Structural Adjustment Program in Lesotho

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Résumé: *L'objet de cet article est d'évaluer le programme d'ajustement structurel tel qu'il est appliqué au Lésotho. Le programme a été mis en place en 1988 par le gouvernement du Lésotho et le Fonds Monétaire International et devait, dans sa première phase, couvrir la période 1988-1991. Il avait pour objectifs de réduire les dépenses budgétaires, d'augmenter la production et de promouvoir les exportations. Le programme a été rendu nécessaire par les déficits chroniques de la balance des paiements et du budget. La grande faiblesse du programme réside dans le fait qu'il ne fait pas état des mécanismes par lesquels l'économie s'ajustera et, dans ces conditions, il est très peu probable que les déficits seront résorbés. Les politiques les plus crédibles sont celles qui restructureront le budget de telle sorte que les mécanismes de feed-back des dépenses du budget et de la balance des paiements deviennent modérés. En outre, à moins qu'un désinvestissement ne soit opéré et que le gouvernement consacre plus de temps à l'élaboration de la politique et qu'il reconsidère l'accord de l'union douanière de l'Afrique australe dans le but de le restructurer profondément, les perspectives d'industrialisation du Lésotho ne sont pas bonnes.*

The purpose of structural adjustment programs in broad terms is to reduce government intervention, encourage private initiatives and promote exports to pay for imports and debt servicing. Structural adjustment measures are normally prompted by chronic balance of payments and budget deficits in the face of rising inflation and increasing unemployment. Lesotho fitting this description, recently accepted the International Monetary Fund's (IMF) structural adjustment program (SAP) which is expected to run from April 1988 to March 1991 in the first instance. The objective of SAP is to correct both the budget and the balance of payments deficits and to promote private initiatives, production and exports. The IMF's short run concern is that the civil service is too large, subsidies to parastatals are a drain on the budget, external loans are too high and borrowing from external banks is excessive. Borrowing from local banks at high interest rates is also seen to be undesirable. Consequently, the country can only prosper if these trends can be reversed and enough savings can be generated for the promotion of industrial growth.

The purpose of this paper is to evaluate the structural adjustment program for Lesotho focusing on her industrial development. This program is still new so that our analysis is somewhat counter factual. Our comments are base on the Fourth Five-Year Development Plan 1986/87 - 90/91 which

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was drawn when the negotiations with the International Monetary Fund and the World Bank were started and other publications of the said institutions as well as government ones.

Industrial Structure

Lesotho is completely surrounded by South Africa and is only 30,000 sq. kms. in size, compared to South Africa's 1.2 sq. million kilometers of land mass. With 1.5 million people, Lesotho is also dwarfed by South Africa's 35 million population. And the kingdom's per capita gross domestic product in 1985 amounted to a mere $270 - less than a sixth of South Africa's $1,666.

Lesotho's small economy is inextricably linked to that of South Africa in several ways. First, together with Botswana and Swaziland, Lesotho is a member of the Southern African Customs Union (SACU). Under this Union, members maintain a common tariff against non-members and permit "free trade" among one another. The SACU is advantageous to the kingdom in that it represents a major source of government revenue. Annex 1 indicates that in 1985/86 the country received M161.1 million from customs and these receipts are expected to almost double to M228.7 in 1990/91 with or without structural adjustment. Customs revenue receipts average over 50% of total revenue sources of the country.

The migrant labor system serves as another key link between Lesotho's economy and that of South Africa. Some 140,000 citizens of the kingdom - about 60% of the total work force are employed in South Africa's coal and gold mines. Their earnings contribute to government coffers through customs payments and sales taxes collected on purchases made possible by their remittances to dependants back home. These two links and others play an important role in the success of development strategies adopted by Lesotho.

Since independence in 1965, the growth of the industrial sector has been erratic. Promoted by the Lesotho Industrial Corporation (LNDC), a parastatal, industrial effort concentrated on light import substitution and assembly type export promotion activities. The import substitution industries concentrated on food and beverage production and because of their capital intensivity have accounted for a disproportionate share of value added in the manufacturing sector as well as high cost per job created. On the other hand, the export oriented industries have been relatively successful and more labour intensive compared to import substitution ones mainly because they are concentrated in clothes, shoes and umbrella manufacturing. Currently LNDC is sponsoring in partnership with foreign entrepreneurs - 53 enterprises of which 32 are export oriented and 17 are in import substitution.

The small industries sector is promoted by Basotho Enterprise Development Corporation (BEDCO). It focuses on developing Basotho entrepreneurs particularly its domestic market. The Fourth Five-Year

Development Plan reports that this sector has registered some growth, accounting for 63 of the 67 new licences issued in the past five years. It should, however, be noted that these enterprises operate in the informal sector. Overall, the Plan reports that the manufacturing sector has generated 3,500 new jobs in the last five years at the cost of M2200 per job at 1984/85 prices.

The contribution of the manufacturing sector to GDP has stagnated at 5% since 1980 as indicated in Annex 2. Its real growth rate which was estimated at 11% in 1982/83 fell to -8.7% in 1983/84 rising slightly to 2.1% in 1984/85. The import substitution performance of Lesotho was measured and is reported in Annex 3. The results indicate that the performance of the sector has been negative over the period 1970/71 to 1980/82 suggesting that overall, this effort has not been successful.

The Budget Outlook

The fiscal effort required to service the debt can best be measured by the ratio of debt service to GDP. According to the Policy Framework Paper this ratio averaged 6% between 1983/84 and 1987/88 including interest and amortization. The World Bank[1] projections indicate that debt service as a percentage of total government expenditure is currently 9% and is expected to rise to 15% by 1987. According to the World Bank[2] the government deficit in 1986/87 was estimated at 15% of GDP, jumping from the 4% and 13% levels in the two previous years. These ratios reflect increasing expenditures, sharply rising interest payments on the national debt, payments to loss making parastatals and budget overruns by departments as well as recurrent costs that are increasing at a rate of 17%.

It is expected that without structural adjustment, government expenditures will rise from M321.9 million in 1985/86 to M639.8 million in 1990/91 as indicated in Annex 1. The expenditures will generate a deficit of from M68.8 million in 1985/86 to M188.5 million in 1990/91 without structural adjustment, which will fall to M98.5 million in 1991 with structural adjustment as indicated in Annex 4. These projections are given without indicating mechanisms or how the economy will adjust. This is in fact the major weakness of the program because a closer analysis of the relationships between the budget and the balance of payments indicate that expenditure feedback mechanisms will make it very unlikely that the projected changes will happen.

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1 World Bank, *Lesotho Country Economic Memorandum*, Report No. 6671.650, May 28, 1987:34).

2 Ibid. p. 27.

Structural Program

It is expected that the deficit will be reduced by both revenue increasing and expenditure reducing measures. In order to increase revenue, the tax base will be enlarged to cover public enterprises currently exempted, and income tax structure will be revised to allow for increased revenue collection. The collection of sales taxes will be improved by strengthening collection and reporting procedures particularly at the border with South Africa. However, given the open borders between Lesotho and South Africa, these rates cannot be increased by much beyond the current 12% without triggering illegal cross border trade. Sales taxes are already taxed two times. First, imported consumer goods assessed sales taxes in South Africa and the same rate is imposed again in the Lesotho market. These taxes will be regressive for the most part in that the poor will be unable to avoid them. However, the rich and people who have cars, and can travel with ease, can avoid them by buying in the neighbouring Bantustans where consumer goods are tax free.

According to the Fourth Five Year Development Plan, the size of the civil service is 11,492 with an average vacancy rate of 27%. Plans are underway to reduce the civil service and those targeted are daily paid and contract employees. But Annexes 1 and 4 indicate that despite these retrenchments, salaries will remain high. The success of these measures will depend on the extent to which fringe benefits will be controlled as well as wage and promotion freeze. More revenue may be saved through strict control on the use of consumables and utilization of government property.

The program requires that interest payments be controlled in order to reduce them. The first measure will be to accept non concessional loans and to avoid paying high interest rates. Some of the outstanding loans will be paid out of new non concessional loans where they can be raised and the shortfall will be carried by conditionality funds. Outside the external debt, some debt is from local banks including RMA capital markets. The interest rates in the RMA market are comparatively high because they are set by South Africa.

The monetary authorities in Lesotho are not obliged to set their interest rates according to RMA ones. They can keep an independent interest rate policy. Possibilities of capital flight are not an immediate problem because the commercial banks are highly liquid. Funds cannot shift easily to the RMA markets to take advantage of the interest rate differences because by law Lesotho banks can only deposit up to 25% of their funds in the South African capital markets. Increasing interest rates would mean that the banks are increasing the cost of idle funds. At the moment, this seems to be the tendency, because in 1985 when South Africa increased its prime rate to 25% to attract short term funds, Lesotho did likewise with the effect of increasing the cost of these funds.

High bank liquidity reflects two problems. First, the lack of bankable projects. Secondly, the monies held by the banks is short term deposits belonging mainly to migrant workers. By law, they can draw on these deposits at any time and even though the average balance is very high at any one time, the bankers are always fearful of a bank run in the event South Africa repatriated the migrant workers. The deposits are not insured because of high insurance rates and because these funds are idle, it would not be worthwhile to carry high insurance policies against them. As a result, keeping them in low risk accounts seems like a prudent policy at the moment. Restructuring may require separating out the accounts to free some monies for investment purposes. New institutions, such as investment banks may be considered. In order to achieve the program targets of reducing interest payments, from a projected rise of M59.3 million in 1990/91 compared to M44.5 million over the same period under structural adjustment changes at the policy level will also be necessary.

The cost recovery in government ministries is less than 5%, down from 15% in the past according to the Fourth Five Year Development Plan. The target to increase cost recovery from a 15% to 400% range through increasing user fees in health, education water, energy supply and grazing lands may work if applied selectively, without causing additional hardships. However, increasing cost recovery for public utilities may increase average costs to industry and may particularly cause a hardship on small entrepreneurs. If these rates are higher than those charged in South Africa, potential investors may be discouraged. Similarly, sales taxes on cars may be increased and if these are beyond certain critical ceilings, people may register their cars in South Africa, evoking some SACU clauses. In fact, it seems that many user charges that can be avoided at little cost, will be avoided and in some cases, protection will be granted under the SACU agreement. For example, under the agreement, South African registered heavy duty trucks as well as light ones can travel freely in Lesotho without special permission or payment of duties. On the other hand, only light Lesotho vehicles can travel in South Africa, but heavy duty trucks are not allowed except in very special cases. Does this not then suggest that reforms at the SACU level must be part of the restructuring program? Could this be an oversight on the part of the International Monetary Fund?

New taxes will include income taxes on more than 140,000 migrant workers employed in the South African mines. The migrant workers are about 50% of the country's labour force and currently, their contribution to government is indirect and it takes several forms: first, normally by agreement with the South African mining companies, the mine workers are allowed to spend 40% of their earnings in South Africa and the remaining 60% is sent home and is eventually remitted to the migrant worker in the form of domestic currency. The 60% in South African currency is the money remitted to the worker's family or is held for the worker until he returns. The money serves the function of supporting families, contributing to the sales tax through purchases of family members, adding to customs revenue through imports and finally easing the domestic unemployment problem.

All factors considered, income tax on migrant earnings would be an unreliable tax base since recruits are determined by employment conditions in South Africa where unemployment is increasing. At any one time, there are more blacks unemployed compared to whites in South Africa. In 1984, there were 14,128 whites unemployed while blacks were 492,000, Asians 18,650, and coloureds 63,000. These trends greatly influence the recruitment patterns.

An interesting point is that income is taxable up to M4,000.00 and taxing them would have implications on tax policy in that the taxable ceiling will have to be lowered for every body. In the event this is not done, tax avoidance will occur as some migrants will change their addresses to South African ones while others may smuggle themselves across the border to avoid authorities. If this proves to be cumbersome, there may be outright civil disobedience. The danger signals are clearly there and must be avoided.

Perhaps, if the objective is only to collect revenue, the much regressive poll tax could be considered. Otherwise, if the objective is to reverse the brain drain, such migrants could be taxed heavily. Already, Lesotho is experiencing high levels of the brain drain in that many educated people are leaving the country to work in industry and as teaching professionals in South Africa's Bantustans. To the extent that migrants are to be taxed, this group could be taxed heavily as a deterrent to migration and a way to force them to pay for the education they received in Lesotho.

A recent study[3] established that those accounting for the brain drain are not political but are economic refugees. They migrate to the Bantustans for purposes of increasing their earnings. Migration may be economically rational, but in terms of the priorities of the region, political considerations come first. Prah contends that these migrants, together with many others from elsewhere particularly, Ghana and Uganda, help sustain the apartheid system through their expertise. This may seem paradoxical for Basotho because they are nurturing the system that indirectly caused them to leave home. So that in their case, taxation should have several objectives. In the first place, it should make it unprofitable for them to migrate. And secondly, as part of restructuring they should be encouraged through negative

3 Prah, K., "Economic Refugees of the Bantustans: Ghanaians and Ugandans in the South African Homelands", *Southern Africa: Political and Economic Monthly*, vol. 2, No., 2, November 1988, p. 16.

incentives to return home so as to participate fully in the restructuring programme.

A comparison of revenue increasing and revenue reducing measures indicates that the deficit will be controlled mainly through the collection of revenue. Annexes 1 and 2 indicate that collection of both income and sales taxes is expected to increase. But, while revenues are expected to increase, the high expenditure items are projected to fall by small margins. These high expenditure items are indicated in Annexes 5 and 6 as recurrent expenditures, and salaries. Interest payments will add to savings because they will decline but net lending is expected to increase.

A comparison of salaries in Annexes 5 and 6 suggest that very little savings will be realized. Salaries will be M221.9 million in 1990/91 without SAP, compared to M210.7 million with SAP over the same period. Curtailing subsidies to parastatals may also have little effect. Public expenditure on industry is very small relative to total government expenditures accounting for about 2% of the total in the most recent five years[4].

The budget deficit is complicated further by the balance of payments deficit. Lesotho imports 90% of its consumer goods from South Africa but its exports have failed to match imports causing chronic current account deficits particularly against South Africa. The exports fell markedly in 1980 with the closure of diamond mines which contributed 60% to the country's total exports. Consequently, the percentage of imports covered by exports fell from 11% in 1987/89 to 8.4% in 1981/82 after the closure of the mines. Also, given the openness of Lesotho's economy, highlighted by the GNP/GDP ratio which was 1.8 in 1975, 1.7 in 1980 and 1.9 in 1986[5] it can be expected that with increased revenue, the propensity of government to import will increase.

The financing of imports is expected to be made through loans and the remaining balance will be financed under SAP stand by arrangements over a three period as follows: SDR3.0m in 1988/89; SDR4.4m in 1989/90 and SDR2.1m in 1990/91. Some of the funds will pay for the development of an export infrastructure and other areas of need as the government may determine[6].

The Expenditure Feedback Mechanism

The balance of payments and the budget sustain deficits through expenditure feedback mechanism. The feedback is triggered through the customs receipts

4 World Bank, *Public Expenditure Priorities in Lesotho*, Report No. 7243.LSO, September, 1988, p. 40.

5 World Bank report, 1987, op. cit. p. 14.

6 IMF, *Lesotho/IMF Policy Framework Paper* 1988/89-1990/91, Washington D.C., 1988.

paid out by South Africa. The first of the three payments is based on a two year projected estimate of a tax yield the second payment, called the first adjustment corrects for errors when more information is available and the third factor is called the stabilization factor whose propose is to insure that duty payments average 20% and fluctuate around this figure with an effective floor of 17% and a ceiling of 23%.

The customs revenue to Lesotho depends on three factors which are the average duty rate, the level of imports and the rate of growth for imports. The average duty is determined by South Africa as explained above while the level of imports and their rate of growth are determined by Lesotho. If the rate of growth of imports is expected to be high, the first estimate will be high. The rate of growth of imports is usually based on the expected rate of growth of migrant earnings and capital investments in Lesotho. To maximize customs revenue it is necessary to maximize migrant labour and to embark on projects with a high import content. The cost of revenue benefits may be explained by the lack of policies that protect small domestic entrepreneurs using local resources against competition with South African producers because such entrepreneurs are not seen to make a contribution to customs revenue. But in the long run an opportunity is being lost to develop a chance for a broadly based domestic tax structure.

The expenditure feedback seem like a permanent feature of the economy which will be difficult to break. But a start can be made by first setting a criteria for controlling expenditures as well as building revenue reserves. Without such criteria, unplanned expenditures will remain a feature that will always cause expenditures to deviate from revenue receipts. Initially expenditures could be targeted not to exceed receipt from internal sources and the first estimate of the customs revenue. Yields from the first adjustment and the stabilization factor could be targeted for contingencies while tax revenues could be targeted for recurrent expenditures.

Manufacturing Strategies

Industrialization is constrained by many factors and limits for adjustment are narrow. First, Lesotho will continue to depend on external resources for its investment program but unfortunately, these resources feed into the expenditure feedback mechanism. In recent years, the share of gross domestic investment financed by foreign savings declined from a peak of 35.6% in 1982 to -3.1% in 1985.

This situation is not expected to improve over the program period and efforts will be intensified to reduce subsidies through an intensified divestment program. Most industrial projects are joint ventures and by their nature involve the government in a lot of bureaucracy. The joint venture model[7] takes one of the following five forms: equipment and services industry, assembly work, component manufacturing, agro-industry, and brand name consumables. The first four forms attract foreign companies with external markets while the fifth tends to attract import substitution industries targeting local markets. As an example, in equipment and services the expatriate company provides the design and guidance, and markets the end product. The local partner performs the labour intensive part of the manufacturing process and is responsible for quality and delivery. Under branded name, producers may target the local market such as an example of beer manufacturing. This model is time consuming as it involves government agencies in drawing out negotiations. And, since this model puts an emphasis on project approach, little time is left to concentrate on macro economic policies.

Most economists argue that Lesotho must maintain an attractive incentive package to remain in competition with South Africa. For example, Thompson[8] made a comparative study of incentive packages in SACU and concluded that those offered by Lesotho were not competitive and suggested that they be raised. However, since this study was preliminary and indicative, it is safe to conclude that the relative attraction of these incentives packages has not been established. Some industrialists[9] have claimed that they were attracted to the country by incentives, but there is no way of determining whether they would have come if incentives were not available. It is likely that Lesotho may not be any worse off by adopting a conservative policy toward granting incentives. The tax holidays which will be retained during the program period suggest that the government will again be involved in a lot bureaucracy and will be left with little time to concentrate on much needed policy reforms.

Instead of concentrating on subsidy packages such as the ones that require cash transfers, efforts should be focused on policy initiatives. In the first instance, the SACU agreement should be scrutinized clause by clause to seek options at the disposal of Lesotho. In the past, the government has concentrated on studying clauses that pertain to revenue accruals. It is now imperative, that the country take advantage of SAP to employ expertise to look into the entire agreement and to determine areas of opportunities. It is likely that some aspects of this agreement are not always understood. For

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7 Decaux, B., "The Industrial Sector in Lesotho", Maseru, *Lesotho Development Corporation*, March 28, 1980, p. 41.

8 Thompson, J., *A Comparative Study of Incentives Offered to Foreign Manufacturing Investment in Lesotho and Nearby Countries*, Maseru, Lesotho Development Corporation, 1980.

9 Kirk, R.M., "Industry in Lesotho", *Central Bank of Lesotho Quarterly Review*, vol. 3, No. 1, March 1984.

example, in 1976, the Ministry of Finance was forced to pay into the customs union pool, millions of Rands for a TV assembly plant that failed. The funds were paid on importation of equipment and inputs that were not used but were imported from outside SACU. Payment was required under Article 4. Under Article 4 Lesotho cannot import intermediate goods duty free from outside SACU while South Africa can do so. Article 4 contradicts Article 6 which allows a member country to impose infant industry protection. It would seem as if a better understanding of the agreement could have saved some money because this industry might have been introduced under Article 6 and also provided with Article 7 status described below. The agreement clearly has many ambiguities which must be understood or rewritten.

In addition, since the target market was SACU, the project could not go ahead because of the restrictions in other clauses. Under Article 6 a member of SACU cannot set up an industry if such an industry already exists in one of the member countries. At this time, Swaziland already had an assembly plant of its own and South Africa was contemplating starting one making it difficult for Lesotho to enter the market. In other cases, Article 7 requires that the specified industry prove that it would supply 60% of the market in the first instance before it can receive protection under SACU. Given her resource constraints, Lesotho cannot meet these requirements and no industry can within a short period of time. Lesotho has not taken advantage of Article 6 partly for fear of retaliation and partly, because of inability to identify import substitution industries that show the potential to succeed under such protection. But how much of this reluctance may be due to not understanding the agreement, should be one of the tasks of SAP to determine.

Another aspect of Article 4 is that Lesotho does not qualify for duty free import of inputs into industry. Duty free where Lesotho is concerned, is defined in Article 4 of the agreement to include only imports intended for disaster relief, those under technical assistance agreements as well as those tied to international obligations. Consequently, Lesotho cannot purchase inputs from alternative sources outside SACU. She must buy from South Africa. Further, Lesotho is land locked and it depends on South African ports for access to the sea. However, Lesotho exports must be carried on South African rolling stock which have proven to be unsatisfactory because of what is seen by Lesotho to be deliberate delays, wastage and costly. Road permits are often refused.

The political equation plays an important role in defining the relationship between the two countries. Politically, South Africa otherwise known for its racist policies would like to see Lesotho cooperate openly while the latter fearful of political isolation would not. Lesotho must continuously strive to balance its foreign policy between economic cooperation with South Africa and policies of nonalignment internationally. Consequently, its survival as a nation is largely contingent on its economic ties with South Africa, but, it must not be seen as an appendage of the minority ruled state if it is to retain recognition within the international community. This tendency to balance the two constituencies has left the country in a dilemma and without a definite economic policy. Lack of an articulated economic policy has made her an unwitting victim of South Africa's economic policy in most respects. While Lesotho is playing a balancing game, South Africa maintains a strong economic policy intent on keeping Lesotho as a market for raw material and finished goods as the clauses of the SACU agreement indicate.

Exchange Rates

The leverage of monetary control will be left to South Africa during the program period. Lesotho has a monetary authority which partially fulfils the functions of a central bank. Money supply is controlled by South Africa and the Lesotho Loti exchanges on a one to one basis with the Rand. For each Loti in circulation, there must be a Rand held against it at the South African Central Bank. The South African Rand is legal tender in Lesotho while the Lesotho Loti is not legal tender in South Africa. This arrangement has had its advantages and disadvantages. The benefit of membership to Lesotho is that the Rand and the Loti circulate and exchange freely in Lesotho suppressing the need for foreign exchange particularly for intra-RMA trade. The disadvantage is that the fortunes of the Loti rise and fall with those of the Rand often increasing the debt service burden of Lesotho, without increasing exports. Since 1980, the Loti/US dollar exchange rate depreciated from M0.80 to M2.8 in 1986 as a result of the depreciating rand caused by political unrest in that country. In addition, the substantial nominal depreciation of the rand have not reduced imports from South Africa.

In addition to the secular depreciation of the Rand, Lesotho is disadvantaged by the fact that the Rand is a dual exchange currency divided into a commercial and a financial Rand. As a commercial Rand, it exchanges at commercial rate and as a financial Rand it exchanges at a discount of up to 40%. The financial Rand is applicable only to investment in securities and its transactions are limited to the Johannesburg Stock Exchange. Since Lesotho does not have a developed money market she is unable to attract capital on these terms.

Lesotho could correct the financial Rand anomaly by establishing one of her own and calling it the financial Loti. This should work in the same manner as the financial Rand, but instead of trading at the stock market, it should be traded internally through the Lesotho Monetary Authority. The advantage to Lesotho is that she could be in a position to attract small investors and also take advantage of SADCC wide projects that may be attracted by discounted exchange rates. And since the debt service capacity of Lesotho has been adversely affected by the secular depreciation of the

Rand, Lesotho could consider establishing bilateral exchange rates with her creditors that would keep her exchange rate favourable and independent of events in South Africa. Effectively, she could have a three way exchange rate: the commercial Loti which could exchange on one to one basis with the Rand, a financial Loti, which could be at par with the financial Rand, and a bilateral Loti reserved for trade which could have a value higher than that of the commercial Rand.

Lesotho is currently involved in a multi-million dollar water project. The objective of the project is to develop water and electricity exports to South Africa. Exports are expected to start in ten years. The restructuring program could begin now to determine how these exports will affect the value of the Loti relative to the Rand and to establish methods of payment that would put the Loti at an advantage.

Future Prospects

Economic restructuring must address two important issues which are macro-economic policies and divestment. Macro-economic policies should be focused on moderating the expenditure feedback mechanism of the budget and the balance of payments. Government intervention in the economy has had its advantages but may now have reached its limits. In the first instance it was required to set up the necessary infra-structure which was not there at the time of independence. The infrastructure included roads and serviced sited among other initiatives. The benefits of these initiatives were directed at parastatals and linkages with the broader private sector were not developed. Instead, the thrust of the parastatals was narrow because the focus was also narrow. The established incentives were intended to promote the growth of the parastatals and they were often exempted from paying taxes and other costs for as long as they could justify that they would promote employment, an objective that carries a high premium with the government.

The employment objective has come at a high price. First, the joint venture model already described above is time consuming and often extends the time of production to an average of five years from the time negotiations start to the time production actually begins. In addition, because this model is export oriented, by absorbing all the government resources, the government has lost opportunities to develop policies that would promote local enterprise. Most government officials find production for export comfortable because it can be achieved in isolation without requiring policy changes which would most inevitably call for negotiations with South Africa. Since these industries are assembly type, inputs are imported, assembled into the final product and exported.

The preoccupation with negotiating joint ventures and allocating subsides has left few resources for the government to concentrate on broader macro economic policies. This, therefore, makes a strong case for government to adopt new industrial strategies that would include divestment and promote mixed participation in the economy on set criteria. The advantages of divestment are that direct budget subsidies would be reduced; the expenditure feedback mechanism would be moderated as the need to maximize customs revenue would not be there and the possibility of broadening sources of the sales tax could be available as the economy's indigenous direct cash subsidies could be rationalized to apply only to a few categories. The incentive strategy should aim at providing non cash subsidies to save on recurrent costs and to reduce dependence on government hand outs. Industries could be limited to subsidies of low interest loans, fewer tax holidays, but plenty of investment credits to promote capital accumulation.

The cost of divestment may be reflected in distributional effects. Given the size of Lesotho and its proximity to South Africa, the divestment program tends to attract foreign investors especially in import substitution activities. LNDC started its divestment policy in 1978 when it sold its equity in some companies. In the first five years of the program, companies put up for sale have been bought by foreigners. The main reason being that Lesotho does not have well trained managers and entrepreneurs with enough funding. In cases where the companies sold are export oriented, foreigners have an edge over local entrepreneurs because they have a better knowledge of foreign markets[10].

The benefits of divestment must be weighed against the costs. If the divestment program is to be undertaken, controls must be instituted to ensure that local entrepreneurs participate fully. The government could explore divesting out to management, the chamber of commerce, cooperatives and vocational schools. The divestment program should be selective so that enterprises with greatest social benefits continue to enjoy direct government support.

Restructuring pricing strategies may improve the participation of farmers. The current pricing structure tends to subsidize the middlemen at the expense of both the producers and the consumers. Producer prices are low and they do not always cover the cost of production. The mark-up on inputs to farmers and the mark down on their produce greatly lowers their gains which are distributed to the marketing boards and the milling companies. The consumers do not benefit because their prices are determined by imports. The import market is dominated by a few chain stores which charge

10 K. Nowacki, "Parastatal Development Corporations Policies in Regard to Localization of Industrial Growth in Particular Through Divestment in the Kingdom of Lesotho", Maseru: *Lesotho Development Corporation*, project LES/81/001, 1981, p. 11.

monopoly prices. These prices, when marked up by sales taxes reduce the welfare of consumers. As a result of the distortions caused by the pricing structure, farmers tend to engage in market avoidance by being involved in illegal cross border trade.

Wool is one of the major exports of the country. But the wool exporters are in dilemma in that their export markets in Europe prefer unprocessed wool. These markets prefer it with the fat which they use to produce other by products such as toiletries. Restructuring the product and developing new markets may be another task to be undertaken during the structural adjustment program. Wool production is fully indigenous.

Rolling Plan

In order to gain control of the budget, the government should consider introducing rolling development plans. The advantage of a rolling plan is that it would enable the government to monitor the performance of the economy over a short period of time and the need for contingency expenditures would also be reduced. Conditionality funds could be used to cover the costs of selective divestment and to conduct studies that would recommend appropriate macro-economic policies. The recommended macro-economic policies should focus on moderating the expenditure feedback mechanism between the budget and the balance of payments. In addition, policies that could pluck unnecessary leakages should be put in place. Renegotiating substantially the SACU agreement may be advisable in order to open up market alternatives for Lesotho. Issues such as the right of transit are outstanding otherwise future industrial options will remain narrow.

Annexes

Annex 1 : Government Financial Operations
Without Structural Adjustment

	85/86 Actual	86/87 Est.	87/88 Proj.	88/89 Proj.	89/90 Proj.	90/91 Proj.
Total Exp.	321.9	360.8	420.5	488.6	561.2	639.7
Revenue & Grants	253.1	273.2	308.4	357.2	401.8	451.1
of which: Revenue	243.1	259.7	292.0	338.1	379.9	426.2
Customs	161.1	144.3	157.6	183.5	204.4	228.7
Sales Tax	19.8	42.0	49.1	56.7	64.5	72.9
Income Tax	17.9	21.5	25.3	29.5	33.9	38.6
Company Tax	7.5	10.0	11.8	13.7	15.8	18.0
Other	36.7	41.9	48.2	54.7	61.3	68.0
Grants	10.0	14.0	16.5	19.1	22.0	25.0
Total Exp.	321.9	359.7	409.1	475.8	547.8	625.9
Recurrent Exp.	224.2	269.7	320.9	373.2	430.1	492.2
of which: - Salaries	108.4	123.1	145.3	169.3	194.7	221.9
- Interest	20.8	29.7	37.7	43.3	50.8	59.7
- Other	95.0	116.8	137.9	160.6	184.7	210.6
Capital Exp. & Net Lendg.	97.8	75.0	88.3	102.6	117.7	133.8
Deficit (-) Surplus	-68.8	-87.1	-112.1	-131.4	-159.3	-188.5
Net Financing	68.8	87.1	112.1	131.4	159.3	188.5
Foreign Financing	29.8	27.6	36.9	44.2	51.7	62.6
Borrowing	57.9	45.8	55.3	64.2	73.7	83.7
Amortization	28.1	18.1	18.4	20.0	21.9	21.2
Domestic Financing	39.0	59.5	75.2	87.2	107.6	126.0

Source: ***Fourth Five Year Development Plan 1986/87 - 90/91.*** **Maseru: Ministry of Planning, 1987, p. 91.**

Annex 2 : Industrial Sector's Contribution to GDP
1980/81 - 84/85 (Million Maluti)

	1980/81	1981/82	1982/3	1093/84	1984/85
Manufac. at current prices	11.0	13.5	19.2	19.1	22.3
Handicrafts at current prices	3.7	4.4	5.0	5.8	6.6
Total	4.7	17.9	24.2	24.9	28.9
Total as % of GDP	4.57	5.14	6.38	5.59	5.62
Total in 1984-85 prices	23.3	25.9	31.0	28.3	28.9
Real growth rate of ind. sec.	-	11.1	19.7	-8.7	2.1

Source: Ministry of Trade and Industry in *Fourth Five Year Development Plan, 1986/87 - 90/91*. Maseru: Ministry of Planning, 1987, p. 44.

Annex 3 : Import Substitution in Lesotho Economy - 1974/75 - 1980/83

Period	Q	M	S	U	ΔU	ΔQ	ΔUxS	ΔUxS/DQ
1974-75	98.00	96.10	194.10	0.50	0.00	0.00		
1975-76	111.00	139.50	250.50	0.44	-0.06	13.00	-20.65	-1.59
1976-77	143.30	191.00	334.30	0.43	-0.08	45.30	-31.62	-0.70
1977-78	186.40	228.40	414.80	0.45	-0.06	88.40	-28.64	-0.32
1978-79	249.80	266.10	515.90	0.48	-0.02	151.80	-12.53	-0.08
1979-80	267.10	338.50	605.60	0.44	-0.06	169.10	-45.22	-0.27
1980-81	321.70	386.60	708.30	0.45	-0.05	223.70	-43.48	-0.19
1981-82	348.50	509.00	857.50	0.41	-0.10	250.50	0.00	

Q = Domestic Production | D = Final Domestic
M = Imports | E = Exports
R = Intermediate Demand | S = Q + M = Total Supply

1. $\Delta S = \Delta R + \Delta D + \Delta E$ = Change in total supply
2. $U_1 = Q_1 / S_1$ = Ratio of domestic production to total supply in the base year
3. $U_2 = Q_2 / S_2$ = Ratio in the next period
4. $\Delta Q = U_1 (\Delta R + \Delta D) + U_1 (\Delta E) + (U_2 - U_1) \times S_2$

where $U_1 (\Delta R + \Delta D)$ = change in domestic output of intermediate goods and final domestic demand on the assumption of a constant U_1

$U_1 (\Delta E)$ = change in domestic output for exports on the assumption of a constant U_1

5. $(U_2 - U_1) \times S_2$ = change in domestic supply output as a proportion of total supply to
6. $\dfrac{(U_2 - U_1) \times S_2}{\Delta Q}$

Expression (5) is the Chenery measure of import-substitution while expression (6) is that of Desai

Source: *Annual Statistical Bulletin*, 1981/82/83, Maseru: Ministry of Planning and Statistics.

Annex 4 : Government Financial Projections Without Structural Adjustment

	85/86 Actual	86/87 Est.	87/88 Proj.	88/89 Proj.	89/90 Proj.	90/91 Proj.
Revenue & Grants	253.1	274.7	321.3	385.7	448.6	518.5
of which: Revenue	234.1	259.7	299.0	353.9	405.9	463.3
Customs	161.1	144.3	157.0	183.5	204.4	228.7
Sales Tax	19.8	42.5	54.1	67.8	82.8	98.4
Income Tax	17.9	21.5	26.1	31.1	36.4	42.3
Company Tax	7.5	10.0	11.9	13.9	16.0	18.3
Other	36.7	41.9	49.4	57.6	66.2	75.5
Grants	10.0	14.0	22.3	31.8	42.8	55.2
Total Exp.	321.3	360.7	416.4	478.2	543.6	616.5
Recurrent Exp.	224.2	269.7	311.5	355.7	402.4	455.1
of which: - Salaries	108.4	123.1	142.8	163.5	185.6	210.7
- Interest	20.8	29.7	33.2	37.0	40.7	44.5
- Other	95.0	116.8	135.5	155.2	176.1	199.9
Capital Exp. & Net Lending	97.8	91.2	104.8	122.5	141.2	161.4
Deficit (-) Surplus	-68.8	-87.1	-95.1	-92.4	-95.3	-98.5
Net Financing	68.8	87.1	95.1	92.4	95.3	98.5
Foreign Financing	29.8	27.6	33.7	37.1	40.7	45.7
Borrowing	57.9	45.8	52.0	57.1	62.0	66.9
Amortization	28.1	18.1	18.4	20.0	21.9	21.2
Domestic Financing	39.0	59.5	61.5	55.4	54.9	52.0

Source: *Fourth Five Year Development Plan 1986/87 - 90/91.* Maseru: Ministry of Planning, 1987, p. 92.

Annex 5 : Projected Expenditures Without Structural Adjustment 1986/87 - 1990/91 (Million Maluti)

	85/86 Actual	86/87 Est.	87/88 Proj.	88/89 Proj.	89/90 Proj.	90/91 Proj.
Total Exp.	321.9	360.8	420.5	488.6	561.2	639.7
Recurrent Exp.	224.2	269.7	316.3	367.5	422.3	481.8
Salaries	108.2	123.1	145.3	169.3	194.7	221.9
Interest	20.8	29.7	33.2	37.7	42.9	49.3
Other	95.0	116.8	137.9	160.6	184.7	210.6
Cap. Exp. & Net Lending	97.8	91.2	104.2	121.1	138.6	157.9

Source: *Fourth Five Year Development Plan 1986/87 - 90/91*. Maseru: Ministry of Planning, 1987, p. 90.

Annex 6 : Summary of Projected Expenditure 1986/87 - 1990/91 With Structural Adjustment (Million Maluti)

	85/86 Actual	86/87 Est.	87/88 Proj.	88/89 Proj.	89/90 Proj.	90/91 Proj.
Total Exp.	321.3	360.7	416.4	478.2	543.6	616.5
Recurrent Exp.	224.2	269.7	311.5	355.7	402.4	455.1
Salaries	108.4	123.1	142.8	163.5	185.6	210.7
Interest	20.8	29.7	33.2	37.0	40.7	44.5
Other	95.5	116.8	135.5	155.2	176.1	199.9
Cap. Exp. & Net Lending	97.8	91.2	104.8	122.5	141.2	161.4

Source: *Fourth Five Year Development Plan 1986/87 - 90/91*. Maseru: Ministry of Planning, 1987, p. 92.