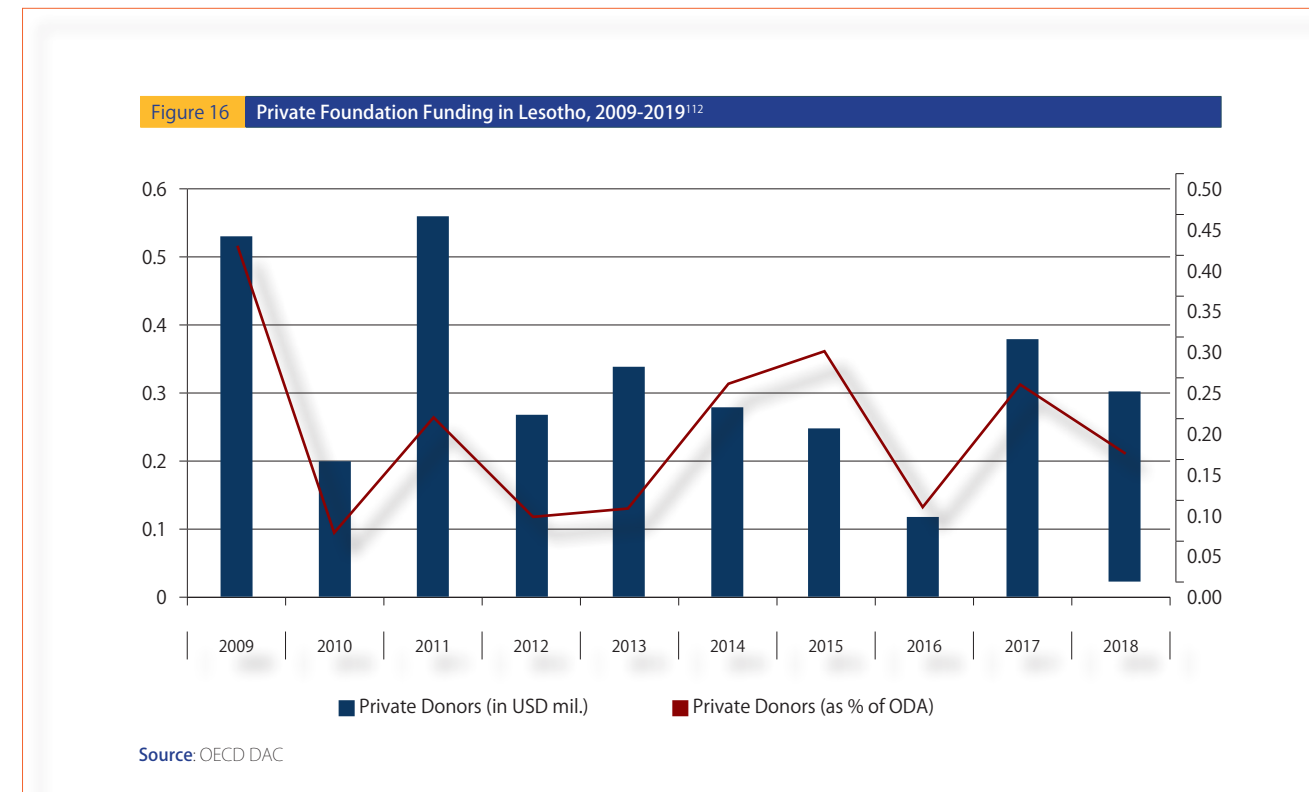
¹¹¹ <https://remittanceprices.worldbank.org/en/corridor/South-Africa/Lesotho>



1.2.4.3 International Third Sector Finance

International Third sector finance (philanthropic, charity) has been growing, especially over the last 30 years, and is now considered an important contributor to development. It is estimated that the charity sector controls assets exceeding USD 1.5 trillion globally (Johnson, 2018). Africa has been a place of interest for many global foundations and many faith, education and health charities are operating in the continent. However, their engagement with Lesotho has been minimal, with total development flows received from the international charitable organisations not surpassing USD3.21 million, on average, annually during the period 2005-2018. This figure is roughly 0.14 per cent of all ODA received (USD2,252.34 mil.). This is highly surprising, as Lesotho has a very high prevalence of HIV/AIDS and tuberculosis, and many medical charities are assisting programmes with the alleviation of these diseases worldwide.

There are further opportunities to mobilise philanthropic finance and explore the opportunities to ‘blend finance’, both public and private, with the philanthropy and contribute to the delivery of NSDP II and beyond. At present, philanthropy funding is primarily directed to humanitarian causes, and in that sense, it may alleviate the pressure on public finance for social security spending. Mobilising religious/church finance may be another opportunity to be explored, as the religious denominations and their charities are active in Lesotho, but it is not clear as to what extent they support societal development and may contribute to the achievement of NSDP II and SDGs.



¹² No record of any giving prior to 2009.



The NSDP II Financing Strategy (Government of Lesotho, n.d.) does not pay particular attention to the International Third sector financing. However, it has been reported that Lesotho has received significantly more from International NGOs and Foundations than reported by OECD. For instance, in the period 2014/2015 to 2018/2019, Lesotho received a total of USD43.30 million and USD52.662 million from International NGOs and International Foundations, respectively. However, there were no specifics on the commitments and uses (Government of Lesotho, n.d., p. 7). International philanthropy can certainly be an important source of development finance, especially in addressing HIV/AIDS and related health issues while also complementing the funding provided through the specialized funds.

MoDP reports differently to DAC, stating that the international NGOs (charities) and foundations (international third sector) were more active (MoDP, 2018a; 2019b; 2020a). MoDP’s Department of Aid Coordination points out that in the fiscal year 2016/17, USD1.1 million was received from the foreign foundations; in the fiscal year 2017/18, international NGOs directed USD1.26 million to Lesotho, whilst international foundations spent USD8.13 million or in total – USD 9.39 million in the same year. The fiscal year 2018/19 was the most successful, as Lesotho received USD85.24 million – USD41.81 from the international NGOs and USD43.43 million from the international foundations. The fiscal year 2019/20 recorded a drop, as only USD 34.00 million was awarded to Lesotho – USD33.4 million by international NGOs and only USD60,000 from the international foundations. One of the possible explanations for this discrepancy in reports is that the assistance was received from the NGOs and foundations that came from the non-DAC countries and their commitments were therefore not reported in the DAC database. Moreover, as private foundations report their activities voluntarily, it is possible that some of the reports have not been up-to-date and/or have not captured all the flows.

1.3 Risk Analysis

Lesotho has experienced political instability in the immediate past, and the probability of instability is still assessed as high (IMF, 2019). Associated with it, are the risk of ongoing national reforms (constitutional, PFM, judiciary, economic, parliamentary, etc.) which may create additional instability, despite the ultimate positive outcomes.

In economic terms, Lesotho is an open economy that is influenced by global trends, and at present, especially due to the COVID-19 pandemic, some protectionist measures may be applied, which might adversely affect the country’s economic performance. Growth in the next 3-5 years will be primarily driven by Phase II of the Lesotho Highlands Water Project (LHWP)¹³. Project risk associated with the undertaking may affect the overall country risk, as the project is exceptionally large for a small economy. The Government arrears that have accumulated in the last few years put an additional risk burden, which may also lead to a further deterioration of the fiscal discipline, along the lines that ‘if the Government owes us, we may owe the Government’, as well.

Lesotho’s economy is well-integrated into the South African economy as a landlocked country surrounded by a large and economically more advanced neighbour. However, the spill overs from South Africa also present a major challenge, as the

¹³ <https://www.aurecongroup.com/projects/water/lesotho-highlands-water-project> and <http://www.lhda.org.ls/lhdaweb>



Government may have very little choice in addressing them. For instance, not to risk the peg to ZAR, the Government has decided to enter into the arrears on its payment obligations (primarily the public servant salaries and social security dues), rather than to look for the more aggressive economic measures (BIS, 2003; IMF, 2019).

Lesotho has experienced droughts in the past and the recovery path was complex and costly, mainly due to increased vulnerabilities and potential reversal on development gains, especially on poverty eradication. It has been reported that the 2016 drought alleviation measures costed up to 2 per cent of GDP (IMF, 2019). Future droughts may have longer-term negative consequences on the agriculture sector, as the response may not be timely (as the past suggests).

Lesotho has one of the highest prevalence of HIV/AIDS in the world, where 25 per cent of the adult population (15 to 49 years) is HIV positive¹¹⁴. Also, tuberculosis is a big health challenge as there are 611 cases in 100,000 people, as per WHO reports (WHO, 2020). The two health challenges, together with the current COVID-19 pandemic, may have a direct impact on the health budget by increasing the costs of health provision. Lesotho's expenditures on health have been growing and the health outcomes have been improving since the 1990s. However, the only tertiary hospital in the country is a PPP-operated facility that has been draining national resources, whilst many district hospitals have shown relatively low absorption capacity.

The government operates 40 per cent of the primary and 55 per cent of the secondary health facilities, which have very low occupancy rates, averaging 32 per cent. It is assumed that poor awareness, lack of access, and poor quality may be reasons for these low numbers. In contrast, the PPP-operated hospital records a 74 per cent occupancy rate (UNICEF and World Bank 2017). Lesotho annually spends about USD105 per head on health. This is somewhat higher than other LMICs or Sub-Saharan Africa Average (USD 90.02 and 97.71, respectively), but it is over five times less than South Africa and over 50 per cent less than Eswatini (Swaziland)¹¹⁵. Another important trend is that the health sector's recurrent expenditures have been growing year on year, whilst the development expenditures have been dropping even faster, year on year (UNICEF and World Bank, 2017). In the long run, this may hamper the overall capacity of the sector to provide good health services, as the standard of facilities deteriorate.

The NSDP II Financing Strategy has outlined three possible risks associated with the capacity to finance the NSDP II: 1) Risk of political instability; 2) High staff turnover and possible loss of institutional knowledge, and 3) Weak regulatory framework (Government of Lesotho, n.d.). All three risks are valid and may harm the capacity to attract finance, however, some of the risks listed above may have more detrimental effects, than others. The NSDP II Financing Strategy suggests certain mitigation measures/actions address each risk (Table 2 below).

¹¹⁴ <https://www.unaids.org/en/regionscountries/countries/lesotho>
¹¹⁵ USD570.21 and USD247.90, respectively (UNICEF and World Bank, 2017)



No.	Risks	Mitigation measures
1.	Instability: political instability, riots, and other uncertainties, will result in investors lacking confidence to bring their money into the country.	<ul style="list-style-type: none"> The strategy should be owned at the highest level. Sensitization of Cabinet about the strategy will also help to instil ownership.
2.	Staff turnover: high staff turnover resulting in loss of institutional memory.	<ul style="list-style-type: none"> Proper documentation and filing. Continuous capacity building to have a pool of human resources. Public service review to introduce sustainable packages to retain staff.
3.	Weak regulatory frameworks.	<ul style="list-style-type: none"> Propose legal frameworks that will support the initiation of some of the mechanisms and build the confidence of the investors.

Source: Government of Lesotho, n.d., p. 45

The Government has undertaken a series of measures to mitigate the risks and the concept of risk has been embedded in the planning process across the Government and thus allowing the responsible public entities to plan and take necessary actions to address the risk concerns. Risk matrices may be found in the documents provided by IFIs (IMF, 2019) and attempts to create an effective risk matrix may be found in some of the key Government documents, such as NSDP II Financing Strategy (Government of Lesotho, n.d.). Unfortunately, the major reform planning and implementation documents do not have appropriate in-built risk assessments. Moreover, risk reporting is generally lacking across the public sector.

1.4 Policy and Institutional Binding Constraints

1.4.1 Constitutional Reforms

The Government has proposed the National Reforms Programme which covers the reforming the following sectors: the Constitution, Parliament, Public Service, Justice, Security, Economic, and Media. The issue of constitutional reform has been opened for a number of years now and has been accelerated following the extraordinary elections held in 2017.

To provide a background for the constitutional changes, the Parliament had commissioned an expert report to summarise the views and needs for the intervention – *Reform Expert Paper* ('Nyane and Makhobole, 2019). The Report addresses some 20 issues, where changes had been requested¹¹⁶.

The *Reform Expert Paper* does not table the issues of equality and equity at the centre of the reforms process, but it does mention twice the issues related to gender – 'gender affirmation' and 'gender balance' in its recommendations ('Nyane and Makhobole, 2019). Other independent reports clearly show that the challenges of gender equality and gender-based violence have not been addressed effectively, even at an institutional level¹¹⁷. The EU has committed itself to support governance reforms in Lesotho and in their programme document, equity and equality (both gender and economic/

¹¹⁶ The Report, interestingly, addresses the pension rights of the holders of Prime Ministership.
¹¹⁷ See an article, as recent as March 2021, at: https://www.unaids.org/en/resources/presscentre/featurestories/2021/march/20210308_lesotho-legal-system-curb-gender-based-violence

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income) feature very strongly (EU, 2020). The UN has also been strongly committed to supporting Lesotho's reforms process and values of equity and equality are at the core of their approach.

The reforms process has been guided by the National Dialogue Preparations Committee (NDPC), which organised the Multi-Stakeholder National Dialogue and the Extended Multi-Stakeholder National Dialogue. In these forums, issues of the Bill of Rights, decentralisation, public finance, First Lady, parliament, judiciary, executive, political parties, and institutions supporting democracy were raised.

Overall, the calls for a change of the Constitution are a result of the prolonged political crisis and frustration of the public. Many of the issues are probably non-issues and emerge due to the low capacity of the democratic process in the country. Institutions in Lesotho are regulated like those in advanced democracies copying closely the Westminster model and traditions. However, the capacity may be lacking to efficiently put them into practice. SADC has been involved in the constitutional reform process and its report clearly shows that the comparative legal practice has been duly considered in proposing further steps in the constitutional reform process and review of the Constitution. It is expected that following the post-COVID-19 recovery, the constitutional reform process will most certainly accelerate, as the Parliament is pressing for the changes. Constitutional and institutional changes initiated in the country should provide an effective institutional framework to facilitate the implementation of national plans, including NSDP II and SDGs. Likewise, an effective institutional infrastructure should be supportive of INFF and other development coordination mechanisms that may emerge in the future.

1.4.2 Public Sector Reforms

Lesotho has launched the Public Sector Improvement and Reform Project¹¹⁸ with the support of the World Bank. MoF has been coordinating many projects to improve PFM in Lesotho, such as 1) Integrated Financial Management Information System (IFMIS); 2) Integrated Revenue Management System (IRMS); 3) PFM Reforms; 4) Public Sector Modernisation Project, and 5) Upgrading Payroll and Human Resource Information System.

The public sector/services in Lesotho have faced many shortcomings, notably: 1) the widening service delivery gaps; 2) over-centralization of operations and decision-making authority; 3) the devastating impact of politicisation and the patronage system; 4) ethics and accountability deficits; 5) restricted access to information and blockages to transparency; 6) absence of a framework to hold agencies and their employees accountable for the delivery of measurable outcomes and to exfoliate non-performing entities and individuals and, above all, 7) lack of national consensus on abiding to good governance and public administration values and principles (Government of Lesotho, 2019, p. 6).

The on-going public sector reforms are also critical. The idea is to strengthen performance management across the public services through the formulation of the public service indicators, process re-engineering, and simplification, drafting service charters, training services delivery agents, reviewing and defining the incentive system, working on the overall

¹¹⁸ See on the current project under the auspices of MoF, at: http://www.finance.gov.ls/projects.php?id=current_projects

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attitude change, enforcing review guidelines, monitoring of customers/client/citizens satisfaction, quick response to the complaints and quick rectification of faults, adoption and application of the highest principles of service, notably, *Batho Pele*¹¹⁹, as well as providing equality of access, inclusiveness, merit, accountability, and transparency (Government of Lesotho, 2019).

Decentralisation should also play an important role in the reforms process. The Government should propose regulations defining the powers that will be decentralised, as well as resources that will be allocated for the delivery of decentralised services/powers. The Reforms should eliminate politicisation and patronage system that has been thwarting the public sector performance. Performance contracting and evaluation should be introduced in the public services, ensuring that long, medium and short-term objectives of the public sector organisations are well defined.

Following assessment commissioned by UNDP and UNCDF in 2014 (MoLGC&PA, 2014), Lesotho drafted the Local Government Bill in 2016¹²⁰ to further facilitate decentralisation efforts. The Government budget is still the major source of finance for sub-national level governments and at present about nine per cent of the national budget accounts for grants to other government bodies (not only the local government entities). Efforts on fiscal decentralisation were accelerated in 2018 but have not progressed as planned. However, there were public criticisms of the bill and there were calls for its revision ('Nyane, 2019).

To strengthen ethical approach and transparency, the Government plans to introduce a zero-tolerance towards corruption. When the Code of Conduct Office is established, officeholders should declare their assets and public servants banned from engaging in business ventures. ICT should be improved to ensure that services are delivered in a modern way, as well as ensuring that public servants receive appropriate training and that the gaps are closed. The Lesotho Institute of Public Administration and Management (LIPAM)¹²¹ is to be used to improve the capacity of public servants, venturing into delivering new programmes and supporting capacity building beyond its current offerings which are primarily, public sector Human Resource Management training.

¹¹⁹ *Batho pele* – 'People First' – has been one of the reform initiatives launched in South Africa by the Mandela Administration in 1997. The service to the citizenry is at the centre, with 8 core principles stemming from it: 1) Consultation; 2) Service Standards; 3) Redress; 4) Access; 5) Courtesy; 6) Information; 7) Openness and Transparency and 8) Value-for-Money.

¹²⁰ Which is still under consideration in the Parliament at the time of writing (July 2021)

¹²¹ LIPAM established in 1976, is still a department within the Ministry of Public Service (MoPS) and offers certificate and diploma courses. At Diploma level two programmes are accredited with the Council of Higher Education. The Reforms agenda proposes that LIPAM becomes an independent education and training body.



Box 3 Lesotho's Public Sector Reforms

The on-going reforms attempt to address the following strategic priorities: 1) Forging a national consensus on new, citizen-centred, Batho pele, governance and public administration principles; 2) Transforming a politicised public service into a genuinely professional, ethical, merit-based, and results-oriented institution (short-long term options); 3) Inculcating a new service delivery culture in all cadres of the public service; 4) Strengthening watchdog and accountability institutions; 5) Entrenching accountability and transparency via performance contracting, monitoring and evaluation; 6) Enhancing the professionalism of the public service through the implementation of a comprehensive training and capacity development programme; 7) Leveraging latest advances in ICT for improved service delivery; 8) Formulating a holistic youth unemployment strategy; 9) Improve the working conditions and harmonise public services' remunerations and benefits across the civil service; 10) Develop Public Service Legal frameworks, policies and strategies that address the inequalities in the employment and conditions of the persons with disabilities; 11) Improve the quality and accessibility of the education system; 12) Harmonise Local Government laws and systems to improve relationships between the elected authorities and traditional authorities for improved service delivery, and 13) Improve and protect the conditions and rights of workers in the country (Government of Lesotho, 2019, p. 32). The appropriate plan has been prepared, focusing on each of the strategic priorities, clearly stating the current challenges and the suggested course of action. For some priority areas, there are also listed benefits that must be achieved once the reforms have been executed. Tasks are listed as operational (targets) and political (Government of Lesotho, 2019).

Lesotho has over its 54 years of independence, attempted several public sector reforms, aimed at improving the efficiency and effectiveness of the public administration¹²². However, this time, at the centre of the reforms process is a citizen and improving services for the citizens, hence the focus is two-fold – political and operational. As the reforms attempts are supported by the major international and regional partners (UNDP, World Bank, and SADC), they are better coordinated and have found an inspiration from those successfully implemented in South Africa. In parallel with the public sector reform, MoF has implemented several public sector finance (PFM) reforms, addressing some of the challenges that have been brought up by the overall public sector reform.

PFM reforms have looked at the issues of accountability and better financial management across the public sector. They also incorporate the use of ICT in improving the accountability as well as the rolling out of PFM in the public bodies. For instance, the promulgation of the Public Financial Management and Accountability Act in 2012 has improved the overall credibility of the Government finance and process of managing public finance in Lesotho. MoF has developed the Public Financial Management Reform (PFMR) Action Plan which included activities to improve the PFM regulatory framework, transparency, cash management, internal control framework, public procurement and external audit (MoF, 2011). PFM reform plans have been primarily informed by the Public Expenditure and Financial Accountability (PEFA) exercises.

¹²² On some of the early public service reform attempts, Hirschmann, 1987.

The first PEFA for Lesotho was completed in 2007 by the World Bank and suggested several areas for improvement. The subsequent PEFA conducted in 2012 was more explicit in listing areas for improvement. The latter PEFA commended the Government for passing the Public Financial Management and Accountability Act 2011 and the introduction of the new Integrated Financial Management Information System (IFMIS). However, overall progress since 2009 was deemed disappointing by 2012 assessments. The proposed areas of improvement were: 1) Modernisation and implementation of PFM legal framework; 2) Assurance and effectiveness of policy and fiscal transparency; 3) Cash flow management for improved central Government debt management strategy; 4) Improvement of efficiency and effectiveness of internal control environment; 5) Improvement and assurance to compliance with accounting and reporting of budget execution in line with the legal framework and international standards; 6) Alignment of public procurement with international best practices concerning efficiency and transparency; 7) Improvement of external audit and legislative oversight functions to ensure full compliance with INTOSAI and parliamentary best practices respectively, and 8) Development of a robust monitoring and evaluation framework to track the progress of PFM reforms over time with full Government ownership (MoF, 2016). Most, but not all areas for improvement have been addressed as such (IMF, 2018c; Linpico, GRM International and NTU, 2019).

Assessment of PFM reforms shows that coordination is still an issue across the Government and that the overall planning and budgeting (although considerably improved) still needs to be realistic, especially concerning the projections. The introduction of the Central Budget Management System (CBMS) in the fiscal year 2018/2019 has improved the overall outlook on the budget and spending but has not been fully utilised. As SDGs are mainstreamed in NSDP II, the implementation of SDGs is funded through the annual budgets approved by Parliament (MoDP, 2019, p. 101). However, there is room for improving the coordination of the budgeting and planning process to ensure effective SDG tagging and SDG budget tracking. There is a need to address the issue of inadequate documentation and corruption that are serious impediments in the public sector (IMF, 2018c and Linpico, GRM International and NTU, 2019). However, PFM reform has clarified the issue of budget documentation by defining the Budget Strategy Paper (BSP), Budget Speech, and Annual Budget Estimates Book (IMF, 2018c).

PFM reforms are still ongoing addressing the issues of planning and budgeting, transparency and better fiscal management of the public resources. Despite the success of the previously applied chapters of the PFM reform, there is still room for improvement, especially in the reporting, accountability of PFM segments.

1.4.3 Economic Reforms

Economic reforms in Lesotho are aimed at improving the overall international competitiveness of the economy, with a focus to make the public institutions work better and in a more transparent way in their interaction with stakeholders (citizenry, businesses, the general public, etc.). The social dialogue in Lesotho, as a prerequisite to the social consensus for the ongoing society-wide reforms, is designed to platform bring societal actors together. Through public consultation exercise(s) (Government of Lesotho, 2017c) various issues have been raised and proposals put forward.

PART I: THE CURRENT CONTEXT



There is an appeal to see SOEs efficient, streamline the procurement procedures, and ensure equal access to opportunities (Maruping, Montši, and Foon, 2019). SOEs which are highly ridden by nepotism and corruption, should be reformed¹²³.

Farmers should have access to the free market and be able to realise their full market potential directly without being required to engage through various intermediaries (boards and government-appointed agents). Extractive industry players have requested that the multinational companies granted mining licenses in Lesotho should cooperate with the domestic companies and engage them as partners. The National Planning Board (NPB), which is a constitutional body, should be re-activated and transformed into the National Planning Commission (NPC), with a higher level of independence. The (Mohlomi) Code of Corporate Governance¹²⁴ should be introduced with immediate effect, as it has been endorsed, but not applied. The Directorate of Corruption and Economic Offences (DCEO) need to be revamped and given full powers to deal with corruption (Maruping, Montši, and Foon, 2019).

The Government is required to develop the Private Sector Led Growth Policy, which would ensure full empowerment of the private sector in the country's economic growth and development. Fiscal consolidation should ensure that the State becomes less burdensome and that public resources are managed and used responsibly. The Agriculture Transformation Strategy, Industrialisation and Employment policies are to be developed in the short- to medium-term to support the international competitiveness of the economy (Maruping, Montši, and Foon, 2019).

The Trade Policy should promote export diversification (product lines and markets); sharpen promotion and competition strategies and align them with international best practices. Youth and Gender policies should support entrepreneurship in usually marginalised groups, provide entrepreneurial education and training, and support start-ups (Maruping, Montši, and Foon, 2019). The Government's aim should be empowerment of young people and women and enable them to build a sustainable future. General youth and gender policies are in place (MoDP, 2020c). Environmental policy is still in a nascent phase of development and is expected to go together with the economic development policy in promoting sustainability across economic sectors. There are also calls to review and revise the Investment Code.

To achieve these ambitious plans, the existing and new government bodies should either be established or reviewed. Those to be established, in the medium are: Economic Advisory Council, Science, Technology and Innovation for Development Programme, National Public Enterprise Authority, Public Assets Management Authority, Bureau of Standards, Productivity Centre, Competition and Consumer Protection Agency, Entrepreneurship Centre, and the Lesotho Diaspora Forum. The One-Stop Business Facilitation Centre, Basotho Enterprises Development Corporation, National Manpower Development Secretariat¹²⁵ and National Planning Board¹²⁶ are to be reformed and strengthened, in the short-term (Maruping, Montši, and Foon, 2019).

¹²³ Maruping, Montši and Foon, 2019, pp. 3-4, 10-11. In Lesotho's context nepotism and corruption are seen as a single problem that has to be addressed concurrently.

¹²⁴ <https://www.maserumetro.com/news/news/corporate-governance-code-complete-but/>; The Code was developed by the Lesotho's Institute of Directors (IoD), with the seed-funding provided by AfDB. The Code promotes consistency in corporate governance, meritocracy, transparency and accountability.

¹²⁵ It should also be transferred from the Ministry of Education and Training to the Ministry of Labour and Employment.

¹²⁶ NPB should be transformed into an autonomous NPC.

PART I: THE CURRENT CONTEXT



Lesotho lacks both the soft and hard infrastructure. She has low levels of economic development, high-income disparities, high levels of poverty and unemployment. These factors may harm the country's socio-economic stability. Lesotho is also committed to the promotion of green development and its ensuing sustainable green infrastructure¹²⁷. This makes the need for expeditious reforms more pressing and have to be introduced in short- to medium-run. The private sector has largely been neglected. In turn, it is largely the informal sector. The reforms must ensure that the informal sector is reduced and that economic agents are brought into the mainstream economy (Maruping, Montši, and Foon, 2019). The informal sector in Lesotho exhibits an interesting feature – informal workers are registered with the local communities. The capital city local government, Maseru (Maseru City Council, for instance, keeps the register of informal traders¹²⁸ (Chingono, 2016). Therefore, mobilising the non-public sector players and engaging them in development and societal oversight is a must.

At present, very little is spent on research and development (R&D) in both by the public and private sectors. Hence, building the R&D support infrastructure at the central Government level, through establishment of Lesotho's Science, Technology and Innovation for Development Programme (STIP), would promote the culture of R&D in the country. Reforms call for an 'eco-friendly industrialisation' where the incoming industry would adhere to world-class environmental and sustainability standards. It is, however, noted that there is an obvious capacity gap in the ministries, districts, and agencies (MDAs¹²⁹) and that the Environmental Act, 2009 lacks implementation (Maruping, Montši, and Foon, 2019).

As a country that is prone to climate change, such as increasingly inclement weather, Lesotho should be prioritising the development of green architecture¹³⁰ (Cilliers, 2019) like many southern African and African countries (Cilliers, 2019). Usually, the reason for this lack of prioritisation can be found in a poor understanding of green architecture and spatial planning.

In the NSDP II Financing Strategy, climate-related financing sources have been mentioned as a possible revenue stream but at present, green finance has not played an important role. Lesotho has the potential to explore further the Green bonds and develop projects that attract green finance¹³¹. There are opportunities to explore the 'debt swap'¹³² for the environment and climate change¹³³ where the country could use the 'freed' resources to invest in addressing the climate change challenges. Debt swap opportunities may be used in other 'social' sectors, which would have a positive impact on environmental conservation and climate change. Swaps can also be used to facilitate and accelerate the post-COVID-19 recovery and simultaneously address climate change and nature loss together with the issue of the outstanding (and growing) national debt. This instrument may be attractive to both Lesotho and the lenders, especially speedy post-

¹²⁷ <https://www.greengrowthknowledge.org/country/lesotho>

¹²⁸ The vast majority of registered traders are women, 'as men do not register' Chingono, 2016, p. 634)

¹²⁹ In some other countries of the Anglophone Africa MDA usually means, Ministries, Departments and Agencies, a legacy of the British Colonial past. However, in Lesotho, MDAs refer to Ministries, Districts and Agencies, as stated above.

¹³⁰ Green infrastructure is defined as 'a network of multi-functional green space and other green features, urban and rural, which can deliver quality of life and environmental benefits for communities'. <https://www.tcpa.org.uk/green-infrastructure-definition>

¹³¹ On green bond in an African context (FSD Africa, 2020)

¹³² Debt swap is sometimes referred to as 'debt conversion'

¹³³ 'Debt for climate and nature programme swaps are where a creditor allows the debt to be reduced — either by conversion to local currency and/or paid at a lower interest rate or some form of debt write-off — and the money saved is used to invest in poverty reducing climate resilience, climate emissions' (Steel and Patel, 2020, p. 4).



Covid-19 recovery, where Lesotho may link these investments to large water projects to ensure sustainable use of natural resources and their conservation¹³⁴.

Lesotho has been successful in attracting mainly IFIs' financial support for sustainable agriculture. World Bank, IFO, and IFAD have been supporting sustainable agriculture¹³⁵ developments in Lesotho for over twenty years. With the additional efforts into developing projects that meet green finance criteria, there is greater likelihood of attracting green finance to Lesotho. UNCDF's 2020 Lesotho Clean Energy Diagnostic¹³⁶ highlights the market potential and constraints for the cleaner energy products and includes an analysis of household-level use of energy sources for specific cases like cooking and lighting. While there is further potential for electricity grid extension in Lesotho, with only 34 per cent of adults having access to the electricity grid in 2017, the diagnostic identified potential for off-grid (solar) and mini-grid energy provision to meet specific uses: only 9 per cent of Lesotho's residents used electricity for cooking, while 56 per cent still use the biomass sources for cooking.

Capital flight has also been pointed out as an issue. There are calls for a better equipped LRA. Taking advantage of complementary international initiatives¹³⁷ would be a logical step, as well as working with the partners on strengthening the current tax and regulatory activities. The Economic Reform document provides a comprehensive 'Log-frame I for Economic and Social Issues' that outlines the 'Issues' as perceived by the Stakeholders, challenges posed, current situation¹³⁸, recommended action, type of action, implementing agency, and timeframe (Maruping, Montši, and Foon, 2019, pp. 24-77).

The report includes the list of written submissions and suggestions, listed as Log-frame II (Maruping, Montši, and Foon, 2019, pp. 78-90). Planned consultation with the diaspora was organised and their contribution is listed in the Log-frame III (Maruping, Montši, and Foon, 2019, pp. 91-128). Finally, a series of appendices offer possible solutions to some of the challenges outlined in the Reforms paper (such as the transition of NPB into NPC¹³⁹, and the Radical Reform of the Public Procurement System¹⁴⁰).

The Reforms position paper offers a very good starting point in designing the economic reforms and offers straightforward solutions. It refers very strongly and quite often to the issues of constitutional, political, and other social reforms that are on-going in Lesotho. Under the overall theme of building the '*Lesotho, We Want*',¹⁴¹ the document lists issues as perceived by the stakeholders and often offers radical and straightforward solutions. At present, all the solutions are defined on their merit, and not linked strategically and systematically.

¹³⁴ On the climate programmes related financial instruments, (Meirovich, Peters and Rios, 2013).

¹³⁵ <https://borgenproject.org/sustainable-agriculture-in-lesotho/>

¹³⁶ <https://www.uncdf.org/article/6474/energy-and-the-poor-unpacking-the-investment-case-for-clean-energy>

¹³⁷ Such as the Base Erosion and Profit Shifting (BEPS). <https://www.oecd.org/tax/beps/>; and, exchange of information with foreign tax authorities.

¹³⁸ This has, somehow, been erroneously labelled as 'status quo'.

¹³⁹ Appendix I – From National Planning Board to National Planning Commission (Maruping, Montši and Foon, 2019, pp. 129-131).

¹⁴⁰ Appendix II, Maruping, Montši and Foon, 2019, pp. 132-133.

¹⁴¹ <https://lesotho.un.org/en/27090-second-plenary-multi-stakeholder-national-dialogue-lesotho-we-want>



1.5 COVID-19 Challenges and Response

The COVID-19 pandemic is a challenge for both developed and developing economies, affecting public health and the functionality of national health systems. It has created economic havoc and forced the governments worldwide to look at the rising debt 'more flexibly'. It will change the classical approach to the post-crisis recovery, as the citizens around the world would not respond favourably to the classical recipe of austerity measures and tax hikes.

Like many African countries, Lesotho has been caught up unprepared by the pandemic, although fairly late. The first registered case of COVID-19 was reported on May, 13th, 2020. However, even before cases were reported, the Government introduced the national lockdown in March 2020, similar to many countries around the world.

The lockdown and a drop in international trade had severe economic impact on Lesotho. As the Government had very little financial space to support business, IMF approved emergency assistance to Lesotho in July 2020 of USD49.1 mil. (IMF, 2020)¹⁴². Lesotho's economic performance has not been favourable even before the outbreak of the pandemic. Slowdowns in South Africa had a deeper impact on Lesotho's small economy, as it is well-integrated into the South African economy. LRA underperformed its 2019 target by around 9 per cent and deferred tax payments in 2020 have hurt national finances.

In the past, the Lesotho Government decided to go into arrears, rather than to look for other policy options to meet its due obligations (primarily to fund the public sector wage bill and social security obligations). One may only assume that arrears will grow due to the increased COVID-19 related social expenditures, and this will have an immediate negative impact on public sector workers, who constitute 50 per cent of the employed workers in Lesotho. In 2018 and 2019, Lesotho's agriculture seriously underperformed, with a drop in production by 76 per cent. This has triggered a food crisis, as most of the Lesotho's agriculture is subsistence farming and COVID-19 has made the situation worse.

It was estimated that in May 2020, over half a million people in predominantly rural areas were exposed to food shortages (LVAC, 2019)¹⁴³. This number was expected to grow to 900,000 by September 2020 (UNDP, 2020b). It is, however, forecasted that agriculture may be the first to recover post-pandemic due to the increased level of activity in response to the challenges of COVID-19 (UNDP, 2020b). Remittances have fallen and this may mean hardship for 17 per cent of the households which are almost entirely dependent on them. Just in March and April 2020, a drop of USD 2 million was recorded (UNDP, 2020b). Many migrant workers have returned home, with 62 per cent reporting job losses due to the pandemic (IOM Lesotho, 2020).

The retail business sector has been hit very hard by the lockdown and drop in trade. The informal trade, which engage about 30 per cent of the labour active population and contributes 12 per cent to GDP (BOS, 2019b.) was highly affected and this will have a ripple effect on households. As it is suggested that over 80 per cent of MSMEs are not registered

¹⁴² <https://www.imf.org/en/News/Articles/2020/07/29/pr20273-imf-executive-board-approves-emergency-support-to-lesotho-to-address-the-covid-19-pandemic>

¹⁴³ Over 70 per cent of food consumed in Lesotho is imported from South Africa and over 58 per cent of rural population relies almost entirely on subsistence farming (Lesotho Bureau of Statistics, as reported in UNDP, 2020b).



(FinScope, 2016), the estimates about the labour force engaged in the (informal) retail sector may be on a modest side¹⁴⁴. On the whole, the effects will be hardest felt on households and MSMEs.

COVID-19 pandemic is expected to increase poverty by up to 0.9 per cent and it may adversely affect the implementation of NSDP II (towards reaching SDGs). The pandemic will also put an additional strain on the weak health sector. Medical centres in tier one will most likely be unable to cope with a serious continuous COVID-19 pressure¹⁴⁵. The Government has reacted and has transformed two district hospitals into specialised COVID-19 institutions and although the facilities may be limited, they are exclusively devoted to addressing the health challenges of COVID-19.

The overall social situation is expected to worsen due to the loss of: employment; remittance, income and productive assets, resulting in an increased number of vulnerable households by almost 50 per cent to 899,000 (Government of Lesotho, 2021a)¹⁴⁶. The Government will have to support both households and the business sector to mitigate the negative impact of COVID-19 and ensure post-pandemic recovery. At present, the Government is working on the assessment of local supply chains and ensuring that modern technologies are endorsed and utilised during the pandemic. This may also support the overall Government orientation to focus on the development of the services sector¹⁴⁷. Most recent BSP (MoF and MoDP, 2020) predicts an increase in demand for social protection across the country, although not providing quantitative estimates. It is expected that COVID-19 will put additional pressure on the existing social support programmes, especially those that target the most vulnerable groups (children, women, underprivileged¹⁴⁸).

Certainly, many of the plans and projections made before the COVID-19 pandemic will not be realistic anymore, so revising both the financial envelope and policies may be required to facilitate and spur economic and social recovery ■

¹⁴⁴ Self-employment is also a dominant form of employment in MSMEs and the informal economy. MSMEs provide jobs to 118,130 Basotho of whom 59 per cent are women and 83 per cent are self-employed owners.

¹⁴⁵ Lesotho health system reports a physician, pharmacist and six nurses per 10,000 population (MoH, 2018)

¹⁴⁶ 179,000 in urban and 720,000 in rural areas

¹⁴⁷ Also recommended in the economic reform policy document (Maruping, Montši and Foon, 2019)

¹⁴⁸ Such as the Nutrition Support Programme, Child Grant Programme, School Feeding Programme, Orphaned and Vulnerable Children Bursary Programme, Tertiary Bursary Programme, Public Assistance Programme, Old Age Pensions (MoF and MoDP, 2020).



Chapter 2: Elements of a Financing Strategy

2.1 Lesotho Development Finance: An Overview

LESOTHO HAS BEEN SUCCESSFUL in managing its public finances, (Government) revenues, improved the tax collection over time and other fiscal revenues despite their fluctuation. For a long time, Lesotho has not resorted to public borrowing and most of the loans granted came from the IFIs under very favourable conditions, often classifying them as ODA, rather than international debt. Private finance has been a mixed story. International private finance, in the form of remittances, has been a very significant source of development finance for Lesotho but has been both volatile and in decline in the recent past. FDIs have been volatile and although they have contributed to the domestic job creation and industrialisation, they have not been growing and have been very sensitive to the political challenges and increasingly to the lack of stable infrastructure in the country.

The Financing Strategy brings together MTF and MTEF stipulates the expected financing gap. Most importantly, the NSDP II Financing Strategy opens the discussion on how to improve the current financial flows and introduce new financial sources. For instance, there are discussions on the improvement of the tax collection and modernisation of the fiscal system. However, the major discussion is devoted to ODA and commitments of partner countries, followed by the discussion on the public debt (both external and domestic), offering some possible scenarios. The Financing Strategy outlines all the international partners and their commitments in supporting Lesotho's development efforts. Looking at the possible innovative sources, the Financing Strategy underlines the importance of FDIs, PPP, venture capital, better management of natural resources revenues (including possible establishment of the Sovereign Fund), CSR, climate change finances, remittances and diaspora related finance.

The NSDP II Financing Strategy is a comprehensive document that should guide the Government and MDAs in mobilising resources for the realisation of NSDP II, SDGs, UN Agenda 2030 and AU Agenda 2063. The strategy recognises that many financial sources are volatile, and Lesotho should dread carefully, maintain high fiscal discipline and introduce strict fiscal rules (Government of Lesotho, n.d.). The Financing Strategy may be subjected to further improvement, ensuring that it addresses the INFF recommendations and better supports the implementation of NSDP II. The Strategy may focus in a more detail, the financial architecture (especially governance mechanisms), address issues of better linkages between budgeting and planning, focusing on different building blocks (budget, debt, taxation, investment, development cooperation) and support to cross-thematic reform agendas (climate change, gender and so on). The strategy should set and support the enabling environment so that the innovative policies that have been devised can be effectively implemented.



2.2 Policies for Public Finance

2.2.1 Public Financial Management

Following the PEFA conducted in 2012, the Government introduced a comprehensive PFM Reform programme for five years to guide the reform process and ensure that the shortcomings listed in PEFA are addressed. The Reform Plan was in line with NSDP I (2013-2017), as it was supposed to demonstrate the improvements in fiscal stability. In particular, the reform plan was to provide a basis for enhanced economic growth, strengthening fiscal consolidation, and effective service delivery. The next PEFA was conducted in 2016 and reviewed the success of the reforms and suggested next steps.

Public Finance is a constitutional category, being regulated by Chapter 10 (sections 110-117) of the Lesotho Constitution, 1993. The PFM section often in practice relates to Chapter 13, which regulates Public Services in Lesotho. The basic law that regulates PFM is the Public Financial Management and Accountability Act, 2011 (developed with support by the World Bank). The Act defines the basic categories in PFM and provides regulation on financial management, reporting, audit, budget, procurement. The PFM legal framework consists of a set of commercial, tax and related legislation¹⁴⁹. MoF is lately in charge of the entire budgeting process, including medium term budgeting and investment planning (previously held by MoDP). Despite the elaborated legal framework, the current PFM system in Lesotho hampers efficient service delivery. The budget process does not have a strong policy or strategic focus, and controls are deficient (PEFA, 2012; 2017). Overall, Lesotho exhibits a relatively low linkage between Government spending and policy priorities.

The most important move was the passing of the Public Financial Management and Accountability Act (2011)¹⁵⁰, which serves as an organic law. It was developed following the recommendation of the first PEFA exercise, conducted by the World Bank in 2007 (World Bank, 2007). The law is currently under review and is expected to be modernised shortly, most likely in 2022. The law was intended to sustain transparency, accountability, and sound management of the receipts, payments, assets, and liabilities of the Government of Lesotho. Although technically good, it has not been applied in full and many stakeholders believe that it is largely out of date (Linpico, GRM International, and NTU, 2019). The text still meets the minimum expectations, but after a decade of implementation, it is time for review and modernisation.

Lesotho is committed to implementing GRB across the public sector, where all the sectoral ministries are tasked to use GRB in budgeting for their policies and activities. Lesotho Gender and Development Policy (Government of Lesotho, 2018c) has introduced the term '*gender-responsive financing*', even though the idea is not fully developed¹⁵¹. The concept of GRB has been known in Lesotho for a while, though it has not been fully operational and used by MDAs as a standard tool. A gender-driven audit would certainly point out to the challenges that MDAs have faced in implementing both gender

¹⁴⁹ 1) Legislation dealing with taxes (Income Tax Act 1993, VAT Act 2003; Customs and Excise Duties Act, 1982); 2) The Public Services Act, 2005 and the 2008 Public Service Regulations; 3) The Local Government Act, 1997, as amended; 4) The Companies Act of 2011; 5) The Standing Orders of the National Assembly, 28 May 2008, read with the Parliamentary Powers and Privileges Act, Act No 8 of 1994; 6) The Central Bank of Lesotho Act, Act 2000, and 7) Audit Act, 2016 (implemented from 2017).

¹⁵⁰ Often referred to as PFMA Act or PFMAA.

¹⁵¹ The policy just provided a general statement: "All Government agencies and non-state actors are responsible for providing budgetary and human resources needed for implementation of this Policy, including through the strategy of gender responsive budgeting outlined above." (Government of Lesotho, 2018c, p.14).



legislation and policies. At present, GRB is not part of what would be considered mainstream practices. The Gender and Development Policy (GDP) Implementation Plan (MoGYSR, 2019) stipulates amongst its priorities, coordination amongst MDAs to ensure implementation of GRB and relevant tools for tracking funds utilization and their impact (MoGYSR, 2019, p. 19)¹⁵².

2.2.2 Public Debt and Public Debt Management

Lesotho promulgated the Medium-Term Debt Strategy (MTDS) in 2018 (Government of Lesotho, 2018b) and adopted the Public Debt Management Policy Framework (MoF, 2019a) in 2019. However, the proposed Public Debt and Aid Management Bill is still under development, even though it was initially tabled for adoption in 2016 (PEFA, 2017). The Public Debt Management Policy Framework outlines the general approach of the Government towards debt commitments and debt management. In the past, there was no consistent policy on debt and borrowing was more *ad hoc* when needed, rather than a result of a thought process and appropriate planning. With the introduction and enforcement of the policy, debt should be better managed and more policy/strategy-led.

The Lesotho Partnership Policy also stipulates that the '*Government financing needs and repayment obligations are met at the lowest possible cost that is consistent with a prudent degree of risk to maintain debt sustainability in the medium to long-term*' (MoDP, 2013, pp. 3-4). Elaborating further, the Partnership Policy recommends that Government focuses on grants rather than loans. In cases of need for a loan, concessional loans should be considered first. Only when they are not available, should commercial loan options be entertained (MoDP, 2013).

As the Government had challenges in managing cash flow, the Policy deals with cash management where the Government is committing to improving its overall cash management, as well as its contingency liability management (MoF, 2019a). The public sector guarantees which kept the Government exposed are tighten under this Policy. However, it may be necessary to legislate the provisions of guarantees to the public sector entities, as they are, in principle, off-financial statement items that can emerge suddenly and adversely affect the Government's financial situation. The approach to debt management in the times of the COVID-19 pandemic should be more aggressive, especially as there are initiatives that may assist the Government in managing its debt burden, such as DSSI¹⁵³. It is also possible to explore the options of debt swap mechanism, as well as debt consolidation leading to cheaper debt servicing.

The MTDS (Government of Lesotho, 2018b) provides a link between debt and the risk associated with its repayments. The Strategy details four possible strategies: 1) a "*status quo*" financing approach that follows the broad parameters of the borrowing mix as done in recent years; 2) a shift towards more commercial external borrowing, without increasing the total share of external borrowing; 3) a shift toward more domestic borrowing, away from external borrowing; and 4) a shift toward more domestic borrowing accompanied by lengthening of the maturity profile of domestic issuance (Government of Lesotho, 2018b, p. 6). However, MTDS does not outline one strategy to be adopted but leaves that to be

¹⁵² The functioning GRB system is defined as a success indicator for the Priority Area 13: Coordination and Implementation (MoGYSR, 2019, p. 39).

¹⁵³ Refer to the sub-section 1.2.1.1

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decided later. It does link debt strategy to the medium-term fiscal strategy (i.e., Medium-Term Fiscal Framework – MTFF) and its goals. Domestic financing sources are to be given priority and to that effect, a domestic financial market is to be developed. The MTDS is planned to be updated and adopted annually (Government of Lesotho, 2018b, p. 7).

Public debt in Lesotho is regulated by the Loans and Guarantee Act, 1967. The Act provides the limit for Government borrowing but does not provide the purpose of acquiring debt. The Minister of Finance has the authority to borrow, and issue guarantees on behalf of the Government. Interestingly, the Minister can delegate these powers to the Central Bank of Lesotho (CBL), which can issue Treasury bills (T-bills) and other instruments on behalf of the Government. CBL can provide overdrafts and other loans to the Government, but no current legislation states the purposes for which the debt may be acquired or where Government will commit the funds.

The future Public Debt Management Act, currently under development, should address these regulatory gaps. The new Act should, as a minimum, regulate the following: 1) the objectives of public debt management; 2) the purposes for borrowing; 3) the requirement for the MoF to design a medium-term debt management strategy; 4) the formal establishment of debt management committees; and 5) the requirement of external auditing of public debt management activities (Government of Lesotho, 2018b, p. 13). The Act should be oriented to sustainable development - introduce responsible, development instruments, such as green and education bonds and ensure that the public debt is primarily geared towards achieving the sustainable development goals.

The new Act should clearly outline the institutional arrangements and centralise the debt management at MoF and clearly define the relationship between MoF and CBL, which are a bit murky in regard to CBL activities *vis-à-vis* issuance of the Treasury bills in the domestic financial market. The Act should promote accountability and transparency in the borrowing processes and introduce an effective oversight of the loan realisation, ensuring that the spending is NSDP II compliant.

The Public Debt Management Department (PDMD) at MoF will have its role clarified and empowered to effectively deal with all the issues of public debt. MTDS states that Lesotho will primarily rely on the external sources, coming firstly from the multilateral institutions, which in principle corresponds with the current Government's debt profile¹⁵⁴; whilst there is a commitment to developing (in the medium- to long-term) the domestic public debt market.

2.2.3 Public Procurement

The Public Procurement Policy has been endorsed by the Government in 2018 (Government of Lesotho, 2018a). It outlines the basic principles and rules that have to be followed when the public procurement procedure is applied. Before 2007, public procurement was centralised and undertaken by MoF. However, following changes in 2007, the system was decentralised, such that Ministries, Districts, and Agencies were given the authority to undertake public procurement. The overriding requirement of the Policy is to ensure that the best value for money is achieved and at the same time, effective and efficient administration is put in operation¹⁵⁵.

¹⁵⁴ The public debt section of this Study.

¹⁵⁵ Vision and Mission (Government of Lesotho, 2018).

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The policy spells out the commitment of the Government to develop efficient regulations for public procurement, train and advance human resources necessary to implement the Policy, monitor performance, ensure synergies and improve communication with the public and other stakeholders. The policy states that Government will develop an effective oversight body (tentatively called the Public Procurement Authority), separate from the public procurement functions (Government of Lesotho, 2018a). It is envisaged that there will be the Public Procurement Tribunal, so that some form of judicial control may be exercised. The Policy outlines some elements of the public procurement procedure, leaving the details to be worked out in the public procurement legislation and ensuing regulation (Government of Lesotho, 2018a). Lesotho has successfully implemented some aspects of PFM reform and developed several ensuing PFM-related policies and strategies specifically following the PEFA conducted in 2017 (PEFA, 2017). However, very little progress has been achieved following the previous PEFA (PEFA, 2012).

Whilst there was some visible improvement between the first and second PEFA (2007 and 2012, respectively) despite the political instability, no visible improvement was made between 2012 and 2017 and this has been confirmed by the overall matrix results.

2.2.4 Strategic Planning

The National Vision 2020 was launched in 2003. The Vision see Lesotho as a stable democracy, united and prosperous nation at peace with itself and its neighbours that has healthy and well-developed human resources, with a strong economy, well-managed environment, and well-established technology. These long-term goals have been operationalised in the Poverty Reduction Strategy and then the Interim National Development Framework, 2009/10-2010/11. In March 2013, the National Strategic Development Plan (NSDP I) that integrated these two documents was launched. The NSDP I was set to last from 2012/13 to 2016/17. It was replaced by the current NSDP II, covering the period 2018/2019 to 2022//2023.

NSDP II has four pillars ('key priority areas' – KPAs), which should deliver employment and inclusive economic growth. The pillars are: 1) Promoting inclusive and sustainable economic growth and private sector-led job creation; 2) Strengthening human capital (health, nutrition, education & skills development); 3) Building enabling infrastructure, and 4) Strengthening governance and accountability systems (Government of Lesotho, 2017b). The underlying themes of NSDP II are Climate Change, Environment, and Gender.

The new Economic Planers' Manual – EPM (Government of Lesotho, 2020b) deals comprehensively with the planning process in Lesotho, outlining the strategic plans, national plans, sector development plans and planning at the district level. It also defines the roles of planers at MoDP, including the structure and organisation of the personnel ('cadre'). EPM states that a Strategic Plan represents an integrated set of strategic goals, operational objectives, and activities needed to achieve desired results (Government of Lesotho, 2020c, p.4). The planning system in Lesotho consists of 1) The long-term National Vision; 2) The National Strategic Development Plan (NSDP); 3) The Medium-Term Expenditure Framework (MTEF); 4) Sector Plans, and 5) Project Planning. In preparation of most of the planning documents, the lead was taken by MoDP. In some instances, other MDAs and officers may be invited to participate in the process.



Sector plans are developed by line ministries, which will ultimately be responsible for the implementation of the plan, whilst districts have their plans. Sector plans are to plan activities and ensure that they are implemented appropriately (efficiency and effectiveness). Sector plans should be in line with the higher planning documents, such as NSDP and MTEF, and deliver on the country's long-term vision.

MoDP performs an active role during the planning process by assisting the planning units in other MDAs, coordination of the Government-wide efforts and in providing data. BOS is an integral part of MoDP. Cooperation with MoF is required, as EPM focuses on the budget and budgeting process, and in connecting planning with budgeting. Monitoring of the implementation of sector plans is in the hands of the line ministries and MoDP (Government of Lesotho, 2020c).

2.2.5 Partnership Policy

To provide clear structures and guidelines for the mobilisation and management of external assistance, Lesotho has developed the (International) Partnership Policy (MoDP, 2013). The Policy is currently under review, with the participation of diverse development partners. The Policy is set to facilitate the planning process with better coordination with development partners. Although the policy itself focuses primarily on the collaboration with the international partners, it can also be applied to the mobilisation of in-country development actors. The Policy has three main objectives: 1) improve the effectiveness of development cooperation through greater Government ownership and leadership; 2) increase transparency and accountability between the Government and its citizens and between the Government and Development Partners in the management of development cooperation, and 3) accelerate progress towards policy coherence in Lesotho's relationships with its Development Partners (MoDP, 2013, pp. 2-3).

In implementing the Partnership Policy, the Government has undertaken an obligation to present a statement on aid and the volume of debt and to improve the overall transparency of past performances and plans for the future. The Policy allows the Government to refuse aid, on the grounds of its possible adverse effects. Aid has to be aligned with Lesotho's development efforts and be harmonised with other Government (and development partners') efforts. The Policy improves the mutual responsibility for results and is very much results oriented. However, it stops short of introducing responsibility for the ultimate impact (i.e., outcomes).

Lesotho is committed to reducing her aid dependency over time, as well as reducing the transaction costs of aid assistance. The Policy calls for the integration of aid planning into the strategic planning process and outlines how the results of PFM reforms would improve the aid coordination process¹⁵⁶. The Policy stipulates the mutual obligations of Government on one side and development partners on the other, providing the foundations for an effective partnership process. Mutual obligations aim to improve the planning and coordination process, as well as transparency and accountability. Finally, the Policy designates the institution responsible for the implementation process (MoDP together with MoF and Ministry of Foreign Affairs – MoFA) and processes to be followed. The Policy has been in force for almost a decade and even though it has been effective in the planning and coordination processes, it needs revision.

¹⁵⁶ The Policy also discusses some more operational issues, such as management of aid, types of aid that may be received (such as: general budget support, sectoral programme support, project support, in-kind aid and technical assistance), vertical funds, funds from the civil society, etc. (MoDP, 2013).



2.2.6 Budgeting

The budgeting process in Lesotho is the responsibility of MoF, as both capital (investment) and general budgets are controlled by the Ministry. Budget setting is an annual exercise, which includes a proactive relationship with MDAs. The Government has a mid-term view with the Medium-Term Expenditure Framework (MTEF) defining the spending, and the Medium-Term Fiscal Framework (MTFF) defining the revenues over a longer period, which have to be considered during the annual budgetary process. One of the most praiseworthy achievements of the PFM reforms have been the introduction of the clear budgetary process and development of all the necessary budget documentation (IMF, 2018c; Linpico, GRM International and NTU, 2019). Budget circulars and budget speeches have become well-structured and transparent documents, enabling either MDAs to plan and budget well, or to clearly outline the financial position of the Government for the next year, and subjecting it to Parliamentary approval. The ministries' budget proposals are based on their annual sector plans, which in turn, should be in line with NSDP II. In principle, budgetary allocations are linked with the ministries' annual plans and within the ceilings established by MoF. Multi-year sectoral plans developed by the line ministries are aligned to NSDP II.

Lesotho started with the Medium-Term Budgetary Framework (MTBF) in 2005 and has been used ever since (World Bank, 2013). Development of MTEF in Lesotho was initiated in the mid-1990s, first at the central (Government) level and then at the sectoral levels. Sectoral MTEFs facilitate efficient resource mobilisation, rational allocation of resources amongst the sector's programmes, better integration of planning and budgeting, improved integration between recurrent and capital budget, and continuous prioritisation of the sectoral strategies (at the ministry level)¹⁵⁷.

2.2.6.1 Linking planning and budgeting

The MTEF is a framework developed to link planning, which has a medium-term outlook, the annual budget, and consequently link budgetary expenditures more systematically with the socially desired outcomes, like: gender empowerment, population growth, higher literacy rates, lower infant mortality rates, and so on. MTEF ensures that the Government allocates budgetary resources to programs, activities and projects that promote the strategic priorities of the country as outlined in the national development plan(s). Although MTEF primarily promotes allocative efficiency (ensuring desired activities are resourced), it also instils fiscal discipline and operational efficiency. Under an MTEF, each Government entity prepares a medium term (usually three-year) rolling budget, outlining the financial needs of the programmes and projects that require funding¹⁵⁸. MTEFs are prepared based on the multi-year sectoral plans and should be based on the endorsed strategic planning documents (in the case of Lesotho – NSDP II). One of the challenges that the MTEF may have in Lesotho is that the sectoral plans may not fully integrate SDGs (MoDP, 2020c).

MTEF provides a link between the medium- and long-term policies and objectives, as they are presented in the strategic planning documents – the national vision and NSDP, respectively. It sets out two separate phases of the budget preparation

¹⁵⁷ BSP provides the following purpose of MTEF: 'The MTEF process has three main objectives: ensuring fiscal discipline by spending what the public sector can afford; allocating resources in line with national priorities; and ensuring national resources are used efficiently' (MoF, 2018a, p. 4).

¹⁵⁸ For more on MTEF experience. World Bank, 2013; For the review of the African experience with MTEF Fölscher, 2006.

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process: a strategic phase and an operational phase, to strengthen the link between national priorities set out in the NSDP and the budget. The strategic phase is used to review the high-level priorities and strategies before the detailed resource allocation. The operational phase involves the allocation of resources to various spending entities/units and concludes with the passing of the budget by the Parliament.

MoF and MoDP produce a Budget Strategy Paper (BSP) that outlines the main policies and actions for three years. The most recent BSP covers 2021/22-2023/24 (MoF and MoDP, 2020). The BSP sets the budgetary principles for a particular budget cycle and links the (annual) budget to development goals stipulated in the national plan (NSDP II). This practice has been used in Lesotho since the fiscal year 2013/2014. The Macro-Fiscal Framework and Budget Framework Paper (BFP) provide ceilings for ministerial spending, which correspond with MTEF estimates and objectives, targets, and standards. Before the process even starts, the Government approves the Budget Calendar¹⁵⁹, which sets the deadlines to be observed, as well as which organisations are responsible for a particular step/action.

Lesotho has attempted to apply Performance-Based Budgeting (PBB) since the mid-2000s, when the pilot ministries were asked to develop their Budget Framework Papers using a different methodology. Since then, PBB has been rolled out to other MDAs. MoF (and MoFDP before) held meetings with the ministries to interrogate their requests and provide ceilings for sectoral spending. An early experience with PBB has created some hybrid type of Output Oriented Budgeting (OOB), similar to most of the African countries, but the implementation has usually been lagging.

With the introduction of the Public Financial Management and Accountability Act, 2011, the process has been legally regulated and streamlined, bringing an interplay between the executive and legislative arms, i.e., the Executive and Parliament. The Parliament endorses the budget, the financial report and the final accounts of the Government for that particular year.

Lesotho's budget year runs from April to March. The budget process consists of five stages, which are spread over 11 months: 1) Budget (strategic) planning; 2) Budget preparation (executive); 3) Budget approval (legislative); 4) Budget execution (implementation), and 5) Auditing and reporting. These five stages of budgeting are in line with the good/best international practices and in theory, should provide a functional budget. However, legacy PFM practices have led to poor performance in terms of medium-term financial/fiscal planning and a general inability to forecast both revenues and expenditures. Hence, budget underperformance happens routinely. Even though the budget may be appropriate, it may lack good execution and the capacity to spend (absorption capacity)¹⁶⁰. This also hurts the effectiveness of Government's project implementation, which ultimately may cause delays in implementing NSDP II and SDGs.

Whilst MoF provides the ministerial spending ceilings, the ministries, taking into consideration their plans, have to develop their budget framework papers, which feed into the main BFP prepared by MoF. MoF and MoDP hold consultations with the line ministries, which may use this opportunity to re-negotiate spending or additional resources. In principle, OOB

¹⁵⁹ A graphical representation of the budget calendar is presented in Appendix III.

¹⁶⁰ On the issue of absorption capacity see a very good study, Government of Lesotho, UNICEF Lesotho and World Bank, 2020.

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should reward the past performance with the appropriate future allocations. However, reports indicate differences in budgeted and actual sums especially for revenues which reflects that the forecasting models do not work that well.

MoF performs well in the budget preparation process (PEFA, 2017). The Budget Calendar, approved by Cabinet, outlines the steps in the budget process. Given that the budget year starts in April/May and continues until February/March of the following year, certain steps/activities are associated with each of the months. The short Call Circular is usually issued in September, followed by the Budget Estimates Call Circular issued in November/December. December and January are the most intensive months, where budget estimates are submitted, and discussions held with the line ministries. In January, the budget estimates are presented to Cabinet sub-committee and then to full Cabinet and the draft National Budget sent to the Parliament in (early) February.

The second Budget Call Circular includes proposed expenditure ceilings for each ministry's recurrent and capital expenditures, as well as indicative ceilings for the two outer years. The guidelines for budget submissions are, as a rule, clear and comprehensive. However, after the budget 2018/2019, MDAs generally respect the indicative ceilings and submit the requests in line with the set ceilings. There are still challenges with linking the goals and set expenditure ceilings and it appears that incremental budgeting is applied (Linpico, GRM International, and NTU, 2019). Sometimes the requests are well above the ceilings, with an assumption that MoF will cut the request and hence it is better to fall from a higher (financial) position¹⁶¹.

The Legislature scrutinises the budget proposal and passes the budget in the form of law. It usually takes about four weeks to examine the National Budget in the Parliament, first through the Committees and then in a plenary. The execution of the Budget is technically monitored by MoF, but it is also scrutinised by the Parliament, which approves the final accounts of the budget. MoF has also produced, in the last few years, a *Citizen's Guide to the Budget*¹⁶² (MoF, 2019b; 2020b), which outlines the main features of the budget, stating the public revenues as well as the major classes of expenditures. A summary of key sectoral programmes is presented as key listing of expected outputs in the budget.

The Minister of Finance presents the Budget through the Budget Speech, which is regarded as a supplementary document. The Parliament can reallocate the Budget but cannot increase it. Although the Parliament approves the budget, Cabinet can make certain reallocation throughout the year. The PFMA Act (Article 15) specifies that a Chief Accounting Officer can only make transfers within a programme, and for up to 10 per cent of approved expenditure for capital expenditure and 20 per cent for recurrent¹⁶³ (PEFA, 2017).

Despite some shortcomings in the budgeting process (PEFA, 2012; 2017), it has improved over the last three years, where most of the documents needed to improve the process have been published (BSP, BFP). Budget process management

¹⁶¹ 'The line Ministries interviewed felt that the BFP had no purpose as ultimately their submission varied massively to their detailed budget ceilings.' (Linpico, GRM International and NTU, 2019, p. 8).

¹⁶² The Guide begins with the statement: "Inter-ministerial collaboration, multidisciplinary approaches and subsidiary to tackle poverty, malnutrition, and joblessness focusing on service delivery at the local level"

¹⁶³ The Minister of Finance can only determine a transfer that is not within the same programme or is above 10 per cent or 20 per cent ceilings. There are no limitations on the size and types of reallocations that the Minister can make without the approval of Parliament, except that they are not allowed to increase in total expenditure (PEFA, 2017).

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has been conducted in a timely manner and the budget has been approved following the appropriate and thorough parliamentary engagement. The Budget Calendar can be brought forward by ensuring that all the major activities are not centred about the end of the calendar year and in the early New Year (December/January). It can be concluded that annual budgets are made in achieving NSDP II and SDGs. At present, there is no visible SDG allocation tracking implemented by MoF. This shortcoming should be addressed with the introduction of the INFF. However, some weaknesses in sectoral planning and budgeting have been detected, meaning there is some room for improvement (IMF, 2018c; Linpico, GRM International and NTU, 2019).

2.3 Policies for Private Finance

2.3.1 Promoting Foreign Private Investment

2.3.1.1 Promoting Foreign (Direct) Investment

The National Investment Policy of Lesotho was approved by the Government in 2016 and it was the first document of its kind (Government of Lesotho, 2016b). It clearly states that the Government of Lesotho sees the private investment as an engine of growth, that would make development objectives sustainable for the benefit of the citizens. The Policy supports FDIs in all areas of the economy, except for small businesses, which are reserved for the citizens of Lesotho¹⁶⁴. The foreign investors are legally treated in the same way as the local ones and without any discrimination. Immigration policy towards potential investors is favourable because the Government leads restrictive immigration policy only in the areas reserved for domestic citizens. FDIs are particularly supported if they create jobs, bring new skills and knowledge, improve the productivity of the labour force, support local business, and improve infrastructure (Government of Lesotho, 2016b).

Increasingly, governments around the world are looking to promote impact investments¹⁶⁵, and UNDP, amongst the development partners, have been leading on this issue¹⁶⁶. However, there is relatively little data available to fully assess the impact made by certain investments, as there is no compulsory reporting on the impact (environmental, social, economic, and so on). At present, Lesotho does not practice impact investment and/or sustainability reporting, but there is an opportunity for policy intervention, if linked with the Government's commitment to green economy, and environmental and societal sustainability.

Investing in Lesotho is challenging, partly due to its size (smallest economy in Southern Africa) and lack of investment-ready deals (GIIN, 2016). There have been 12 identifiable impact investments in the country, with ¾ being implemented by IFIs. Three that have been undertaken by the private investors amounted to USD15 million and were placed in agro-

¹⁶⁴ This policy can be found in many developed countries, and countries with the high revenues from natural resources, but not necessarily high level of domestic engagement in the local economy (for instance, the Arabian Gulf countries).

¹⁶⁵ 'Impact investing is defined as the deployment of funds into investments that generate a measurable and beneficial social or environmental impact alongside a financial return on investment.' (Definition provided by the UNDP Istanbul International Centre for Private Sector in Development – IICPSD, <https://www.iicpsd.undp.org/content/istanbul/en/home/thematic-areas/impact-investing.html>).

¹⁶⁶ UNDP SDG Impact Finance (<https://www.undpsif.org/>).

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processing, information and communications technologies (ICTs), and housing (GIIN, 2016). Lesotho's market lacks size and experiences high costs for exports due to its geographical position. There is a lack of a well-trained labour force for more advanced industries. The garment and manufacturing industries have not experienced shortage of qualified labour force). Two industries that have been earmarked (GIIN, 2016) as having high potential for impact investment are agribusiness and water. The water sector has already attracted investments, as two large water projects are in the process of implementation (LHWP and LLWDP II).

Lesotho has a policy of providing low-cost business facilities in the form of factory shells, serviced industrial land as well as offices, and small-scale business incubation premises to the investors. There have been challenges with the continuous supply of electric energy. The Government and the national electricity company (Lesotho Electricity Company – LEC) have invested in new transmission facilities. In addition, the investment in hydropower should ensure an uninterrupted supply of electricity in the future.

Investors are also supported through business facilitation. The Government's One-stop Business Facilitation Centre (OBFC) allows the investors to register companies; get tax registration, industrial and trading licenses, immigration, residence, and labour permits, as well as export and import permits and rebates. The documents are provided by OBFC or the officers delegated from other ministries. The services can also be accessed online due to the Government's digitalisation efforts. The introduction of OBFC has reduced the time to register a company from 40 days to five days¹⁶⁷.

The promotion of investment in Lesotho is not centralised. At present, there is no single government body entrusted with the promotion of foreign investments. However, two institutions are partly tasked to support foreign investments: 1) The Lesotho National Development Corporation (LNDC) and 2) Lesotho Tourism Development Corporation (LTDC). Both organisations deal with foreign investments and (large) scale domestic investments.

Foreign investors may establish operations in an unincorporated form, as sole traders or branches, or incorporate them as a Lesotho company under the recently modernised Companies Act 2011. However, to get access to land, the company must have at least 20 per cent domestic ownership. Lesotho has ratified the SADC Protocol on Finance and Investment (SADC, 2006) and has concluded bilateral investment treaties with Germany, Switzerland, and the United Kingdom. The SADC Protocol establishes the fair and equitable treatment of foreign investors, regardless of the country of origin (both SADC and non-SADC members) (Government of Lesotho, 2016b). There are no restrictions imposed on the FOREX for foreign investors and they are free to repatriate any earnings that they have made. The SADC Protocol forbids nationalisation of private properties and enables foreign investors to seek foreign arbitration, rather than initiate the cases before the national courts. Nevertheless, by African standards, Lesotho has an efficient and impartial judicial system.

To promote local employment, regulations impose restrictions on the number of foreign staff a company may employ. In principle, five per cent of total staff can be expatriates or in other words 5 expatriate employees per 100 employees for companies with more than 350 employees. Companies with less than 350 employees can employ up to 10 foreign staff. Corporate taxation is set at 25 per cent but it has been reduced to 10 per cent for the manufacturing sector. In all taxation

¹⁶⁷ <https://www.privacyshield.gov/article?id=Lesotho-Openness-to-and-Restriction-on-Foreign-Investment>

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treaties, the standard rates of 25 per cent have been reduced to 10 per cent. In the case of dividends, the standard tax is 25 per cent, but for Lesotho residents, the tax rate is 10 per cent, as well as residents of the countries with which Lesotho has a taxation treaty. Dividends of manufacturing companies are exempted from taxation. Royalty and interest revenues of non-residents are favourably taxed at 15 per cent. Corporate tax for agricultural enterprises is 10 per cent and for all employers that invest in the education and training of the local population, redeemable expenses are allowed at a rate of 125 per cent.

It is difficult to establish the net benefits of these promotional policies. Building a sustainable economic system, improving infrastructure, and making doing business cheaper and faster may certainly contribute to the overall attractiveness of the country. Tax incentives, per se, will not give the best results in the long run, as other countries may also follow suit, and quickly change the overall investment attractiveness of the country.

The Government is focusing on attracting investors in manufacturing (as it has already given results), mining, and increasingly, tourism. It is possible that access to some resources and promotion schemes may be developed in the future, to make Lesotho a premium FDI destination. FDI investments are currently low, considering the advantages that Lesotho offers. At present, the approach to FDIs is rather 'opportunistic' and investor driven. In the future, it is essential to ensure that the foreign investments are contributing to Lesotho's national development agenda and her commitment to achieving SDGs as stipulated in NSDP II.

2.3.1.2 Remittances and Diaspora Engagement

Migrant remittances are the major foreign revenue for Lesotho. However, the contribution of remittances in the total revenues has been on a decline and it is necessary to engage with the diaspora in a meaningful way to ensure that they are mobilised to support the national development efforts. LNDC, with the support of IOM¹⁶⁸, has developed a policy to engage diaspora (LNDC, 2019). The National Diaspora Policy was developed with the support of the IOM. It was approved by the Government in May 2021 (Government of Lesotho, 2021b).

The diaspora may be a client, partner, and investor. Hence, providing special services to the diaspora to attract them to engage in the economic development of the country is important. This shift from classical remittances to more complex engagement requires change of focus and providing diaspora with opportunities to engage with in the home country. Developing different fora and offering special facilities may be a step forward. For instance, some countries offer diaspora some bank accounts and/or diaspora investment accounts with special tax treatment.

Engagement with the diaspora, as per the Policy, will have a few pillars such as: Human Capital, Institutional and Leadership, Economic, and Diaspora communities. The economic pillar assumes realisation of a few projects until 2025, which should include diaspora in the economic life of the country, such as 1) Lesotho Lives – Diaspora Tourism Initiative

¹⁶⁸ The Strategy was one of the main outputs of the IOM project 'Enhancing Coordination and Strengthening Institutional Capacity to Effectively Engage with Diaspora in Lesotho'. Besides training and capacity development efforts, the Project has also triggered the establishment of the Directorate for Diaspora in MFA, the development of the Lesotho Diaspora Policy, and diaspora mapping.

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(2021-2022); 2) Linked Lesotho – Diaspora Marketplace Competition and Crowdfunding Platform (2021-2025); 3) Lesotho Legacy – Diaspora Philanthropy Fund (2022-2025); and 4) Lesotho Leverages – Diaspora Bond Feasibility Study (2024-2025). Realisation of these projects should establish new economic ties with the diaspora and improve the overall social dialogue in the country. To support the temporary diaspora (i.e., migrant workers), the Government should also engage in financial education (either directly or through the third sector/academia) and promotion of cheaper ways for transferring remittances across the national border.

2.3.2 Promoting Domestic Private Investment

The National Investment Promotion Policy, 2016 outlines the major initiatives that are used to spur domestic investment into Lesotho's economy. The Basotho Enterprises Development Corporation (BEDCO) is a government body that is tasked exclusively with promoting investment in small businesses by the local population. LNDC and LTDC also facilitate domestic investments, but they also deal with foreign investors. LNDC deals with large domestic investments, whilst LTDC facilitates investment into the tourism sector, regardless of the origin of an investor.

NSDP II stipulates that the economic growth in Lesotho should be driven by private investments (Government of Lesotho, 2017b). However, the NSDP I had the same ambitions, but in the end, employment growth came from the public sector. It was assumed that the private sector would generate about 10,000 new jobs, primarily in agriculture during NSDP I, but employment increased only by 2,000 in total over five years. At the end of the period (2016/2017), the private sector investment declined significantly, putting at risk the very survival of the jobs that were created. Hence, NSDP II has reinforced the focus on private sector investment.

Lesotho has also introduced the Public-Private Partnership Policy, which targets both international and domestic investors. PPPs can be implemented in almost any sector, from the classical hard infrastructure projects to those that provide social services through the PPP model, such as education and social services. The Policy is not detailed on the contract modalities, most likely leaving it to the future PPP Act to regulate. To solidify the position of the private partner, it is necessary to develop the full legal infrastructure, including the PPP Act, to provide a higher level of legal security for the contracting parties.

The Government has pointed out that the lack of access to finance as a major challenge for the private sector growth, especially for entrepreneurs and MSMEs (MoF and MoDP, 2020). Historically, banks preferred to invest excess liquidity in South Africa and avoid risky investments in Lesotho. This has generally worked well for the banks, as they had one of the best returns in the region. Therefore, the private sector resorted to informal finance or retained earnings, which would not provide the necessary financial injection to support growth.

The Government has, with the support of development partners, focused on the development of mobile money and mobile banking to mobilise the resources and facilitate tax payments (Maliehe, 2018; UNDP Lesotho, 2018). Mobile money is seen as a possible instrument for promoting financial and social inclusion, providing financial services to the remote parts of the country while serving the underprivileged in the country, where over 50 per cent of the population

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does not have a bank account (Demirgüç-Kunt, et al., 2017). The usage growth and the widening of the services offered indicate much unexplored potential for mobile-based financial products and services.

Government considers public sector efficiency to be important for private sector development, therefore a set of measures have been introduced and instruments put in place. For instance, OBFC facility is at disposal of domestic investors as well, where they can register a company, obtain licenses, and permits, and complete initial taxation requirements. Although OBFC have been in place for almost a decade, it has not been regarded as successful, and the economic reform document suggests a revival of the model (Maruping, Montši, and Foon, 2019).

The Government offers assistance to facilities, where LNDC and BEDCO lease serviced land and factory shells and other premises at discounted rates to investors. Aspiring entrepreneurs face challenges in accessing land, office space, and finance, hence the Government's efforts to improve access to premises and basic facilities/infrastructure. At present, assistance to the start-ups is limited and is provided by the Government corporations tasked to support business development (i.e. LNDC, BEDCO). Their assistance is not necessarily linked with supporting the projects contributing to NSDP II and SDGs achievements. It may be appropriate to explore the option of a specialised hubs to accelerate investments and economic activities that will contribute to achieving SDGs.

The Government has set up the Partial Credit Guarantee Fund (PCGF) to improve access to finance for local entrepreneurs. The fund provides 50/50 guarantee coverage for existing business and 70/30 guarantee coverage for start-ups on the final loss. LNDC operates a similar scheme, where 50 per cent of the loan is guaranteed for a company with a minimum of 51 per cent domestic ownership. The Government is also promoting the use of leasing for new entrepreneurs, as the Financial Institutions Act, 2010 has allowed leasing within the domestic financial sector. The National Inclusive Finance Strategy has called for better access to finance for the unprivileged, underserved, and those deemed as economically non-viable (non-bankable) customers¹⁶⁹ (Government of Lesotho, 2012). However, banks still have complex procedures and often put administrative barriers for prospective entrepreneur (ILO, 2014).

The Government has identified lack of knowledge and skills amongst potential entrepreneurs hence the need to equip them with such. Entrepreneurship and work-skills development centres have been established by mainly BEDCO, MDAs, Ministry of Trade and Industry (MoTI), MoF, and LRA, etc. Higher and further education establishments are also involved in capacity building and development partners do support these programmes¹⁷⁰.

The Government is supporting the access to market for new domestic firms. For instance, procurement rules allow a 10 per cent price preference on Lesotho goods and a further 7.5 per cent preference for contracts performed, at least 50 per cent, in Lesotho or sub-contracted at least 50 per cent to local (Basotho) business¹⁷¹. If the contract is over the value of LSL500,000¹⁷², at least 25 per cent of the work has to be sub-contracted to local Basotho businesses, where

¹⁶⁹ Providing access 'to credit for micro, small and medium enterprises, as well as the unbanked and underserved population' (Government of Lesotho, 2012).

¹⁷⁰ World Bank has supported development of two skills training centres for textile and garment workers.

¹⁷¹ Basotho business is one where the majority owners are residents of Lesotho and where the majority of directors are Basotho (citizens of Lesotho).

¹⁷² About USD34,835.00 at the time of writing (July 2021).

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sub-contracting is allowed. In addition, local businesses may be given an opportunity to match the best price of the winning bid. The Government may restrict the import of certain goods (mainly agricultural products) to protect the local production. According to the Industrial Licensing Act, a manufacturer may be granted an exclusive industrial license (Government of Lesotho, 2016b).

Certain economic activities are reserved for indigenous citizens of Lesotho only and cannot attract foreign investment. These are primarily small businesses and professions which cannot benefit from foreign investment or transfer of knowledge and advanced skills¹⁷³. However, despite the efforts done by the Government, private sector investment is lagging behind the NSDP II targets. This may be partly due to the economic slowdown in South Africa and in Lesotho, COVID-19 pandemic measures (the lockdown and slowdown of economic activities), and inadequate financial facilities offered by the banks and other financial intermediaries in Lesotho ■

¹⁷³ However, despite restrictive regulations, anecdotal reference suggests that there are a number of foreign owned businesses in the restricted sectors. <https://www.privacyshield.gov/article?id=Lesotho-Openness-to-and-Restriction-on-Foreign-Investment>



Chapter 3: Existing Monitoring and Review Systems

3.1 Monitoring Systems

MONITORING DEVELOPMENT FINANCE flows has been a challenge in Lesotho and the Government has attempted to address this issue. It has been reported that up to USD100 million per year have not been captured and this often led to the frustration of IDPs who have scaled-down their support in recent years. Lesotho has been one of the highest (in many years the highest) recipients of ODA per head of population in Africa (OECD, 2011).

In the last three years (2018-2020), MoDP has produced an annual publication entitled: '*Lesotho Development Cooperation Report*' or DCR¹⁷⁴. In the document, the main flows are captured, and the main trends assessed. The partners are classified as: bilateral, multilateral and third sector (international NGOs and foundations). For each group, the review of the most recent engagements (last five years) has been captured and put into a wider development context. The DCR also attempts to link the official development flows with the NSDP II agenda and outline how particular flows have contributed to achieving the planned results. As reported; health, governance, and humanitarian are the sectors that benefited the most from ODA¹⁷⁵. The Report also provides a clearer picture on the structure of the flows, reporting separately on grants and concessional loans. In the end, DCR provides a look at the predictability of the development flows and their possible impact on the budget (MoDP, 2018a; 2019b; 2020a).

In 2014, Lesotho launched the *Public Sector Investment Database* (PSID), which was to provide an overview of the development funds that Lesotho received. The design and launch were supported by EU and UNDP, with Synergy being the software provider. At the time, it was applauded as a success in mapping the donor funding and providing better coordination of foreign aid (Martin, 2016). The Database also provided a geographic spread of the flows, including maps where the funding has been fully disbursed. At the time, the Government itself acknowledged that the Database is an effective tool in managing aid flows in Lesotho, and to increase harmonisation and transparency (as reported in Martin, 2016). The PSID was managed by MoDP and IDPs had access to it, where they could input their most recent data on projects. The PSID was designed to improve data availability for the NSDP II planning purposes and to allow linking ODA spending with the NSDP II. However, by the time of launching NSDP II, the PSID was defunct. It was introduced under project financing and when the project financing stopped, the maintenance of PSID ceased¹⁷⁶. PSID focussed only on the financial flows from IDPs and did not account for other development financial flows. Hence, it may be advisable to consider extending the reporting requirements and include other flows like the private development flows (FDIs, remittances, third sector, and so on).

¹⁷⁴ DCRs present data from FY2016/17 to FY2019/20, i.e., for four years.

¹⁷⁵ For precise distribution in the last four years, refer to the Figure 12 above in the text.

¹⁷⁶ It is also possible to assume that the centralisation of information was not welcome by some stakeholders, mainly MDAs that have had some off-budget international assistance, as experience from other countries may suggest.



MoDP leads in the monitoring of ODA. The monitoring of other development finance flows is decentralised. MoF and CBL monitor FDIs and remittances, whilst CBL oversees the financial sector and has first-hand information on the credit activities and access to credit by different groups. OOF and portfolio investments are usually picked up by CBL. Specialised government agencies like LNDC, LTDC, and BEDCO collect information as per their professional remit and share it with their line ministries. Data is still largely fragmented, and it is difficult to provide a complete picture of all the flows to the country.

From the 2018/19 Budget, budgeting and financial planning were done using the Central Budget Management System (CBMS). The system was expected to be improved and the full Integrated Financial Management Information System (IFMIS) to be launched. In addition, CBMS is expected to be used for other operations: budget management tasks - virements, supplementary budget, reallocations, and so on (Linpico, GRM International and NTU, 2019). This will improve the monitoring of the budget execution in MDAs and enhance the overall reporting capacity of the Government.

Overall, if budgetary and planning modules are well integrated, they will create a powerful planning and monitoring tool, assisting the Government in timely adjusting the policies and policy interventions. In FY2012/13, LRA began the implementation of the Integrated Revenue Management System (IRMS), which brings together customs and tax administration (World Bank, 2018a). For each of the tax categories, a separate module has been developed or is under development. This should generally facilitate the ease of doing business in Lesotho, lessen the administrative burden besides improving the fiscal collection and management capacity of the Government.

3.2 Review Systems

The review of development cooperation and development finance is usually conducted by MoDP, as the lead government institution. In the past, the review was done occasionally. However, in the last three years, the MoDP has been producing the DCR at the end of every year. The DCR serves as both the monitoring and review instrument.

In 2019, the Government of Lesotho undertook the VNR to assess progress made on the full implementation of NSDP II. The exercise was aimed at identifying development gaps and priority areas where strategic interventions may be required (MoDP, 2019a). The VNR was undertaken to provide a platform to monitor and review progress of NSDP II, and thus enable timely corrective intervention should it be needed. VNR focuses on all 17 SDGs, providing a review of the achievements. One outcome from the VNR is that the Lesotho Government has a practice of occasional review its policies. For instance, in 2018, the Government ran the Joint Education Sector Review and to be reviewed were the National HIV/AIDS Policy, the Minerals and Mining Policy and HSDS. Some MDAs, like the Ministry of Social Development (MoSD), provide a national review document on their operations – the Social Protection Annual Review. This Annual review provides an overview of the results in implementing the National Social Protection Strategy (Government of Lesotho, 2013b) singling out successes and current issues in implementation. The World Bank and UNICEF have also undertaken the Health Sector Expenditure Review (UNICEF and World Bank, 2018) and World Bank has conducted the Education Public Expenditure Review (World Bank, 2019b) and the Public Expenditure Review (World Bank, 2018a).



SDG 17: Partnership, is of particular importance for international development review and monitoring. Reflectively, VNR presents the current state of partnership and collaboration with IDPs in achieving NSDP II and SDG agenda. The Lesotho Partnership Policy (MoDP, 2013) has provided a framework for monitoring and review, as well as coordination with IDPs. The development partner coordination structures exist at a ministerial and technical level, and these are currently being reviewed to strengthen similar engagement mechanisms with the civil society and private sector. It is presently agreed that there is not enough consultation between the national/local development actors and with the public (i.e., government) structures (Government of Lesotho, 2019a). The development of the Lesotho Partnership Policy was directly linked with the results of the 2010 Survey on Aid Effectiveness, which indicated the need for increased aid coordination. The Lesotho Partnership Policy (MoDP, 2013) is currently under review and MoDP is in the process of developing a national partnership and coordination strategic plan to strengthen engagement mechanisms with all development partners (international and domestic). The new structures will include development partners, civic sector (CSOs), private sector and special groups.

Realising that monitoring and review, as well as policy coordination, are burning issues, the Government of Lesotho, with the support of AfDB, in 2020 developed two documents that should improve the existing processes¹⁷⁷. The first is the Economic Planners' Manual (Government of Lesotho, 2020c) which should improve the planning process. The second is the Guidelines for Policy Formulation, Implementation, Monitoring and Evaluation and Review (henceforth Policy Guidelines), which should provide for better monitoring, review, and intra-government coordination and consistency (Government of Lesotho, 2020b). However, as the final drafts were presented in late 2020, it was still too early to assess their impact.

The Government has taken capacity building seriously. In the last few years, it has improved the overall capacity of the civil and public services to deal with the recent policy challenges, oversee the policy definition and implementation, and *post-factum* analyse the reach and successes of the particular policies. Lack of proper monitoring and review has been outlined as an issue of concern by IDPs and has contributed to the drop in the international financial assistance to Lesotho. Government's monitoring and review documents (MoDP, 2018a; 2019b; 2020a; Government of Lesotho, 2019a, amongst others) point out this challenge.

Policy review is usually initiated by the line ministry in charge of implementing the respective policy. The most recently developed policies have a section on monitoring and review (MoEM, 2017; MoF, 2019a), which makes it compulsory to review and update such policy on a regular basis. Risk assessment review has also become a part of the review process. In most cases, support is sought from IDPs through technical assistance. The appointed team of experts usually works with the technical counterpart team from the particular ministry or ministries and proposes the document that is then presented to the Minister and/or the Cabinet. In some cases, the review is conducted by the external consultants and presented to the Government, which usually endorses it. At present, there is no practice of public consultation and creation of task forces that include representatives of the Government and the other stakeholders. However, there are signs that this may improve very shortly as the Government has committed itself to develop a consultation platform with the private and third sectors, during the VNR 2019 process (MoDP, 2019a) ■

¹⁷⁷ <https://www.afdb.org/fr/documents/eoi-lesotho-development-guidelines-policy-formulation-implementation-monitoring-and-evaluation-and-review-and-development-economic-planners-manual-government-lesotho>



Chapter 4: Governance and Co-ordination Mechanisms

4.1 Intra-government Co-ordination Mechanisms

LESOTHO HAS AN ELABORATE BODY of sectoral strategies and policies. In most cases, the main drivers behind the development of these policy documents were the international community, i.e. IDPs. In several cases, technical assistance was provided for their development and in some instances, for the implementation and follow-up. The policies and strategies are owned by a responsible line ministry, which is charged with reporting results to the Government (i.e. Cabinet) and in some cases, to the Parliament. Concerning the collaboration with IDPs, Cabinet-level cooperation is usually envisaged, with some involvement of the Parliament.

NSDP II has outlined the governance mechanism for its implementation, consisting of 1) the National Oversight Committee; 2) Cabinet Sub-Committee on SDGs; 3) Technical Committee; 4) Technical Sub-Committees and 5) Technical Working Groups; besides the Parliamentary Forum. The National Oversight Committee (NOC) is the highest body within the system, followed by Cabinet Sub-Committee on SDGs. Whist the Prime Minister chairs NOC, Cabinet Sub-Committee is chaired by the Minister of Development Planning. All bodies within the system have very wide membership, including political representatives, civil servants, representatives of the third sector, the church, industry, international development community, academia, and so on. The review of the NSDP II governance structure¹⁷⁸ that was recently conducted, suggested the simplification of the structure, as the original one is 'top heavy' (MoDP, 2020c). During the review and reform of the NSDP governance structure, it may be advisable to consider utilising some of the bodies that were created as a part of the national consensus-building process – the Multi-Stakeholder National Dialogue – such as various task commissions.

In the process of developing policy documents, there is some level of cooperation between MDAs where one Ministry takes lead and coordinates the consultation process. This is in principle done at the technical level where the line Minister will ultimately present the draft policy to the Cabinet. It seems that the inter-ministerial discussion before Cabinet meeting is missing. However, the lack of coordination is often stated as the main reason why some of the previous national plans (such as NSDP I) have failed to make the necessary impact (Government of Lesotho, 2017b). The NSDP II is set to improve on these shortfalls.

Aid is coordinated from MoDP, where the Department of Aid Coordination maintains relations with IDPs, monitors the development finance flows, keeps records, and most recently – publishes the DCR annually (DCR, 2018; 2019; 2020). However, all the line ministries also approach international development partners and offer projects to be supported. In some instances, the existence of the projects was not initially known to MoDP. Hence, it is necessary to ensure, better coordination between sectoral ministries and that their approach to IDPs is well thought through and coordinated centrally. Sectoral and cross-sectoral coordination is a key in the successful mobilisation of resources for development and meeting the NSDP II and SDG targets.

¹⁷⁸ A graphical representation of the NSDP II Governance structure is presented in Appendix II.

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In the case of NSDP II, the focus was more on coordinating efforts with the development partners, beyond the traditional IDPs by involving both civil society and users of aid. The private sector will be involved in the process of coordination. However, to improve intra-government coordination, emphasis should be put on the development of an efficient system for the collection, analysis, and reporting of data. NSDP II refers to the NSDS (MoDP, 2005), which is currently under review. NSDP II calls for the better coordination of aid, better national planning, and coordination, and strengthened monitoring and evaluation system (Government of Lesotho, 2017b).

In the mid-2000s, AfDB and ADF assessments raised an issue of poor coordination of public services in Lesotho (AfDB and ADF, 2006). The planning and budgeting processes were not properly coordinated, even though the situation may have improved since then, as MoDP and MoF are joint authors of the BSP (MoF and MoDP, 2020). Furthermore, the budget preparation process shows a higher level of participation of MDAs, but there is still room for significant improvement.

The production of this very document (Development Finance Assessment Study) has demonstrated a high level of cooperation and coordination of various departments of the Government, making joint ownership possible. Most recently, the development of the Policy Guidelines (Government of Lesotho, 2020b) may lead to the improvement of the overall policy formulation process within the Government, although it fell short of supporting intra-government coordination and defining the strict instrument for achieving it.

4.2 Platforms for Public-Private Dialogue

The notion of social dialogue is rather weak in Lesotho. This may partly be attributed to low political culture (AfDB and ADF, 2006) or the public sector that has traditionally been economically strong and the complacency of public servants to disregard public consultations. However, since the 1990s and especially from the 2000s, the civic sector has been growing steadily. There are many civic (third sector) organisations in the country, in almost all spheres of social life. Some Government development policies rely on strong and growing private sector for delivery of national development ambitions. However, the dialogue between the public sector on one side and the private and third sectors on the other is, at best, limited. In contrast, the private and third sector organisations do get invited for consultations and be provided fora for presenting their views and preferences for certain policies. For instance, in the case of the National Trade Strategy and Policy, commercial and industrial associations were invited for consultations on the major policy proposals. In the case of the Poverty Reduction Strategy, the public was also timely consulted.

Public-Private Dialogue (PPD) is often defined as *'A forum that brings together the government, private sector and relevant stakeholders in a formal or informal process to achieve shared objectives and play a transformational role for a set of issues.'* (Herzberg and Sisombat, 2016). Dialogue may take many forms, such as alliances, collaboration, policy dialogue, coalitions, and business relations (Eurecna, 2020). In several African countries, forums and/or councils are formed to bring together different stakeholders from the public and private sectors, as well as from other strata of society. Effective PPD requires institutional prerequisites, such as a) strong civil society with requisite freedom of speech and association, and

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b) dialogue is seen as meaningful, where the differences are respected and appreciated. Dialogue should be legitimate, transparent, inclusive, focused, and meaningful to deliver results (Eurecna, 2020).

Lesotho has had experience with PPD and already had a draft PPD Charter drafted in 2006 with the support of IDPs. Most of the citizenry are aware of the past dialogue, as well as the current dialogues, most notably the Multi-National Stakeholder Dialogue (MNSD). However, 60 per cent of respondents of the recent survey had no trust in Government when it comes to the promotion of economic growth. The diagnostics conducted show that the institutional framework, instruments, and private sector are more ready for dialogue than the public sector itself (Eurecna, 2020).

It is against this background that NSDP II recognised the problem of the legitimacy of power without a social dialogue and called for improved relations with the private and third sectors, through consultations and dialogue. The National Investment Policy of Lesotho (Government of Lesotho, 2016b) states that some public sector organisations should be consulted when decisions are made, such as the Lesotho Chamber of Commerce, the Business Council, the Private Sector Foundation of Lesotho and the LRA Private Sector Forum¹⁷⁹. Furthermore, for some recent strategies there were engagements with stakeholders, but the implementation is still lacking (MoEM, 2017).

The newly adopted Policy Guidelines (Government of Lesotho, 2020b) envisage consultations as a step in the policy formulation process. Consultations with the societal stakeholders are envisaged from the preparatory phase when the Issue Papers and/or Concept Notes are developed. In addition, the Consultation Process requires the preparation of a Consultation Plan, which has to stipulate the steps in the process and allocate the resources needed to complete the consultation process¹⁸⁰. The implementation of the Policy Guidelines should certainly improve the governance process and ensure that policies are in line with the citizen's expectations and priorities.

It is advisable to utilise the positive experience of the ongoing Multi-National Stakeholder Dialogue and include various societal actors in the consultative process. For instance, NOC which has been built to oversee the implementation of NSDP II may serve as a springboard for another national body that would have a remit that goes beyond the development but looks at the society as a whole. In building an effective public-private dialogue, participants should agree on the mandate, the architecture, the champions, the expected outcomes, and ensure good coordination and mediation. The development of an effective monitoring and evaluation system is a must and should be sector-specific (Eurecna, 2020).

¹⁷⁹ Refer to the section 4.2 for more details.

¹⁸⁰ The Consultation Plan should include: 1) budget; 2) timelines; 3) key dates and actions; 4) methods/techniques to be used in the engagement; 5) organisational logistics; c) communication strategy; 7) desired outcomes, and 8) other considerations (e.g., constraints, characteristics of participants, etc.) (Government of Lesotho, 2020b, p. 10)



4.3 Intra-governmental Mechanisms for Co-ordinating Coherent Financing Policies

MoDP oversees the process of aid assistance and development finance from the international public sector. Domestic revenues are under exclusive control of MoF, whereas debt and debt management are operationally under CBL. This arrangement with CBL is primarily due to the nascent and shallow domestic financial market. In other words, CBL may make operational decisions without prior consultation with MoF when acting as an agent of the State. Private international flows (FDIs, remittances and portfolio investments) are overseen by CBL, and reported to the Government. International charity and foundation finance are overseen by MoDP, though there are some discrepancies in data provided within and from outside the country.

All data flows that have been captured by the Aid Coordination Department of MoDP are published annually in the DCR (DCR, 2018; 2019; 2020). The DCR is an annual, albeit strategic, review of the development finance flows to Lesotho, primarily from the international public sources or finance traditionally classified as 'aid'. Despite the focus on the international public finance, some flows are not covered. For instance, OOFs are not covered.

The NSDP II Financing Strategy (Government of Lesotho, n.d.) outlines main sources of finance for the implementation of NSDP II. In principle, the strategy provides very broad financing requirements and lists the possible sources of finance. The strategy does not deal with the institutional setting and organisation. An innovative element is that the strategy mentions the new, 'non-traditional' sources of finance, which may be explored. FDIs are stated as the most likely new sources of finance as they have been underutilised during NSDP I. Equity, and portfolio investments and venture capital funds, have been listed as possible non-traditional sources despite the former being low and volatile in Lesotho. The strategy attempts to coordinate IDPs' financial support with NSDP II financing needs and goals. In doing so, the Financing Strategy clearly outlines the inflows and does a weak attempt to estimate flows for the period under consideration.

The Financing Strategy calls for the better use of mineral resources income to ensure that the royalties and other revenues are utilised better through the establishment of the Natural Resource Fund (Government of Lesotho, n.d.). The Fund should be established by law following the development of supportive policy (The Natural Resource Fund Policy). The Financing Strategy moreover calls for a better definition of CSR and regulation of Climate Change Financing. Recent droughts and inclement weather, which had a serious impact on agricultural production, have reaffirmed the risk of exposure due to climate change. The Strategy advocates for better collaboration with specialised international funds, like the Global Environmental Facility (GEF) and the Green Climate Fund (GCF). However, to fully utilise these and other possible climate-related facilities¹⁸¹, Lesotho needs to strengthen the National Designated Authority (NDA), its organisational capacity, and improve the regulations and policies to demonstrate that it is a credible partner. The Financing Strategy also suggests enhanced capacity to manage funds through the National Climate Change Financing Mechanism (NCFM).

The National Climate Change Policy was developed in 2017 covering the period 2017-2027 (MoEM, 2017). The document is comprehensive in itself. The Financial Strategy also outlines the basic principles of mobilising financial resources in the

¹⁸¹ Especially, the Least Developed Countries Fund (LDCF), Adaptation Fund (AF) and the Special Climate Change Fund (SCCF).



Policy Statement 21: Mobilise Financial Resources. In line with the Government commitment to mobilise more private resources, it stresses the importance of private sector participation in financing climate change-related projects. It lists the following main sources: 1) bilateral and multilateral sources; 2) national budget; 3) private sector finance and FDSIs; 4) capital markets funding; 5) leveraging the Pension fund finance, and 6) other financial instruments. Soft loans from MFI are perceived as an important source of finance. To improve the opportunities for climate change finance mobilisation, it is necessary to address some limitations, such as inadequate national financing mechanisms and the low institutional capacity for financial mobilisation (MoEM, 2017, p.43). The overall capacity building across the sector is a major task together with the establishment of the Climate Change Fund under the auspices of MoEM. However, an overall view is that the climate change financing should be integrated into the sectoral budgeting. The need to build the capacity in developing bankable projects has been outlined in the Policy and emerged during the national DFA consultation process. The NSDP II Financing Strategy does not deal with the implementation mechanism, per se but is a general document and more of a concept paper than a strategic document. It is devoid of an action plan with clear responsibilities for government and non-governmental partners in the implementation the strategy, prevention of duplication of work, and a clear accountability framework ■

PART II: RECOMMENDATIONS FOR THE INFF ROADMAP



Introduction – INFF: Purpose

THE INTEGRATED NATIONAL FINANCIAL FRAMEWORK (INFF) is a strategic document linking policy and finance issues in delivering the Government development objectives and plans. It recommends policies and operational reforms necessary to mobilise the financial resources required to meet the developmental commitments. The framework process brings together the Government, the international and national development actors, by facilitating a collaboration and social dialogue to ensure that public and private resources are mobilised and effectively invested. The INFF provides a strategic platform for mobilising and securing development cooperation and assistance from the international and domestic partners, private and third sector as well as other development stakeholders for achieving the sustainable development targets. In Lesotho's context, INFF aims to support the implementation of NSDP II and SDGs targets and compile the required sources of finance to attain the identified priorities.

INFF Roadmap is developed as a part of the DFA process, outlining ways to improve to development finance and policies in the country, to achieve integrated planning and financing. The DFA undertakes a comprehensive assessment of public and private finance trends and analyse how different development finance flows contribute to the national development to meet aspirations of NSDP II, UN 2030 SDGs and AU Agenda 2063. It outlines a holistic approach to mobilising the public and private finance, both domestic and international, to finance developmental efforts. It also identifies policies and institutional factors that the Government may use to influence and promote investment for advancement of the national plan.

The INFF Roadmap also identifies the financial flow priorities and policies appealing to development players and steps to be considered to develop the full INFF. Lesotho has not fully utilised the domestic and international non-public sector players and it is necessary to change its strategy to realise the current and future development plans.

1. Recommendations for the Financing Strategy

1.1 Domestic Public Sources

Context/Findings:

To improve domestic public development finance flows, the Government should introduce policies that would improve and stabilise tax revenues. One of the main tasks is to ensure that annual revenue targets are realistic and achievable. In Lesotho, taxes are the second major public finance flow (39 per cent on average) and have been slowly growing over the last 15-years, though with a significant level of volatility. Similarly, non-tax revenues have grown as well and some are becoming significant and the Government should consider singling them out and managing them individually. This would contribute to the better collection and address the issues of tax evasion. Although SACU revenues are the most important single public finance flow, they are volatile and the Government does not have control over them. However, the Government may address the sharing model and argue for an increase in the development element of SACU revenues. The Government should focus on better management of tax and non-tax revenues, as it can control their performance, either through the policies or oversight and management of LRA. It should also be noted that the collection of other public

PART II: RECOMMENDATIONS FOR THE INFF ROADMAP



revenues has been erratic, mainly due to poor implementation and corruption. The financial contribution of SoEs is also minimal and there is a need for better control of their governance and performance.

VAT is an important form of tax revenue and improving its performance will have a positive impact on the Government revenues in the short- to medium term. However, it should also be noted that sales taxes, including VAT, may have regressive tax effects.

Recommendations:

A. General Public Revenue System Interventions

1. The Government should improve the capacity of public revenue forecasts, ensuring that the targets are reached, rather than revising them later in the year, due to underperformance. Targets have to be ambitious and realistic, for them to be achieved with the reasonable effort by LRA. MoF needs to build capacity to provide accurate forecasts.
2. The Government should reduce its over-reliance on SACU revenues and seek to improve its public finance revenues, while attempting to get a favourable share through SACU sharing formula. SACU revenues have been very volatile in the past and had adverse impact on Government's ability to deliver its programmes.
3. The Government should strengthen the fiscal management capacity of the local governments to ensure successful implementation of the impending fiscal decentralisation process. De-concentration of powers will not create fiscally sustainable sub-national governments, and without their revenues, they will not be able to discharge their duties effectively.
4. The Government should strengthen the local capital market for both public and private debt, and further explore opportunities for the issuing impact green, education, health, and other 'focussed' bonds.
5. SDG expenditure tracking must be introduced and be strictly enforced. The Public Sector spending should be directly linked with the NSDP II goals and SDG commitments, to help track public resources allocation and contribution to development targets. The tracking and tagging should improve the collection and disaggregation of development finance statistics.
6. The Government should complete the costing of the Gender and Development Policy (GDP), as a prerequisite for the successful realisation of the Implementation Plan of the same policy.
7. Digitalisation efforts in public finance administration should be accelerated with the step-by-step introduction of digital taxation for all types of taxpayers and taxes, tax administration and tax enforcement.
8. The Government should introduce Gender Responsive Budgeting (GRB) without delay to demonstrate its commitment to gender equality and inclusion.

PART II: RECOMMENDATIONS FOR THE INFF ROADMAP



9. The Government may consider developing and enforcing the Gender Responsive Tax Policy and promoting and supporting female entrepreneurship and women-owned businesses.

B. Tax Revenues Related Interventions

1. Although VAT is one of the best performing public revenues, the Government should consider a few interventions, such as a) lowering the rather high VAT-registration threshold (LSL500,000) relative to the domestic economy and consider introducing active measures in supporting companies to register for VAT; b) introducing compulsory fiscal registers to capture a variety of small vendors into the mainstream, and c) organising a fiscal lottery, to entice citizens to register for VAT to participate.
2. The Government may consider reducing the corporate tax rate systematically. At present, corporate tax rates are high for a developing economy eager to attract foreign investors in large numbers and there are several bilateral and special reductions of tax rates for some classes of investors/businesses, which complicates the tax process and incentivise investors to search for regulatory loopholes.
3. The Government should explore expanding the tax base, targeting the current informal economy, particularly the informal retail sector and self-employed labour force and introduce green taxes, defined health contribution/tax, and the elimination of fuel subsidies and other forms of unproductive state aid.

C. Other Public Revenues Related Interventions

1. The Government may explore further the improvement of what is currently classified as 'other revenues' and disaggregate them on the classical/traditional non-tax revenues (user fees and charges, fines, semi-commercial revenues), SOE/public enterprises' revenues, various types of royalties, etc., so that they can be monitored individually and necessary policy measures for their improved collection may be promptly introduced.
2. The Government may consider restructuring SOEs or public enterprises to ensure that they contribute financially to the national development objectives. Currently, they are mainly generating losses while they should be making surpluses or profits based on the industries they operate.
3. At present, the Water and Electricity Royalties are reported under the budget line: 'Other revenues'. They should be reported as two separate revenue lines so that they can be monitored and if necessary, adjustments be made on policy. Their high volatility suggests a need for closer look at revenue management, as water and electricity royalties should be predictable.
4. The Government may develop the Dividend Policy Framework for the Public Enterprises or SoEs, outlining its expectations in terms of the targeted dividend revenues and their overall contribution to the national public finance.

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1.2 Domestic Private Sources

Context/Findings:

To spur development, the country must mobilise domestic financial resources, have a dynamic private business sector and provide an environment conducive for promotion of entrepreneurship and small business development. Like many developing economies, Lesotho depends on MSMEs for sustaining economic growth. However, domestic private investment has been lagging behind, despite the Government's efforts to improve access to finance and mobilisation of domestic private sector to actively invest in development. Access to credit is a challenge for many MSMEs and the banking sector has to be mobilised to address this challenge. Similarly, it is necessary to mobilise free financial resources through savings, which can then be used for investment in development purposes. Government's credit guarantee schemes have been used for some time, but it is not clear to what extent they have contributed to economic development, and this must be ascertained. Similarly, the PPP experience has been negative due to adverse involvement with the flagship PPP project (Queen 'Mamohato Memorial Hospital). The third sector has grown rapidly but has not been fully integrated into the national development efforts. Likewise, there is a need to ensure that CSR projects make impact by investing in initiatives that are aligned with the national development efforts. CSR is practiced in Lesotho and the NSDP II Financing Strategy recognises it as a possible alternative source of finance. However, CSR policies are lacking and could only be found in the large companies in the country.

Recommendations:

1. CBL could introduce lending targets to MSME clients for all banks in Lesotho and strongly enforce such policy. Special focus should be made in supporting women-owned businesses. MSMEs still have a problem of access to credit, a feature which has been recognised in NSDP II and other Government documents as a challenge to grow the domestic private sector. These measures have worked well in some developing countries, both in Africa and beyond.
2. National savings are not high and are not directed towards the national economy. CBL may impose similar targets to (1) above on the domestic savings accumulation and credits and limit the placement of these funds (accumulated domestic savings) to overseas uses/accounts.
3. The Government may review the credit guarantee and other business promotion schemes and see why they have not been successful in attracting MSMEs and entrepreneurial applicants and what changes to the current policies are required.
4. The Government may consider the establishment of the Sovereign Fund (based on the natural resources revenues and royalties) and task the Fund to co-partner with private sector players, to de-risk potential investments in the identified priority sectors. This may improve project opportunities, as the level of perceived risk may be lowered through the collaboration.

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5. The Government may review the existing tax credit schemes to generate further initiatives for domestic private sector investment and launch incentives that would lead to partnerships with the development actors in the other sectors (third sector and/or public sector). Special attention should be paid to women-owned and sustainable businesses.
6. The Government may review and evaluate its PPP policy to ensure that PPPs contribute more to development finance in the country. Despite the relatively long history of PPP, the country has not been successful in building many PPPs beyond the classical infrastructure projects.
7. The Government may study good/best international practices in PPP and invest in capacity building by ensuring that the MoF PPP Unit has fully qualified staff equipped to manage complex PPP contracts. It should establish transparent mechanisms for PPP implementation, monitoring and control.
8. The Government may consider including the third/civic sector (CSOs) more closely in development affairs and ensuring that their spending is coordinated and aligned with NSDP II/SDGs especially those CSOs focussing predominantly on women-empowerment programmes. Furthermore, the third sector finance should be monitored and reported and where possible at the national level so that its contribution to the national development efforts could be appreciated.
9. The Government should create a database of domestic NGOs/CSOs, to improve its knowledge about the potential domestic development partners and map out their international connections and collaborative engagements, to mobilise them to deliver national development efforts; and leverage the financing and support for the scaling up of their work at the national level. This may also be extended to the faith-based organisations as well. This may require the review of the Societies Act, 1966.
10. The Government should promote further digitalisation in the country, offering e-services to the private sector and citizenry, enable digital financial services, and introduce digital (corporate) taxation. This is particularly important in promoting MSMEs and entrepreneurial development in the country.

1.3 International Public Sources

Context/Findings:

The international public finance stream mainly consists of ODA and in some years, very modest OOF. The ODA that is reported as grant revenue in Lesotho's budget roughly represented and averaged about 7.26 per cent of the total budget in the period from 2005 to 2020. In some years, ODA contributed almost 15 per cent (2011) and in some years just 3.4 per cent (2013). Overall, ODA have been volatile, mainly due to the political instability in the country in some periods. The main ODA partners are DAC countries, followed by international organisations. China is the second most important bilateral partner after the US and has generally been contributing about USD 30 million annually in the last five years. However, there are no credible reports on the flows from China. Some of the traditional partners, like Ireland, have been participating less and increasingly, international organisations have become main sources of ODA. Interestingly, the UN system is the major international development partner followed by the World Bank Group. OOFs are sparingly

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represented, possibly due to negative perception of the Government (MoDP, n.d.). Although Lesotho is now classified as LMIC, ODAs are still a significant source of finance.

Recommendations:

1. In the short term, the Government should engage with bilateral donors to maximize their contribution towards NSDP II. In the current climate, bilateral donors may play a more prominent role, as international aid is increasingly becoming bilaterally driven. The Government should particularly approach the traditional donors and explore the opportunities for future collaboration despite their recent diminishing contributions. One such donor is Ireland, which had international aid engagement with Lesotho.
2. The Government may reconsider its position on OOF as well as for MICs, as these flows are becoming an important source of development finance, largely replacing bilateral ODA.
3. The Government should revive and expand the former PSID, where all the development financial flows (public and private) were reported. It will also fully capture projects and programmes focussing on cross-sectoral and cross-cutting issues like gender and climate change. It is possible to redevelop PSID to be the SDG Dashboard which links both financial and non-financial performance information.
4. The Government may consider engaging more with the South-South and Triangular Cooperation for Sustainable Development partners. Lesotho has the advantage of size as a small country and the ODA contribution may be easier to notice and the impact can be more significant.
5. The Government should explore opportunities to issue green and social impact bonds (including gender-empowerment investments) on the international capital markets, with the support of the multinational development partners.
6. The Government should actively implement the National Climate Change Strategy, develop a comprehensive National Climate Change Financing Strategy and support the creation of a climate finance project team within MoEM, or another appropriate MDA, to attract more climate finance to the country.

1.4 International Private Sources

Context/Findings:

International private sources of development finance mainly come from remittances of migrant workers and FDIs. Remittances are the second single most important development flow after domestic public finance revenues. FDIs have been volatile and in the range from USD9.51 million (2010) to USD 206.51 million (2015). FDIs were very important in the years when ODA (the third most important source of development finance) had dropped and much of the shock was alleviated by the increase in FDIs (even though not in all the years). Potential FDI investors have expressed dissatisfaction with the current state of infrastructure, as well as challenges of transporting goods to ports and the government's red

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tape. International remittances have been dropping as per cent of GNI and now revolve around USD0.5 billion. The drop in remittance revenues in 2019 was 9 per cent and in 2020, decreased by 14 per cent and the negative trend is expected to continue into 2021. Most of the migrant workers are engaged on seasonal contracts, hence their employment is not stable and remittances more volatile. In the past, the economic downturn in South Africa had a significant impact on remittance revenues in Lesotho. On a global level, private finance investments in developing countries have been weak in the sectors relevant to SDGs (IATF, 2021). A similar conclusion may be drawn for Lesotho based on anecdotal references.

Recommendations:

1. The Government may strengthen the overall capacity of the one-stop shops (business facilitation centres) which have not served their purpose in full. Special attention should be given to the services provided to women entrepreneurs and women-owned businesses.
2. The Government may establish the National Investment Promotion Council to serve as a multi-party and civil society caucus to promote Lesotho as an investment destination and take measures for the promotion of investments especially foreign investments. The Council should ensure that such foreign investment is aligned to NSDP II and SDGs.
3. The Government should review the mandates of LNDC and LTDC ensuring that they are fully supported in discharging their statutory functions (organisationally and financially).
4. To facilitate easy transfer of remittances to Lesotho, the Government may consider the creation of corridors and leverage on digital technologies (especially digital corridors) to ensure that the cost of transfers is kept low and that the physical cash transfers over the border are discouraged.
5. To mobilise remittances for development purposes, the Government may introduce investment opportunities for migrant workers and those in diaspora, such as diaspora bonds or diaspora banking and investment accounts, giving these classes of investors fiscal and other initiatives through use of all facilities and opportunities such as for digital banking/financial services. Special consideration should be given to women migrants and returning women migrants.
6. Portfolio investments are considered an innovative finance flow. However, given Lesotho's stage of economic development, the Government may reconsider its stance and become inactive in promoting portfolio and equity investments but first build a strong regulatory and enforcement framework. Portfolio investments are highly volatile and prone to political and societal instabilities. In fact, in years when Lesotho had recorded portfolio investment flows, they were negative.
7. The Government should develop a framework for collaboration with the international NGOs, i.e. the international third sector organisations, particularly those in the fields of health and education, and on cross-cutting issues, like gender, and climate change.

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8. The Government may create a separate body charged with export promotion and provide clear performance targets. This body will have to be autonomous and with capacity necessary to perform.
9. The Government should gradually be selective in supporting foreign investment by focusing on sectors relevant to SDGs and NSDP II (and subsequent NSDPs). Special support should be given to investments addressing cross-cutting issues such as gender and climate change.

2. Recommendations for Monitoring and Review Systems

2.1 Monitoring Systems

Context/Findings:

An effective monitoring and evaluation (M&E) system provides the organisation with previous experiences and corrective actions necessary in the process of implementation. Taking corrective actions during implementation is of utmost importance for the effective delivery of development policy. The NSDP II information is not aligned to SDGs and the situation needs to be corrected as data is available. To ensure that the expenditures are linked to NSDP II and SDGs is critical and the Government must build its capacity for monitoring and evaluation. Evaluation should also further provide input on the projects and serve as another learning tool in the design of future projects. Ultimately, this creates an SDG-devoted platform that would link both inputs (including financial expenditures) and outputs and policy outcomes.

Recommendations:

1. The Government should consider the immediate introduction of SDG expenditure tracking and SDG reporting in support of SDGs and NSDP II implementation. This exercise should be extended to other policy priority areas like gender, climate change, health improvement, and so on.
2. The Government should establish an integrated financing dashboard platform, consolidating data from different financial flows and drawn from the existing financial systems (IFMIS, IRMS, CBMS) capable of capturing sector and cross-cutting initiatives such as gender and climate finance. This task should include re-launching the Public Sector Investment Database (PSID) to provide information for the Development Dashboard platform or serve as the SDG Development Dashboard.
3. The Monitoring and Evaluation Framework should be subjected to regular and periodic reviews, where the results of the exercise should be covered in the implementation performance reports. The Framework itself should facilitate the development and operations of the integrated reporting platform in tracking individual projects against NSDP II and SDG targets and indicators, SDGs and budget alignment.

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- Monitoring and Evaluation capacity in MDAs should be strengthened and the Government may consider investing in system-wide capacity building to ensure that individual MDAs are entirely capable to produce M&E reports and use them in modification of policies.
- Information sharing protocols should be established with the development partners outside the public sector (MDAs and SOEs/public enterprises). Particular attention is to be paid to NGOs, third sector organisations, private informal networks, church organisations, etc.
- The Government may consider strengthening the capacity of BOS, especially in terms of overcoming inadequate data challenges, both at the central and district level. BOS should develop data protocols that would ensure that the districts report their contribution towards achieving NSDP II and UN 2030 Agenda (SDG) targets.
- The Government scores low on accountability across the board. It may consider developing a Community-based Monitoring System and a network of Data Labs to complement the BOS to facilitate real-time data collection. Local Data Labs should be able to capture all locally generated data and disaggregate cross-cutting issues related to data (gender and climate change, at present).

2.2 Review Systems

Context/Findings:

The Government undertakes reviews of strategies and policies as a matter of governance. However, the frequency of the reviews has not been formally established. The reviews are often done under external pressures mainly from the IDPs. In some instances, the reviews were completed as an administrative exercise and reports produced, recommendations made, but no action taken. Several external reviews and assessment documents have come to the same conclusion (for instance, the successive PEFA exercises) on reviews.

Recommendations:

- The Government should adopt policies of reviews to ensure that Government strategies and policies are regularly reviewed every two to three years and the MDAs are tasked to automatically initiate reviews in their sectors.
- The new policy review rules should include the sub-national level of Government so that districts are tasked to review their respective policies on the regular intervals and report the outcomes to the supervising ministry.
- The Government may apply two types of reviews: a) internal and b) external. In the former, the review is initiated and managed from within the MDA that oversees implementing certain strategy/policy, whilst in the latter, the review is conducted by an independent outside team (which may include the civil servants from another MDA, representatives of the civil society, or any other development and/or societal partner).

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3. Recommendations for Governance and Co-ordination Mechanisms

3.1 Governance Settings and Systems

Context/Findings:

Lesotho has an elaborate system of governance and coordination in relation to economic development and SDG delivery. There are currently four layers of engagement, viz the National Oversight Committee, Cabinet Sub-Committee on SDGs, Technical Committee, Technical Sub-Committees, and Technical Working Groups. There is also the Parliamentary Forum at the national legislative body. The first two top layers can be considered as a governance element, whilst other layers are technical and more coordinative. The National Oversight Committee (NOC) is chaired by the Prime Minister and is the highest body within the system. It is followed by Cabinet Sub-Committee on SDGs which is chaired by the Minister of Development Planning. Both bodies have representatives from the public, private sector, civic sector, academia, international development partners, and other societal stakeholders and interested parties. The structure is very much top-heavy but, is operational and performs as expected.

Recommendations:

- The Government may simplify the overall structure by having a top-level political body for strategic oversight, with Cabinet-level political and operational committee, supported by the Secretariat housed and technically supported by MoDP. The Secretariat would provide coordination and assist in organising ad hoc working groups.
- The Government may involve the Head of State as a national SDG Champion and include him in all the public promotions as a symbol of national unity.
- The Government should identify relevant structures to integrate the INFF, building on the current governance and coordination mechanism to facilitate ownership.

3.2 Co-ordination Mechanism and Systems

Context/Findings:

The set of technical coordination bodies is rather cumbersome and may adversely affect the efficiency of the Government machinery. Below the two strategic and political coordination bodies (NOC and Cabinet Sub-Committee on SDGs), there is the Technical Committee chaired by the Principal Secretary of MoDP, with membership from: Principal Secretaries of ministries, several heads of other agencies, NGOs, third sector organisations and development partners. Technical Sub-Committees are organised for each of the NSPD II Key Priority Areas (KPAs), which in turn are supported by several Technical Working Groups (TWGs). TWGs are sector-based and are chaired by the respective ministry. Almost all levels of coordination have representatives of a number of stakeholders, from the public, private and third sectors, academia, and international development partners. There is also the Parliamentary Forum at the legislature. The governance infrastructure

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was meant to be all-inclusive and technical enough to deliver the plan, but in practice, it is rather cumbersome and difficult to coordinate.

Recommendations:

1. Strengthen the coordination role of the MoDP and capacitate its staff to facilitate integrated and SDG-aligned planning, implementation, and monitoring of national development agenda to attain national targets.
2. Strengthen linkages between BOS and MDAs and develop staff capacity to facilitate coordination and information sharing. Cross-cutting issues (gender and climate change) data should be appropriately disaggregated.
3. Districts should create a simpler structure with one political and one technical body to oversee the implementation of NSDP II and attainment of UN 2030 Agenda.

4. Recommendations for Further Assessments and Diagnostics

Context/Findings:

In terms of domestic public finance, the Government's annual budget plans and outturns differ significantly in some years. This has led to the revision of priorities and some rebalancing within the budget with the Government running serious arrears (especially salaries owed to civil servants). There is a high level of alignment between NSDP II and SDGs, but not cascaded well to the sectoral level. There are discrepancies between the sectoral and the national plans. Additional coordination and adjustments may be required to enable hierarchical linkages between national and sectoral plans and required integration.

It takes a long time for public organisations to introduce changes and implement policy reforms. The reforms projects often overlap and may lack the necessary level of coordination to ensure that resources have been directed to the best possible uses and the public received the best value-for-money.

Recommendations:

1. The Government should undertake necessary preparatory work when developing a national development framework and/or vision that would provide a long-term view and present the national development ambitions. These should be aligned with the national SDG commitments and facilitate the development of the Financing Strategy.
2. As the planned and executed budgets differ almost every year, it may be beneficial to carry out a Comprehensive Spending Review in Lesotho to ascertain the expenditures, their effectiveness, and efficiency, and recommend the necessary re-alignments. Special attention should be given to the cross-cutting issues (gender and climate change).

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3. The Government should ensure that the VNR (2019) recommendations are implemented. This may require further analysis on the impact of the introduced interventions and their contribution to the achievement of the development goals.
4. The Government should conduct a review of SOEs/Public Enterprises and their contribution to Lesotho's development priorities and potential opportunities for direct contribution to development financing targets. The Government should ensure that the public sector bodies (MDAs/SOEs/Public Enterprises/Parastatals) transform themselves in the direction of learning organisations, where the collective knowledge is advanced, shared, and used to ensure that errors from the past are not repeated.
5. The Government may focus more on bilateral collaboration with IDPs. International organisations are a major source of international public finance in Lesotho and it may not be a sustainable trend. As bilateral relations are becoming important for ODAs allocation, Lesotho may focus on a few major bilateral donors to ensure the flow of ODA in the near to mid-term future.
6. The Government should conduct a review and explore opportunities with the South-South and Triangular Cooperation (SSTC) as Lesotho is a leader in Africa in utilising SSTC funding, although the full potential has not been explored. Upon positive review, SSTC may be accelerated, especially in the areas where SDG results are lagging. It may also be useful to analyse the SSTC in the Health Sector, where past records are good.
7. The international and domestic charity finance is presently utilised marginally, therefore, it is advisable to commission a study to analyse the current state of domestic and international charities' activities in Lesotho, analyse best practices in other SADC countries, and explore the opportunities to mobilise faith finance for development purposes and how to map them against NSDP II and Agenda 2030 efforts. Special focus should be given to the charities that are active in health, education, gender and climate change.
8. The Government may conduct a comprehensive Gender Audit and urgently assess the effectiveness of its gender policies.
9. The Government should complete the SDG Investor mapping exercise as a matter of utmost priority. Gender and climate change data should be appropriately disaggregated and separately reported ■

SUMMARY AND CONCLUSION



Summary and Conclusion

Lesotho has successfully mobilised public financial resources but is lagging in mobilisation of private sector finance. Although Lesotho is a LMIC, it still receives a relatively high ODA, primarily from international organisations. Domestic public resources have been on a slow, steady increase (with an occasional dip), even though the growth in revenues has not been as high as in some other African countries. Taxes have been the main source of public revenues and amongst them the Income-tax. Corporate tax rates are relatively high for an African country hoping to attract international investors. However, there are several categories where lower tax rates are applied. Non-tax revenues have not been that significant and should be explored in the future, especially those that are considered the traditional non-tax revenues – fees and (user) charges.

Revenues from the SOEs/public enterprises have been modest, as many SOEs have been experiencing some years of underperformance. The reform of the SOE sector is still pending and certainly should be considered a high priority. Private investment is relatively low, but because of public investments, the overall capital formation is relatively high for a developing country. The development of a comprehensive dividend policy for SOEs and public enterprises may effectively address the current challenges.

Lesotho's domestic borrowing has been limited mainly because the financial market is relatively underdeveloped and without the necessary depth. Efforts to place the Government bonds locally have not been very successful and the Government has resorted to foreign borrowing, which has been growing. However, foreign borrowing has traditionally been linked with the preferential loans offered by the international organisations and bilateral IDPs rather than the classical borrowing in the financial markets (international bonds and commercial credits). With the current COVID-19 challenges, underperforming local revenues, and debt market, it is expected that the Government will aggressively borrow in the international market.

Domestic investment has been limited and the credit to the private sector although growing is relatively low. The banking sector primarily serves households and MSMEs still face challenges in securing finance from banks and other forms of finance. PPPs have delivered mixed results with the major PPP in the country having improved the service delivery but having put immense pressure on an already strained health budget main due to the poor contractual arrangements and inappropriate risk sharing. However, despite this unfortunate experience, the Government and NSDP II lay very high expectations in PPP to provide private finance necessary to deliver development goals in particularly the infrastructure projects.

ODAs represents an important development flow even though volatile and highly responsive to the political situation in the country. At present, about 10 per cent of the government budget comes from ODA grants. The main donors are international organisation and few major bilateral partners (US and China, leading the tally). OOFs are still relatively small and are mainly provided by international organisations. Their low participation may be partly explained by the general negative perception by the Government. As Lesotho develops, ODA will most likely be gradually replaced by OOF as a major flow of international public finance.

SUMMARY AND CONCLUSION



Remittances are the major international private flow and have over the years been the most important international revenue, and currently the second most important revenue after the public revenues. The Government should facilitate the development of remittance transfers corridors like the digital corridors to ensure that the remittances are transferred at the lowest possible cost. The recipients should easily access the remitted money with minimum administration.

FDIs are relatively modest and fairly volatile. However, the inflow of foreign capital has significantly changed the industrial structure of Lesotho and has enabled economic development. The garment industry, which is largely dominated by foreign capital, has become the second most important employer in the country after the public sector. The garment industry has supported gender development employing largely women whose options for employment are limited due to the weak local labour market.

CSR and charity finance are still largely unexplored in Lesotho and should be given careful consideration by the Government. As the social dialogue is about to intensify, the opportunities to share NSDP II targets with the new domestic development partners should not be missed and, the mobilisation of the third sector may be at the centre of future activities.

Lesotho has an elaborate development architecture though assessed as top-heavy. The development bodies for implementation of NSDP II, UN 2030 Agenda and AU 2063 Agenda have far too many layers, with significant overlap in the responsibilities and authority. Hence, it is advisable to make a necessary policy review plan to ensure that the reviews are done on time and contribute to better implementation management.

In the last fifteen years, Lesotho has demonstrated a noticeable growth in the public revenues and has improved PFM processes and procedures to achieve these results. PFM reforms are still ongoing through the support of IDPs to improve the shortcomings noted in PEFA report(s) and other assessment exercises. Overall, the better use of technology, organisation of work, and organisational architecture has ensured these positive results. Lesotho is dependent on ODA and international public finance sources which are an important inflow especially for the capital budget. It would be advisable to replace these financial sources in the medium-term, with domestically generated sources, alternative finance flows, and other sources of finance, particularly those sourced from the private sector. This would ensure the long-term sustainable financial position, desired economic growth and development.

Further democratisation, the inclusion of the non-traditional domestic development partners, and improved social dialogue would contribute to an attractive local climate for development where the private investors, both domestic and international, would be comfortable to invest in the stable long-term projects. This should improve the overall coordination of development efforts and bridge the gap between the public and private sectors. Ultimately, the NSDP II could be implemented, and SDGs achieved.

Achievements must be reported, though SDG reporting is considered weak. Therefore, SDGs expenditure tagging, tracking and reporting have to become a matter of routine where all the sectors report their results vis-à-vis NSDP II and the country's SDG commitments. SDGs have been well-linked with NSDP II at the national level but have not been fully operationalised on the sectoral and sub-national level and are without a proper reporting model. These shortcomings need to be addressed effectively and on time to allow for a policy and/or operational reaction ■

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Appendix 1

Brief Methodology for Carrying out the Development Finance Assessment

The approach that will be followed in carrying out the substantive analysis and used to facilitate dialogues will follow the methodology detailed in the DFA Guidebook (version 3.0). The methodology collates and analyses data and information concerning the four building blocks of an INFF. The key analysis includes:

1. COVID-19 and priorities building back better

- Identifying priorities for recovery and building back better from COVID-19, and medium to longer-term sustainable development objectives aligned with the NSDP II and SDGs.
- Reviewing the impacts of the COVID-19 pandemic and Government responses to date, including key financing interventions.

2. INFF building block 1: assessment and diagnostics

- Collating existing estimates of financing needs and costs, both overall and sectoral, associated with realizing national development priorities aligned with the NSDP II.
- Undertaking a comprehensive and updated analysis of historic trends, the current context and future outlook across the financing landscape considering public, private, domestic, and international financing resources, flows, and instruments, with attention to the COVID-19 impact on each financial flow, as well as an assessment of the digital finance landscape (e.g., digital savings, credit, insurance, and payment).
- Mapping and analysing a variety of risks that can affect financing needs, trends, and availability of financing for the sustainable development priorities, drawing from available literature and analysis. The possible scope of risk may include economic, political, fiscal, financial, climate, environmental, disaster, pandemic, or other risks, as well as policy and institutional risks and constraints.
- Developing simple scenarios to model future trajectories of key financing flows, based on data availability and assumptions about COVID-19 recovery, future risks, progress toward financing policy targets, and other factors.

Analysing the strengths and opportunities to strengthen institutions' capacity to effectively deliver public and private financing policies.



3. INFF building block 2: financing strategy

- Reviewing existing policies and ongoing reforms for the governance of public and private financing which facilitate mobilising and promoting investments and advance national sustainable development priorities. Policies in the Lesotho context relevant to financing the NSDP II are to be analysed, including those governing:
 - Public finance: e.g. domestic revenue mobilization strategy, annual and medium-term budget framework, public debt strategy, public entity management and development cooperation policy.
 - Private finance: e.g. private investment policies and investment promotion strategy, financial sector development and financial inclusion policies, PPP policy, diaspora engagement strategy.
 - Analysing opportunities for mobilising new sources of finance, including those related to digital finance and risk finance ecosystem, and strengthening the alignment of public and private financing with development priorities.
 - Working with the Oversight Committee to develop solutions and recommendations for reforms to public finance policies, institutional structures, and capacity, with a view of supporting an integrated public finance approach to building back better and financing the NSDP II. Working with the Oversight Committee to develop solutions and recommendations for reforms to private finance policies, institutional structures, and capacity to support an integrated approach to public policy for private finance for building back better.

4. INFF building block 3: monitoring and review

- Assessing the financing monitoring, tracking, and reporting systems in place and their inter-linkages (e.g., Integrated Financial Management Information System, Public Sector Investment Programme Database and Debt Management Database), institutional statistical capacity for monitoring public and private finance, and their contributions to sustainable development outcomes aligned with SDGs and NSDP II.
- Working with the Oversight Committee to develop solutions and recommendations for building capacity and integrating and strengthening monitoring frameworks for the INFF.



5. INFF building block 4: governance and coordination

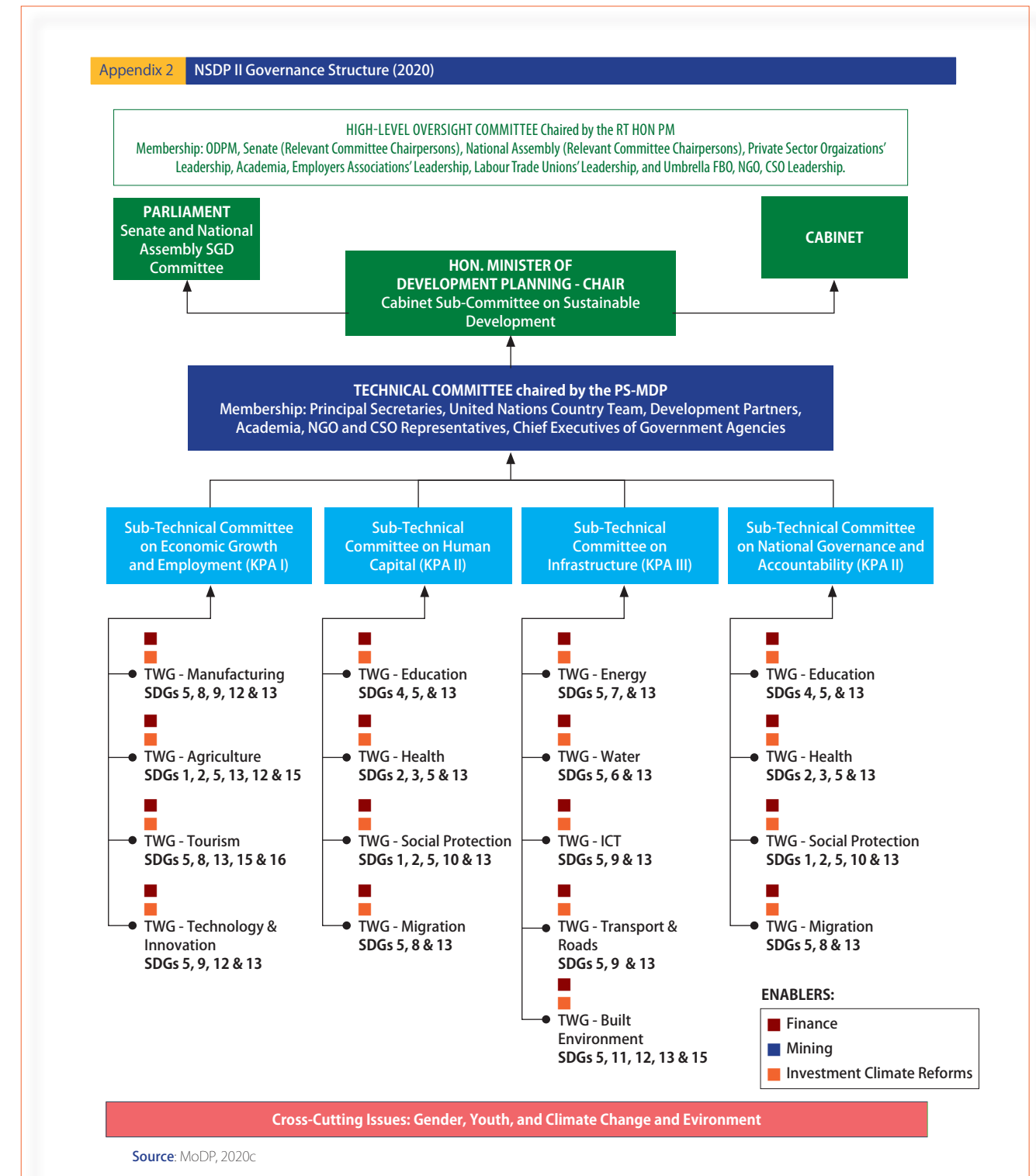
- Analysing the institutional frameworks and mechanisms in place through which the government manages policies towards different types of financing for the NSDP II and the COVID-19 response and recovery priorities, e.g., the planning and budgeting processes in linking both public and private finance with the SDGs and development priorities.
- Mapping key stakeholders and their roles in establishing an INFF, including both state and non-state actors. Analysing existing platforms and mechanisms (e.g. SDG Coordination Mechanisms, Public Sector Investment Committee, Aid Coordination forum, Technical groups, Parliamentary forum) for coordination of financing policy and dialogue within government and with external actors; such as the private sector, civil society organizations (CSOs), think tanks, international financial institutions (IFIs) and development partners, relevant to the development priorities in NSDP II.
- Working with the Oversight Committee to develop recommendations for strengthening the institutional structures and capacity for more integrated management and implementation of financing policies and stronger public-private dialogue on financing the development priorities in NSDP II.

6. INFF Roadmap

- Working with the Oversight Committee to develop an agreed, articulated INFF Roadmap, highlighting the recommendations and reform process on financing solutions as well as institutional changes and capacity development options for an integrated financing strategy for advancing sustainable development in Lesotho ■

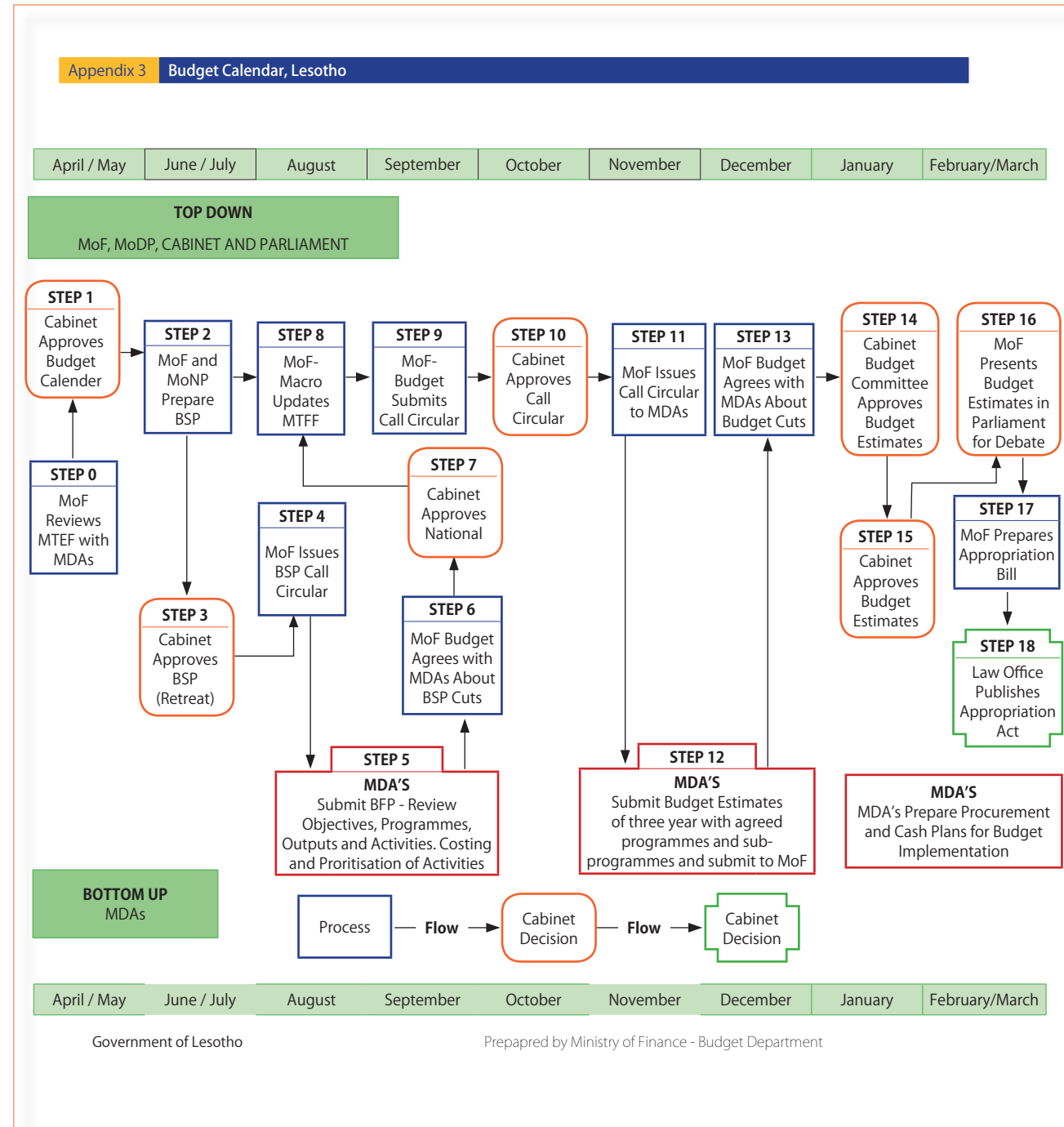


Appendix 2 - NSDP II Governance Structure (2020)





Appendix 3 - Budget Calendar, Lesotho



Appendix 4
The Kingdom of Lesotho Education and Public Health Expenditure Review Findings and Recommendations

No	Education Expenditure Review: Findings and Recommendations	Public Health Expenditure Review: Findings and Recommendations
1	High governmental spending in the education sector reflects the Government's priority of providing free primary education.	The Government of Lesotho has made considerable strides in the past five years toward addressing challenges concerning accessibility of services and the quality of its primary health infrastructure.
2	Since the introduction of free primary education in the year 2000, the number of teachers has increased by 50 per cent, contributing to lower student-teacher ratios notwithstanding the great geographical disparities.	Moving forward, to meet the goal of universal health coverage, the Government of Lesotho must improve the quality and cost-effectiveness of health care and increase access to underserved populations—and achieve these objectives under extremely tight budget constraints.
3	The largest share of education spending is for recurrent expenses, with the Ministry of Education and Training spending almost 80 per cent of its budget on staff.	The data for the MoH expenditure on outsourced health services reveals that over the past four years, the ministry's public-private partnership (PPP) with Tsepong (QMMH) has accounted for approximately 30 per cent of total MoH recurrent expenditure.
4	Despite high spending on education and human resources, sector outcomes have been inadequate and inequitable especially in rural remote and mountainous areas of the country.	Payments to CHAL have increased by 121 per cent over the period studied.
5	Poor planning and human resource management are the main causes of education sector failures.	Data on budget utilization rates across the health sector reveal sharp differences.
6	Despite the resource constraint, operational and capital budget spending are often underspent, due to the complexity and lack of usability of the budget management system.	Improvements in health outcomes continue to be low: maternal and neonatal mortality rates in Lesotho are among the highest in the world, with 1,024 per 100,000 and 59 per 1,000, respectively.
7	The bursary scheme for tertiary education is neither effective nor sustainable, and recovery from the schemes is urgent.	Increasing the use of health funds and the efficiency in health sector management should be a priority for the Government of Lesotho.
8	Education spending in Lesotho favours the rich.	Improve the institutional capacity to collect, validate, and utilize evidence on health outcomes, service delivery performance, and health expenditure allocations and utilization at all levels to guide decision making.
9	Various factors have made the accelerated growth of secondary enrolment likely; however, expansion of secondary education is expensive due to high unit costs.	Improve allocative equity of funding across districts and district hospitals, as current funding is skewed on both an absolute and per capita level.
10	There appears to be limited demand for higher levels of school education among many students and parents.	Change the payment system for hospitals and provide greater autonomy in the day-to-day management of individual hospital facilities.
11	To improve the quality of spending in the education sector, the budget management process and monitoring of "value for money" need to be strengthened.	Improve efficiency and equity in funding for primary health centres, as there are large variations in funding per health centre and per medical visit across Lesotho.
12	Now that universal and free primary education has been attained, it is important for the Government to reiterate its commitment to expanding junior secondary education — and to make it universal over time by 2030.	In each health facility, staffing should depend on services provided, patient demand, and workload, and not be fixed according to rigid input-based norms.
13	The expansion of the education system will only be successful if it continues to raise the quality of education	Create the institutional capacity necessary within the MoH to exercise oversight of its outsourced services given the large share of the budget they absorb.
14	To be viable, the expansion of junior secondary education should combine fiscal austerity and the efficient allocation of resources to address equity concerns.	Revise the CHAL Memorandum of Understanding to ensure greater accountability and oversight of funds and health outcomes.
15	The expansion of the junior secondary school network would also require effective teacher incentives and management, as well as strong reforms for teacher salaries	Conduct further studies on efficiency and quality within QMMH to ensure funds are being used well.
16	The introduction of an established/official list of teachers in schools is a priority.	Conduct further recommended studies listed below to arrive at specific recommendations to improve major problem areas.

Source: World Bank, 2019a; UNICEF and World Bank, 2017

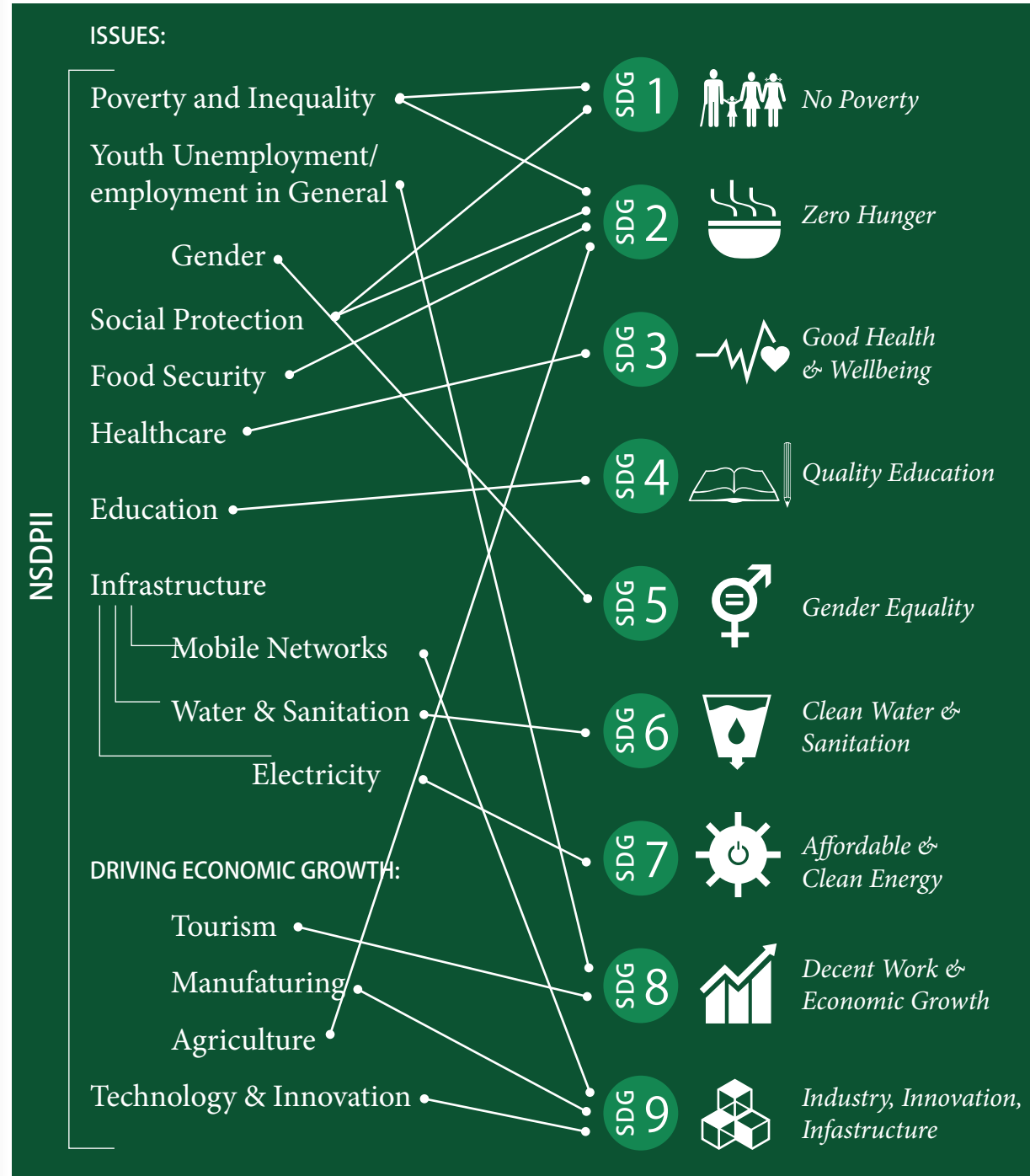


Appendix 5 - Links between NSDP II and SDGs

Appendix 5 Links between NSDP II and SDGs

LINKS BETWEEN

Issues Considered, Policies in Lesotho and UN SDGs



Source: UNCDF Lesotho (provided during the DFA consultation process)

Appendix 6 - Table Summary of the Recommendations – Finance Flows

Timeline	Domestic Finance			International Finance		
	Public	Private	Description	Public	Private	Description
Short-Term 1 – 3 Years	<p>Lead: MoF</p> <p>The Government should improve the capacity for public revenue forecasts by ensuring that the targets are met, rather than retrospective revisions due to underperformance</p> <p>Lead: MoF</p>	<p>Lead: CBL</p> <p>CBL to consider introducing targets for lending to MSMEs clients, especially female-owned businesses (for the domestic banking institutions)</p>	<p>The domestic private sector is largely comprised of MSMEs and has challenges of access finance. Mechanisms to promote access to finance for MSMEs should be established. Banks should be encouraged to assist MSMEs to develop bankable proposals.</p>	<p>Lead: MoDP and MFA</p> <p>Engage with the bilateral international development partners/ donors</p>	<p>Lead: MoTI</p> <p>Strengthen the overall capacity of the one-stop Business Facilitation Centres (including specialised services to women-entrepreneurs and women-owned businesses)</p>	<p>Improve the efficiency of One-stop business facilitation centers. This will improve ease of doing business, promote international private investment (FDIs), and improve the overall business support architecture in the country. One of the support measures may be opening of a special service window for female entrepreneurs.</p>
	<p>Lead: MoF and MoDP</p> <p>The Government should track gender equality achievement demonstrated with gender disaggregated data in planning and financing. The Government should promote the alignment of NSDP II and SDGs in spending and introduce expenditure tagging and tracking where expenditure is clearly linked to SDG target, output or outcome.</p>	<p>Lead: CBL</p> <p>CBL to impose targets on the domestic savings accumulation and credit extended to the domestic private sector</p>	<p>To improve domestic investment, it is necessary to promote the domestic saving levels, which are currently very low and ensure that the domestic savings are invested productively within the country.</p>	<p>Revive and expand the former PSD, to align public sector investment, NSDP II, Agenda 2063, and SDGs with the special emphasis on gender and climate change-related projects</p> <p>Lead: Cabinet and MoDP</p>	<p>International aid is increasingly bilateral. Government should approach traditional bilateral donors and explore opportunities for future collaboration to ensure budget contribution for NSDP II and SDG implementation</p>	<p>PSD provided a good oversight of the aggregated aid received and its revival would improve the foreign assistance management, while its the expansion to include other flows would facilitate better oversight of the total development finance flows.</p>
	<p>Lead: MoF</p> <p>The Government should introduce and enforce Gender Responsive Budgeting (GRB), as soon as possible</p>	<p>The Government should develop a CSOs engagement policy/ framework and create and/or maintain a database of domestic NGOs/CSOs with a special focus on third sector organisations that deal with gender-equality and women empowerment</p> <p>Lead: MoHR&CS, MoDP</p>	<p>Although currently weak financially, the domestic civil sector has a big potential in mobilising technical know-how and finance. CSOs also play an important role in promoting gender (women) empowerment and equality. These measures may require the modernisation of CSOs legal framework.</p>			
<p>Lead: MoF</p> <p>The Government should introduce and enforce Gender Responsive Budgeting (GRB), as soon as possible</p>	<p>Introduction of Gender Responsive Budgeting (GRB) would ensure that the resources are allocated to achieving gender goals stipulated in NSDP II, and other government policy documents.</p>					



Appendix 6 - Table Summary of the Recommendations – Finance Flows (continued)

Timeline	Domestic Finance		International Finance	
	Description	Private	Description	Private
Medium-Term (3-5 years)	<p>The Government should reduce its overreliance on SACU revenues, improve its public finance revenues, and attempt to negotiate a better deal under the SACU sharing formula</p> <p>Lead: Cabinet, MoF, MFA</p>	<p>The Government should review the current Credit Guarantee and business promotion schemes</p> <p>Lead: MoTI and MoF</p>	<p>ODF is an international public finance development flow whose importance has been growing, especially for MKs. At present ODFs are not favourable to the Government and as such it may be missing an important finance flow.</p> <p>Lead: Cabinet, MoDP</p>	<p>The Government should establish the National Investment Promotion Council, to support and promote international private sector investments.</p> <p>Lead: Cabinet, MoTI</p>
	<p>The Government should reclassify 'Other revenues', and report them as the separate revenue items</p> <p>Lead: MoF</p>	<p>The Government should introduce special tax credits and/or tax incentives for investments by domestic firms (especially in women-owned and sustainable businesses)</p> <p>Lead: MoF</p>	<p>Lesotho has experienced severe weather in the last decade and hence the need to focus on the projects that would conserve the environment and address the challenges of climate change.</p> <p>Lead: Cabinet, MoTI</p>	<p>LNDI and LTDC currently have a wide remit and impossible mission under their current structure and the overall capacity. The review may trigger some realignment, including additional powers, finances, organisational capacity and so on.</p>
	<p>The Government should initiate major restructuring of the SOEs/public enterprises</p> <p>Lead: Cabinet, MoF, MoTI, SAI</p>	<p>The Government should evaluate PPP Policy and learn from best PPP practices</p> <p>Lead: MoF</p>	<p>Lesotho developed the National Climate Change Policy in 2017 but without a financing strategy necessary for proper implementation the Policy and Strategy.</p> <p>Lead: MoF and CBL</p>	<p>Although the total costs of remittance transfers have been dropping, the cost of transferring funds to Lesotho is still one of the highest in Africa. The Lesotho migrant workers should benefit from using the current and emerging digital technologies, with the Government creating an enabling environment through bilateral engagements with the originating countries.</p>



Appendix 6 - Table Summary of the Recommendations – Finance Flows (continued)

Timeline	Domestic Finance		International Finance	
	Description	Private	Description	Private
Medium-Term (3-5 years)	<p>The Government should complete the costing of the Gender and Development Policy (GDP)</p> <p>Lead: MoF, MoGYSR</p>	<p>The Gender and Development Policy Implementation (i.e. Action) Plan requires financial and other resources to be implemented and without proper costing, it will not be possible to ascertain the resources needed to implement GDP and gender-related NSDP II goals and SDGs.</p>		
	<p>The Government should accelerate its tax administration digitalisation efforts</p> <p>Lead: LRA, MoF</p>	<p>Further development of e-tax administration will result in more effective and efficient collection of government public revenues and will enable better administration of tax collection and tax enforcement.</p>		
Long-Term (5-7 years)	<p>The Government may consider reducing the corporate tax rate, in a systematic manner</p> <p>Lead: Cabinet, MoF</p>	<p>The Government should consider establishing the Sovereign Wealth Fund</p> <p>Lead: Cabinet, MoF</p>	<p>The Sovereign (Wealth) Funds are usually used to secure revenues generated by natural resources exploitation, and as Lesotho is a resource-abundant country. This may be an option to secure strategic development investments in the future.</p>	<p>The Government should support foreign investments in the sectors of relevance to SDGs and NSDP II.</p> <p>Lead: Cabinet, MoDP, MoF, CBL</p>
	<p>The Government must focus on further strengthening the local capital markets</p> <p>Lead: MoF, CBL</p>	<p>A functional domestic capital market is needed to enable the development of new debt management and explore the launch of novel financial instruments, including green and impact bonds.</p>		
	<p>The Government may consider developing and enforcing the Gender Responsive Tax Policy including promotion and support of female entrepreneurship</p> <p>Lead: MoF</p>	<p>The introduction of Gender Responsive Tax Policy may have a positive impact on the promotion of women's economic engagement and entrepreneurial behaviour by spurring economic growth and delivering on NSDP II and GDP goals, as well as SDG gender related goals and commitments.</p>		



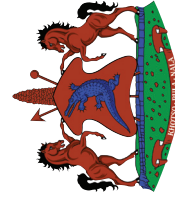
Appendix 7 - Table Summary of the Recommendations – Policies

Timeline	Monitoring and Review	Description	Governance and Coordination	Description	Further Assessment	Description
Short-Term 1 – 3 Years	The Government should introduce SDG expenditure tracking and SDG reporting policies and operating procedures, across all sectors/MDAs (with a special focus on the cross-cutting, gender, and climate change allocations) Lead: MoDP, MoF	To monitor and review the delivery of NSDP II and SDG Agenda, the Government must ensure that spending is development aligned and appropriately managed. Possessing the right (financial) information is a prerequisite for the implementation success.	The Government should build on the current governance and coordination mechanism, empower MDC to oversee the INFF process, ensure the efficient implementation and continuous financing dialogues amongst the key stakeholders for delivery on NSDP II (and subsequent NSDPs) and SDGs Lead: Cabinet, MoDP	To effectively manage INFF, it is necessary to build a collective governance body with wide membership, including public, private, third sector, academia, etc. to build a strong national development finance for the nation. Empowering the leading national development oversight body is the best course of action.	Undertake preparatory work for the development of the national development vision (long-term development framework) Lead: The Parliament, Cabinet, and MoDP	The long-term national vision is needed to guide the national strategic planning efforts, development of national development documents, and financing strategies.
Medium-Term (3-5 years)	The Government should establish an integrated financing dashboard platform (including the relaunch and integration of PSDI), capable of capturing sectoral and cross-sectoral, cross-cutting initiatives, such as gender and climate change Lead: MoDP, MoF	The dashboard facilitates better coordination of resource mobilization efforts, linking development goals, and better overall management of development efforts.	The Government should simplify the overall governance and coordination structure/architecture Lead: Cabinet, MoDP	At present development, governance, and coordination structures have many layers, and many of them overlap. The structure is also top-heavy, which may adversely affect the implementation. Delayering and flattening the structure may be made more efficient.	The Government may consider conducting a Comprehensive Spending Review (with special consideration for the cross-cutting issues, such as gender and climate change) Lead: Cabinet, MoF	Lesotho has conducted several expenditure reviews to reveal how the resources are allocated and spent, but not necessarily issues of value-for-money and spending alternatives. A spending review would address these issues offering a different perspective.
	The Government should conduct regular review of the Monitoring and Evaluation Framework Lead: Cabinet, MoPS	Maintaining the Monitoring and Evaluation Framework is necessary for ensuring that the policies and actions are monitored and evaluated in the best possible manner.	The Government should invite the Head of State to act as a national SDG champion Lead: Cabinet, Parliament, MoPS	The Head of State represents the people and the nation, and his direct action on the promotion of development should have a positive impact on the overall development efforts and would attract the increased public interest.	The Government may undertake additional research required for the implementation of WNR 2019 recommendations Lead: MoDP	NSDP II is generally aligned to SDGs, however, the sectoral plans have not cascaded SDGs at the sectoral level, and this has to be addressed. The implementation of WNR 2019 recommendations is a must.
	The Government should introduce and enforce Gender Responsive Budgeting (GRB), as soon as possible Lead: MoF	Introduction of Gender Responsive Budgeting (GRB) would ensure that the resources are allocated to achieving gender goals stipulated in NSDP II, and other government policy documents.	MoDP should be charged with coordinating NSDP II and SDG implementation and coordination. It should be supported to build organisational capacity Lead: Cabinet, Parliament	At present, there are several technical groups and sub-committees with little sound coordination. The establishment of the NSDP II/SDG Secretariat would create a primary contact and administrative point for national development efforts.	The Government may conduct a review of SOEs/Public Enterprises in Lesotho Lead: MoF, MoPS	In all consultation documents leading to Plenary II, SOEs have been criticized by the public, as being dysfunctional. They do not contribute financially as they should, and the review is to trigger their comprehensive overhaul.
	The Government should strengthen the Monitoring and Evaluation capacity in MDAs Lead: Cabinet, MoPS	The Monitoring and Evaluation capacity differs between various MDAs, with districts being the weakest link. To improve the implementation of the framework, capacity must be raised.	BOS should systematically collect data, and regularly share it with MoDP (ensuring that the data on cross-cutting issues – gender and climate change are appropriately disaggregated) Lead: BOS	At present, the development-related information is collected and stored across the Government and this intervention should create a single collection/consolidation unit charged with the data collection.	The Government should conduct a review of the bilateral collaboration with IDPs Lead: MoDP, MFA	Lesotho, for several years, has engaged more with the multilaterals IDPs, but less with bilateral partners/donors. The review should inform the need for a policy shift.
	The Government should develop the effective information sharing protocols Lead: Cabinet, MoDP/BOS, MoF	At present, there are limited information sharing practices within the Government, which may lead to less-data-informed policy decision-making than it should be otherwise. Therefore, there is a need to ensure better information sharing.				



Appendix 7 - Table Summary of the Recommendations – Policies (continued)

Timeline	Monitoring and Review	Description	Governance and Coordination	Description	Further Assessment	Description
Medium-Term (3-5 years)	The Government should strengthen the capacity of BOS Lead: Cabinet, MoDP, MoF	It has emerged that BOS is under-resourced and its quality of data could be better, which would ultimately lead to the better-informed policymaking	Districts should create a simpler structure with one political and one technical body to oversee the implementation of NSDP II/SDGs at a district level Lead: MoLG&CA	Districts often imitate the central government and create similar top-heavy structures. It is proposed that they create a simple, lean, operational structure, and which delivers for the local populace	The Government should conduct a review of and explore the opportunities offered by the South-South and Triangular Cooperation (SSC) Lead: MoDP, MFA	Lesotho has traditionally been very successful in SSC funding and can further explore opportunities offered by SSC.
	The Government should adopt the policy of regular policy reviews and effectively enforce it Lead: Cabinet, MoPS	Government requires MDAs to periodically review their policies and strategies but this is not done on the regular intervals. This proposal is to ensure that the policies are reviewed regularly to ensure that the lessons learned are incorporated	The Government should ensure that the relevant current development structures are integrated within emerging INFF Lead: Cabinet, MoF, MoDP	For the success of INFF implementation, it is of utmost importance to ensure that all relevant stakeholders are included in the process, especially those who are already involved with the national development efforts.	The Government should commission a study on the domestic and international charities activities in Lesotho (with a special focus on cross-cutting issues – gender and climate change) Lead: Cabinet, MoDP	At present, the information on the domestic and international CSOs is sporadic and often incomplete. The study would provide a comprehensive picture of the sector, its current state and future capacity of CSOs in support of national development efforts.
	The Government should establish requirements and rules should include the sub-national level government to ensure that policies are reviewed in regularly Lead: MoLG&CA	Recently decentralised subnational governments often lack capacity and/or resources to review policies on regular intervals, hence the new regulations should ensure that reviews are conducted as prescribed.			The Government should complete the Gender Audit Lead: Cabinet, MoGYSR	Despite the legislation and regulation on gender issues, full equality has not been achieved. Consequently, it is difficult to assess the quality of policies from a gender perspective. A comprehensive audit would provide necessary information on gender issues and policies for further improvement.
Long-Term (5-7 years)	The Government should establish community-based Monitoring Systems and Local Data Labs (which should be able to capture all the locally generated data on the cross-cutting issues, such as gender and climate change) Lead: Cabinet, MoLG &CA, MoDP, BOS	Decentralisation of data-collection and appropriate data sharing protocols would ensure that the central Government has all the necessary information, but at the same time. Additionally, there would be enough data generation at local level for better informed local policy-making.			The Government should undertake SDG Investor mapping (with a special focus on cross-sectoral and cross-cutting issues such as gender and climate change) Lead: MoDP	Investor mapping provides a comprehensive picture on potential SDG investments, and a clearer picture on the investor priority groups, which with small investment would provide the best returns.



Appendix 7 - Table Summary of the Recommendations – Policies (continued)

Timeline	Monitoring and Review	Description	Governance and Coordination	Description	Further Assessment	Description
Long-Term (5-7 years)	The Government should enforce two types of reviews: a) internal and b) external. Lead: The Cabinet, MoPS	Internal reviews would be mainly light touch while the minor changes would be introduced whereas the external reviews would be major and would require the external participation (people outside MDA that conducts the review). The latter would ensure that the good practices are shared within the government or through the cross-fertilisation with the other sectors.				

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