Kingdom of Lesotho and the IMF

Press Release:
IMF Executive Board Completes Second and Third Reviews Under Extended Credit Facility Arrangement for the Kingdom of Lesotho, and Approves Request for Augmentation of Access and US$13.42 Million Disbursement April 9, 2012

March 23, 2012

The following item is a Letter of Intent of the government of Kingdom of Lesotho, which describes the policies that Kingdom of Lesotho intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Kingdom of Lesotho, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
Kingdom of Lesotho: Letter of Intent

March 23, 2012

Ms. Christine Lagarde  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
United States of America

Dear Ms. Lagarde,

This letter and the attached Memorandum of Economic and Financial Policies (MEFP) update and supplement my communication of February 24, 2011; describe performance under the government’s economic program, and outline the Government’s economic policies and program for the remainder of 2011/12 and 2012/13.

Lesotho was hit by successive shocks that had a devastating effect on infrastructure, people and Government fiscal operations. A sharp decline in SACU revenue of more than 50 percent in 2010 was followed by devastating floods in early 2011, whose impact is estimated at about M700 million (Seven Hundred Million Maloti) and has affected about 600,000 (Six Hundred Thousand) people or 58 percent of the population. In response, the Government embarked on a program of rehabilitation and fiscal consolidation aimed at rebuilding our reserves from the current low level of three months of import cover to at least 5 months of coverage over the medium term. In this regard, we are seeking external support, including additional financial support from the IMF. Notwithstanding these severe shocks, we have been successfully implementing economic and financial policy reforms which the Fund is supporting through a three-year Extended Credit Facility (ECF) arrangement.

All performance criteria through end-March 2011 and end-September were met. Structural reforms have progressed albeit with some delays. Five out of eight structural benchmarks (SBs) due under the second and third reviews were implemented while the other three have not yet been implemented. The new Financial Institutions Act has been passed by both Houses of Parliament and is now in force, while the audit of domestic arrears (a benchmark for March 2011) has been delayed and is now expected to be completed by March 2012. This is due to the problems with the Integrated Financial Management Information System (see Table 2 of the attached MEFP).

Regarding the National Strategic Development Plan (NSDP), I am pleased to inform you that Cabinet has approved the NSDP subject to final editing and inclusion of a Foreword by The Right Honourable The Prime Minister prior to printing. The NSDP describes the
Government's strategy for high and sustainable growth, employment creation and poverty reduction and covers the period 2012/13–2016/17. We expect the NSDP to be used as a basis for the Joint Staff Advisory Note (JSAN) jointly prepared by the staffs of the World Bank and the IMF.

The NSDP is an outcome of the joint effort by all Basotho, the Government and Development Partners who participated through working groups and public consultations. On behalf of the Government of Lesotho, I would like to extend to you our gratitude for the support of the Fund in the NSDP preparation process. We look forward to working with the IMF in ensuring effective and full implementation of the NSDP. The NSDP will also be posted on our website, http://www.gov.ls/. We have no objection to the publication of the NSDP on the IMF website as well.

In view of the foregoing, the Government of Lesotho requests (i) the completion of the second and third reviews, (ii) the augmentation of access to resources under the ECF arrangement by an amount of SDR 8.73 million (equivalent to 25 percent of quota), and (iii) disbursement of the third and fourth tranche under the arrangement, equivalent to SDR 20.085 million (57.6 percent of quota), which includes the proposed augmented amount. Performance criteria and structural benchmarks for 2011-12 are included in Tables 1 and 3 of the MEFP.

We continue to believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, notwithstanding the new macroeconomic challenges we face. The Government however, stands ready to take any further measures that may become necessary to achieve our policy objectives. The government of Lesotho will consult with the IMF—at its own initiative or whenever the Managing Director of the IMF requests such a consultation—on the adoption of these measures and in advance of any revisions to the policies contained in the MEFP. These consultations will be in accordance with the IMF’s policies on such consultations.

The Government will provide such information as the IMF may request in connection with the progress made in implementing the economic and financial policies, and achieving the objectives of the program. The Government authorizes the IMF to publish this letter, the attached MEFP and TMU, and the related Staff Report, including placement of these documents on the IMF website.

Yours sincerely,

/s/

Hon. Timothy T. Thahane,
Minister of Finance and Development Planning

Attachments
Kingdom of Lesotho: Memorandum of Economic and Financial Policies for 2011/12–2012/13

I. INTRODUCTION AND BACKGROUND

1. The Government of Lesotho firmly reiterates its commitment to the medium-term economic program supported by the ECF arrangement. As laid out in the MEFP dated February 24, 2011, our program aims at restoring fiscal and external sustainability, while limiting the adverse impact of fiscal consolidation on the poor and vulnerable groups; mitigating the impact of external shocks and achieving broad-based growth for sustained poverty reduction; and strengthening the financial sector and the business climate.

2. This memorandum:

   - Describes the recent economic developments, including the impact of the floods on the economy in late 2010 and early 2011.

   - Reviews macroeconomic and financial performance under the ECF-supported program through end-September 2011.

   - Updates the MEFP of February 24, 2011 and describes macroeconomic and financial policies for the remainder of 2011/12 and 2012/13.

II. RECENT ECONOMIC DEVELOPMENTS

3. Despite the significant drop in Southern African Customs Union (SACU) revenues in 2010/11, we have made remarkable progress in economic reforms and achieved large fiscal consolidation. The fiscal deficit for 2010/11 was reduced to 5 percent of GDP, reflecting strong revenue performance including windfall SACU revenues, a large dividends payment from the Central Bank of Lesotho (CBL), and efforts to contain spending. The core SACU fiscal balance improved significantly (by some 15 percent of GDP) from a deficit of 20 percent of GDP in 2009/10 to a deficit of 5½ percent of GDP in 2010/11. This

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1 This compared with original projection under the program of 19 percent of GDP, and budgeted deficit of 12.3 percent of GDP.

2 The SACU revenues received in 2010/11 were significantly larger than originally projected.

3 SACU revenues are separated into core component (equivalent to 15 percent of GDP being the lowest annual receipt in the last two decades) and noncore component (the rest). The core fiscal balance is defined as the fiscal balance excluding the noncore component of SACU revenues and the foreign project loans.
Breda achievement in fiscal adjustment also helped to limit external imbalances, despite rising international commodity prices. The level of reserves stood at $961 million at the end-2010/11, much higher than the original program projection of $855 million.

4. The floods in early 2011 caused widespread damages and loss of lives. According to the 2011 Post Disaster Needs assessment (conducted jointly with Lesotho’s development partners), 250,000 people (13.6 percent of the total population) were affected by the floods. With heavy losses of crops and livestock, significant food imports were required. Infrastructure damages (roads, water and sanitation) have also been significant. Under these circumstances, we made budgetary provision in 2011/12 (2.2 percent of GDP) to cover some of the costs of recovery and rehabilitation, some of which programs will carry over into 2012/13.

5. A combination of the global food and oil price shock and the floods has taken a heavy toll on our economy, requiring additional external assistance. Preliminary estimates put the financial requirements for post-flood recovery and reconstruction at M649 million (about 3½ percent of GDP) for both public and private sectors. The reconstruction, together with the surge in international commodity prices, also increased our import costs by about 4 percent of GDP compared to what was projected when we embarked on the ECF-supported program. Thus far, our development partners have pledged US$2.8 million, of which will be disbursed in 2012/13. We have been seeking further external support, including the augmentation of the ECF arrangement.

6. Lesotho’s medium-term macroeconomic prospects remain challenging despite a modest growth recovery. Economic growth is expected to improve, with the expansion of mining activities and the implementation of large infrastructure projects (including the Metolong dam). At the same time, however, the current account deficit is expected to increase in 2011/12 resulting from increased imports which will lead to further pressures on international reserves. In the short-term, our main challenge is to sustain our fiscal consolidation efforts while meeting our urgent reconstruction and development needs. Looking forward, the uncertain global economic outlook is also a source of concern.

III. Performance Under the Program

7. Overall performance under the ECF-supported program has been strong. All quantitative performance criteria for end-March 2011 and end-September 2011 were met. The indicative target for the floor on social spending was also met (Table 1).

8. Structural reforms are also progressing, albeit with delays in some areas (Table 2). In the financial sector, the implementation of the Financial Institutions Act will pave the way for further strengthening of the supervisory and regulatory framework for banks and non-bank financial institutions. A plan for capacity building in line ministries to
prepare medium-term expenditure frameworks (MTEF) has been produced; and work has begun to prepare regulations for implementation of the National Lease Financing proposal, consistent with the new Financial Institutions Act (FIA). The review of the Cooperatives Societies Act and the launch of a partial credit guarantee scheme have been completed, albeit with some delays. On the audit of domestic arrears, however, progress has been made following the establishment of a task team in December 2011. On the front office revenue receipting system, to ensure smooth introduction, the work has begun with three pilot ministries and one sub-accountancy. The Industrial Licensing Bill has been drafted and submitted to the Attorney General for approval.

IV. MACROECONOMIC POLICIES UNDER THE PROGRAM

9. We remain committed to a fiscal consolidation program aimed at achieving a sustainable fiscal and external position over the medium term while addressing our development and social needs. In support of our exchange rate peg, significant fiscal consolidation is called for to restore macroeconomic stability and preserve an adequate level of international reserves. We continue to make efforts in cutting non-productive expenditures while creating fiscal space for critical infrastructure projects and for support to vulnerable groups. The current account imbalance is expected to narrow over the medium-term, in line with fiscal consolidation, supported by strong performance in the mining sector. We expect that the implementation of our medium-term policy framework will restore fiscal and external sustainability.

10. Over the medium-term, to achieve our objective of sustained economic growth as the most effective route for poverty reduction, we will also make further efforts in increasing Lesotho’s resilience to shocks and promoting private sector development. To prepare for future shocks, we intend to gradually rebuild the international reserves buffer, raising international reserves toward the equivalent of five months of imports. A public debt management strategy will be formulated to support fiscal and debt sustainability. To achieve sustained growth and increase employment, we will also promote private sector development through enhancing access to credit and improving business climate. In this regard, the government has committed to implementing a set of comprehensive reforms under the National Strategic Development Plan (NSDP).

A. Macroeconomic Policies for the remainder of 2011/12

11. We will make further progress in fiscal consolidation while securing flood-related capital outlays. Despite the high costs of rehabilitation of flood-damaged infrastructure (2.2 percent of GDP), included in the 2011/12 budget, we have maintained tight limits on recurrent expenditure. As a result, the fiscal deficit is projected at 10½ percent of GDP in 2011/12, even tighter than the adjustment program agreed to during the first review, and compatible with restoring macroeconomic stability. To enhance the efficiency of
revenue administration, LRA has embarked on broadening the tax base by expanding the taxpayer’s registration. In the event that fiscal revenue is better than expected, the available resources will be used to build up our deposits at the CBL.

Seeking external financing

12. High international commodity prices and the floods have created large financing needs, for which we are seeking external support, including an augmentation of the ECF arrangement in an amount equivalent to SDR 8.73 million (25 percent of quota). High international fuel and food prices have added substantially to import costs, and the loss of crops caused by the flooding has necessitated significant reconstruction and emergency food imports (estimated at about US$60 million). To seek donor support, we presented our case at an international disaster management conference in Geneva in May 2011. Operational guidelines for the Disaster Risks Reduction Fund were prepared in November 2011, for which the total of US$2.8 million has been pledged by UN Central Emergency Response, UNDP, Ireland, People’s Republic of China, and OCHA. The fund will be operational in 2012/13.

13. To ensure debt sustainability, the government will continue to seek external financing through grants and concessional loans and save any unplanned inflows. As agreed with the IMF, non-concessional financing will be limited to the European Investment Bank loan for the Metolong Dam Project. In addition, we are assessing options for the medium-term financing of the second phase of the Lesotho Highlands Water Project, which, as an enclave project, is unlikely to be available on concessional terms.

B. Macroeconomic Policies for 2012/13 and beyond

14. To achieve our medium-term objective of rebuilding international reserves in support of the peg, we will maintain our adjustment efforts. While SACU revenues are projected to increase, we will target a deficit limit in the core SACU fiscal balance of 8.6 percent of GDP for 2012/13. Accordingly, we intend to step up fiscal consolidation by (i) freezing new positions (excluding those related to education, police and defense), (ii) keeping civil servant wages constant in real terms, (iii) reducing non-priority outlays through stricter expenditure control, and (iv) establishing strict guidelines to limit contingency spending to emergencies. We remain committed to further containing recurrent expenditures, especially spending on goods and services, while protecting spending for vulnerable groups and some priority infrastructure and ensuring efficiency in public service delivery. On the revenue side, we will undertake a full restructuring of the Lesotho Revenue Authority (LRA) in 2012/13, including the operationalization of a full-service Large Tax Payer Unit by end-March 2013, that will cater to medium-to-large taxpayers. The LRA continues to implement core business processes and enforcement strategies designed to strengthen revenue collection, by improving recovery of unpaid taxes, strengthening compliance and service delivery. In case
SACU revenues are higher than anticipated, the available resources will be used to build up deposits at the CBL. If SACU revenues are projected to decline over the medium-term, we will undertake offsetting measures to reduce spending on goods and services.

C. Structural Reforms

Public Financial Management

15. **PFM reforms will continue, with the support of our development partners, to improve the efficiency of our budget process.** Steady progress has been made, but challenges remain, including problems with the functionality of IFMIS. Cash management will be further strengthened through the establishment of the Cash Management Unit, and a comprehensive inventory of all government accounts, including those at commercial banks, will be undertaken by December 2012 (structural benchmark). By March 2012, we will start implementing a front office revenue receipting system in three ministries and one sub-accountancy, capturing all non-tax revenues from these pilot ministries in the IFMIS (structural benchmark). Activities will also focus on further improvements in the functionality of IFMIS, resolving interface and other IFMIS problems, and increasing staff training in the use of the system.

16. **With a view to strengthening expenditure management, we will step up our efforts to clear domestic arrears with assistance from our development partners.** Drawing upon the recommendations of an IMF technical assistance team, we have formulated a time-bound audit plan with a view to completing an audit of domestic arrears by March 2012 (structural benchmark). We have given instructions to line ministries to verify the data in the system each month and to report any arrears on monthly basis. We intend to modify a legal framework for allowing the recognition of electronic documents. This is critical for expediting the government payments and the reconciliation of treasury and the central bank accounts. We are also committed to preventing the emergence of new domestic arrears in the future by implementing processes that ensure timely payments to suppliers.

Supporting financial sector development

17. **We have strengthened our legal framework to promote financial sector development.** Following the enactment of the new FIA in February 2012, a time-bound action plan for its effective implementation has been prepared, and work is also underway to prepare regulations for nonbank financial institutions by mid-2012. The FIA empowers the CBL to deal effectively with unlawful business practices, including Ponzi schemes, and to regulate and supervise nonbank financial institutions (money lenders, foreign exchange bureau, and microfinance). In addition, by mid-2012, we plan on advancing the work to modernize Postbank (e.g., mobile banking) and expand its services to the rural areas,
introducing the new Insurance law, and formulating the new pension and retirement fund law.

**Improving productivity and the investment climate**

18. **We will continue to work closely with our development partners to implement reforms that will facilitate private sector development and economic diversification.** A number of reforms aimed at improving the business environment have been implemented, and several are underway. The Partial Credit Guarantee Scheme was launched in August 2011, with a view to allowing greater access to credit by small and medium enterprises. The Companies Act 1967 has been reviewed and the new Companies Act 2011 will come into operation by June 2012; the new Act introduces a short, simple and cost effective mechanism for incorporation and registration of companies. The Trading Enterprise Regulations have been amended, and published in December 2011, the amendment reduces the time required to start a business by at least 14 days and while the Law used to require every business to operate from business premises, the Regulations now allow some businesses (i.e. consultancies) to operate from residences. Among the next steps, we intend to submit the Industrial Licensing Bill to Parliament by end-September 2012 (structural benchmarks), which would streamline the process of granting manufacturing/industrial licenses in a transparent manner.

**Poverty reduction strategy document**

19. **A comprehensive five-year National Strategic Development Plan (NSDP) (2012/13-2016/17) has been finalized with the support of our development partners, and was submitted on March 23, 2012 to the IMF and the World Bank as a Poverty Reduction Strategy document.** The NSDP was prepared in a fully participatory manner through comprehensive stakeholder consultation. The Government has set the objective of enabling the private sector to create at least 50,000 sustainable jobs by the end of the Plan period. To this end, we intend to increase private sector participation by significantly reducing barriers to private investment and private sector development. Those barriers are: (i) uncompetitive business environment, (ii) relatively poor infrastructure for trade facilitation that also crowds out private investment, (iii) low productivity as a result of limited quality technical skills, poor health mainly as a result of HIV and AIDS and low entrepreneurship capacity and quality management and (iv) limited institutional capacity for regulatory and policy reforms, investment and trade promotion and weak private sector organizations. To address these problems, the NSDP sets its primary objectives as: (i) accelerating shared and employment creating economic growth, (ii) developing infrastructure (Minimum Infrastructure Platform), (iii) enhancing the skills base and foundation for innovation, (iv) reversing environmental degradation and adapt to climate change, (v) improving health,
combat HIV and AIDS and reduce social vulnerability, and (vi) building effective institutions and promote democratic governance.

20. Under the NSDP, we are forecasting at real average GDP growth of 1.5 percent under the low growth scenario, 5.8 percent under the moderate scenario and 6.7 percent under the Plan scenario. For the purpose of the program and the budget, we maintain the conservative assumption of average growth of 4.5 percent during 2012/13 and 2016/17.

<table>
<thead>
<tr>
<th>Real GDP Growth Forecast under the Budget and the ECF Arrangement</th>
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<tbody>
<tr>
<td>Real GDP Growth (annual change)</td>
</tr>
</tbody>
</table>

V. PROGRAM ISSUES

Safeguards assessment

21. **We have made significant progress in implementing the recommendations of the 2010 safeguards assessment of the CBL.** The assessment concluded that key elements of the safeguards framework had been strengthened since the 2003 assessment, but also that risks remained, in particular in the external audit mechanism. To address this, we appointed Deloitte & Touche as sole auditor for the CBL’s annual accounts for the year ended December 31, 2010. The audit was completed within the statutory deadline, and the audited financial statements and audit opinion were posted on the bank’s external website in April 2011. The CBL has also introduced internal audits of monetary data to be submitted for program monitoring purposes. We acknowledge that, should the access under the current ECF arrangement be augmented, an updated safeguards assessment would need to be completed. Deloitte & Touche (South Africa) has been reappointed to conduct the 2011 external audit jointly with a local firm. Both firms will sign the audit opinion. The 2011 audit is underway and should be completed by end-March 2012.

Program monitoring

22. **Completion of the fourth, fifth and sixth reviews of the arrangement, by August 20, 2012 and February 20, 2013, and May 20, 2013, respectively, will be based on the observance of quantitative performance criteria through end-March 2012, end-September 2012, and end-March 2013, respectively** (Table 1). The targets for end-June and end-December 2012 will be indicative. The definitions of the variables monitored as quantitative performance criteria are provided in the Technical Memorandum of Understanding (TMU).

23. The Government is committed to ensuring that the program remains on track and will continue to monitor implementation.
<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Table 1. Lesotho: Quantitative Performance Criteria, Benchmarks, and Indicative Targets, March 2011 – September 2012</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ceiling on the domestic financing requirement of the central government</td>
<td>1,453</td>
<td>822</td>
<td>1,435</td>
</tr>
<tr>
<td><strong>Adjusted benchmark</strong></td>
<td>1,670</td>
<td>1,231</td>
<td>Met</td>
</tr>
<tr>
<td>Ceiling on the net domestic assets of the Central Bank of Lesotho</td>
<td>1,335</td>
<td>860</td>
<td>1,314</td>
</tr>
<tr>
<td><strong>Adjusted benchmark</strong></td>
<td>1,051</td>
<td>1,397</td>
<td>Met</td>
</tr>
<tr>
<td>Floor on the stock of net international reserves of the Central Bank of Lesotho</td>
<td>805</td>
<td>692</td>
<td>634</td>
</tr>
<tr>
<td><strong>Adjusted benchmark</strong></td>
<td>776</td>
<td>897</td>
<td>Met</td>
</tr>
<tr>
<td>Ceiling on the stock of external payments arrears</td>
<td>0</td>
<td>0</td>
<td>Met</td>
</tr>
<tr>
<td>Ceiling on the amount of new non-concessional external debt contracted or guaranteed by the public sector (cumulative from end-March 2010)</td>
<td>0</td>
<td>0</td>
<td>Met</td>
</tr>
<tr>
<td>Maturity of less than one year</td>
<td>182</td>
<td>182</td>
<td>Met</td>
</tr>
</tbody>
</table>
| Maturity of one year or more | 0          | 0          | Met        | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0          | 0
| **Indicative targets:** |            |            |            |            |            |            |            |            |            |            |            |            |            |            |            |            |
| Floor on the central government social expenditures | 170        | 205        | …          | 170        | 171        | 170        | 170        | …          | 170        | 183       | 183        | 183        | 183       | 183       | 183 |
| **Memorandum items:** |            |            |            |            |            |            |            |            |            |            |            |            |            |            |            |            |
| General budget support | 552        | 530        | …          | 56         | 0          | 154        | 162        | …          | 207        | 0         | 120        | 180        | 309       | 457       |
| Debt service payments | 249        | 258        | …          | 58         | 48         | 172        | 131        | …          | 329        | 88        | 221        | 309        | 457       |            |            |
| SACU receipts | 2,628       | 2,628      | …          | 688        | 688        | 1,376       | 1,376      | …          | 2,752      | 1,492      | 2,983      | 4,475      | 5,966      |            |            |
| Payment of domestic arrears | 200        | 385        | …          | 200        | …          | 200        | …          | …          | …          | …         | …          | …          | …         | …         | …

Sources: Ministry of Finance and Development Planning; Central Bank of Lesotho; and Fund staff estimates

1 Values are cumulative from April 1st (beginning of the fiscal year)
2 Definitions and program adjusters are specified in the TMU.
3 Adjusted for lower budget support
4 Includes spending on school feeding program, old age pension and HIV/AIDS
5 Continuous performance criteria
6 New nonconcessional borrowing is limited to financing the Mbotlong dam
7 The ceiling on gross cumulative payments of domestic arrears will no longer be monitored as an indicative target.
Table 2: Lesotho Structural Benchmarks for FY2010/11

<table>
<thead>
<tr>
<th>Structural Benchmarks</th>
<th>Test Date</th>
<th>Status</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Public Financial Management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Complete an audit of domestic arrears and prepare a time bound plan for elimination</td>
<td>End-March 2011</td>
<td>Not met</td>
<td>Preliminary work started by internal auditors. The FAD PFM TA mission provided guidance on an auditing framework and regulatory arrangements for arrears management.</td>
</tr>
<tr>
<td>Prepare a time bound plan for capacity building in line ministries to strengthen preparation of MTEF by all ministries</td>
<td>End-June 2011</td>
<td>Met</td>
<td></td>
</tr>
<tr>
<td>Implement the front office revenue receipting system and ensure that all revenues are captured in the IFMIS</td>
<td>End-September 2011</td>
<td>Not met</td>
<td>Delayed due to the problem with IFMIS. To ensure smooth introduction, work has begun with three pilot ministries.</td>
</tr>
<tr>
<td>II. Financial Sector Regulation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Submit to Parliament the new Financial Institutions Bill, which incorporates amendments to deal with supervision of NBFIs by the CBL, and unlawful business practices, including Ponzi schemes</td>
<td>End-March 2011</td>
<td>Met</td>
<td></td>
</tr>
<tr>
<td>Submit to Cabinet a review of the Cooperatives Societies Act with a view to ensuring that all financial institutions that accept deposits from the public comply with and are registered under the FIA</td>
<td>End-March 2011</td>
<td>Met with delay</td>
<td>Submitted to Cabinet for policy clearance in May 2011.</td>
</tr>
<tr>
<td>Launch a Partial Credit Guarantee Scheme, aimed at reducing the risks for banks to lend to small and medium-sized enterprises</td>
<td>End-March 2011</td>
<td>Met with delay</td>
<td>Delayed to allow for consultation with stakeholders, including banks, on modalities for implementation. It was launched in August 2011.</td>
</tr>
<tr>
<td>Submit to Cabinet the National Leasing Finance proposal, aimed at creating a legal environment conducive to leasing, by supplementing the 1974 Hire Purchase Act.</td>
<td>End-June 2011</td>
<td>Met</td>
<td>There was a change in concept/modality. The new FIA makes provision for leasing finance. Work began in May 2011 to prepare the necessary regulations.</td>
</tr>
<tr>
<td>III. Structural Reforms</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Submit to Parliament the Industrial Licensing Bill, which will improve the process of licensing industrial enterprises</td>
<td>End-March 2011</td>
<td>Not met</td>
<td>Delayed due to need for clarifications by the Attorney General's Department.</td>
</tr>
</tbody>
</table>
Table 3. Proposed Structural Benchmarks through December 2012

<table>
<thead>
<tr>
<th>Benchmarks</th>
<th>Test date</th>
<th>Macroeconomic rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Public Financial Management</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Implement the front office revenue receipting system in 3 pilot ministries and 1 sub accountancy ¹</td>
<td>End-March 2012</td>
<td>Strengthen revenue tracking and support medium-term fiscal consolidation</td>
</tr>
<tr>
<td>Complete an audit of domestic arrears and prepare a time bound plan for elimination ²</td>
<td>End-March 2012</td>
<td>Support expenditure control and medium-term fiscal consolidation</td>
</tr>
<tr>
<td>Undertake a comprehensive inventory of Government accounts, including those in commercial banks.</td>
<td>End-June 2012</td>
<td>Support expenditure efficiency and medium-term fiscal consolidation</td>
</tr>
<tr>
<td>Reconcile key Treasury (Revenue and Expenditure) Accounts on a monthly basis and produce a monthly monitoring report showing the status of reconciliation of all bank accounts.</td>
<td>End-September 2012</td>
<td>Support expenditure efficiency and medium-term fiscal consolidation</td>
</tr>
<tr>
<td>Establish a Cash Management Unit in the Treasury.</td>
<td>End-December 2012</td>
<td>Support expenditure efficiency and medium-term fiscal consolidation</td>
</tr>
<tr>
<td><strong>II. Other Structural Reforms</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Submit to Parliament the Industrial Licensing Bill, which will improve the process of licensing industrial enterprises ³</td>
<td>End-September 2012</td>
<td>Improve the business climate to facilitate private sector-led growth, and enhance competitiveness</td>
</tr>
</tbody>
</table>

¹ Previously end-September 2011 structural benchmark
² Previously end-March 2011 structural benchmark
Kingdom of Lesotho—Technical Memorandum of Understanding

1. This memorandum sets forth the understandings between the government of Lesotho and the IMF staff regarding the definitions of the quantitative performance criteria and benchmarks for the second, third and fourth reviews of its arrangement under the ECF-supported program, as well as the respective reporting requirements. These performance criteria and benchmarks are reported in Table 1 of the government’s Memorandum of Economic and Financial Policies (MEFP).

A. Ceiling on the Domestic Financing Requirement (DFR) of the Central Government

2. **Definition.** The central government includes the central administration and all district administrations. The domestic financing requirement of the central government is defined as net credit to the government from the banking system (that is, the Central Bank of Lesotho and the commercial banks) plus holdings of treasury bills and other government securities by the nonbank sector. For program monitoring purposes, the domestic financing requirement will be calculated as the change from the end of the previous fiscal year (which runs from April 1 to March 31) of net credit to the government by the banking system and of holdings of treasury bills and other government securities by the nonbank sector. In particular, the calculation of the domestic financing requirement shall include changes in (i) balances held in the privatization account or balances of other accounts into which proceeds from the sale of public enterprises are deposited; (ii) the amount of outstanding treasury bills issued by the Central Bank of Lesotho for monetary policy purposes and held in the balance of the blocked government deposit account used by the Central Bank of Lesotho to sterilize reserve money absorbed by monetary policy operations. The calculation of the domestic financing requirement shall exclude changes in balances held in any account into which revenues collected by the customs department are held pending their transfer to the SACU revenues pool. External debt service, amortization, disbursements and external grants will be calculated at current exchange rates.

3. **Supporting material.** The Central Bank of Lesotho will provide the monetary survey and other monthly monetary statistics, as well as a table showing the details of all government financing operations from the nonbank public, on a monthly basis and within 30 days of the end of the month. The following information will be presented as memorandum items in the monetary survey: (i) the outstanding balances in the privatization account or accounts; and (ii) details of any monetary operations with treasury bills, including changes in government deposits as a result of such operations. The Central Bank of Lesotho will also provide a table showing the details of government debt by type and holder. The Ministry of Finance and Development Planning will provide detailed monthly budget operation reports and tax arrears reports.
A. Ceiling on the Stock of Net Domestic Assets of the Central Bank of Lesotho

4. **Definition.** The net domestic assets (NDA) of the Central Bank of Lesotho are defined as the difference between reserve money (currency in circulation plus total bank deposits at the central bank) and NFA (as defined in paragraph 5). For program monitoring purposes, the NDA will be calculated as the change from the end of the previous fiscal year (which runs from April 1 to March 31). The NDA thus includes net claims by the Central Bank of Lesotho on the government (loans and treasury bills purchased less government deposits), claims on banks, and “other items net” (other assets, other liabilities, and the capital account).

5. **Definition.** The net foreign assets (NFA) of the Central Bank of Lesotho are defined as foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the central bank. The values of all foreign assets and liabilities will be calculated in U.S. dollars at the end of each quarter using the program exchange rates.

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

B. Floor on the Stock of Net International Reserves of the Central Bank of Lesotho

7. **Definition.** The net international reserves (NIR) are defined as the Central Bank of Lesotho’s liquid, convertible foreign assets minus its short-term foreign liabilities. Pledged or otherwise encumbered assets, including, but not limited to, assets used as collateral or as guarantee for third-party external liabilities are excluded from reserve assets. Reserve assets include cash and balances held with banks, bankers’ acceptances, investments, foreign notes and coins held by the Central Bank of Lesotho, Lesotho’s reserve position in the Fund, and SDR holdings. Reserve liabilities include nonresident deposits at the Central Bank of Lesotho, use of IMF credit, and any other short term liabilities of the central bank to nonresidents. The stock of NIR at the end of each quarter is defined in U.S. dollars and will be calculated using the program exchange rates.¹

8. **Supporting material.** The Central Bank of Lesotho will provide data on its NIR on a monthly basis within three weeks of the end of the month. The NIR data will be provided in a monthly basis within 21 days of the end of the month. The central bank will also provide a table of selected monetary indicators covering the major elements of its balance sheet on a weekly basis.

¹ Program cross exchange rates are: South African rand per U.S. dollar: 7.3; U.S. dollars per pound sterling: 1.5; U.S. dollars per euro: 1.3; Swiss francs per U.S. dollar: 1.1; Swedish kronor per U.S. dollar: 7.3; and Botswana pula per U.S. dollar: 6.8. SDR per U.S. dollar: 0.648; Program maloti per U.S. dollar exchange rate: 7.3.
table showing the currency breakdown of the reserve assets and reserve liabilities of the Central Bank of Lesotho converted into U.S. dollars and maloti at the program exchange rates.

C. Ceiling on the Amount of New Nonconcessional External Debt Contracted or Guaranteed by the Public Sector, with Original Maturity of One Year or More

9. **Definition.** For purposes of the ECF arrangement, concessionality requirements will be applied to foreign-currency denominated debt regardless of the residency of the creditor. The public sector comprises the central government, the Central Bank of Lesotho, and all public enterprises and other official sector entities with majority state ownership. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, adopted by Decision No. 6230-(79/140), as revised on August 24, 2000, as amended effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received. Included in this performance criterion are all current liabilities that are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and that require the public sector (obligor) to make one or more payments in the form of assets (including currency) at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers’ credits, and leases) will be subject to the ceiling. New nonconcessional borrowing is limited to the Metolong Dam Project, a high-return public investment project. The performance criterion will be evaluated on a continuous basis as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from end-March 2010 onward.

10. **Definition.** A loan is concessional if its grant element is at least 35 percent of the value of the loan, calculated using a discount rate based on commercial interest reference rates (CIRRs) reported by the OECD. For loans of maturity of greater than 15 years, the grant element will be based on the ten-year average of OECD CIRRs. For loans of maturity of 15 years or less, the grant element will be based on the six-month average of OECD CIRRs. Margins for differing repayment periods would be added to the CIRRs: 0.75 percent for repayment periods of less than 15 years, 1 percent for repayment periods of 15 to 19 years, 1.15 percent for repayment periods of 20 to 29 years, and 1.25 percent for repayment periods of 30 years or more.

11. **Supporting material.** Details of all new commitments and government guarantees for external borrowing, with detailed explanations, will be provided by the Ministry of Finance and Development Planning on a monthly basis within 30 days of the end of the month.
D. Ceiling on the Amount of New External Debt Contracted or Guaranteed by the Public Sector, with Original Maturity of Less than One Year

12. **Definition.** The public sector comprises the central government, the Central Bank of Lesotho, and all enterprises with majority state ownership. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, adopted by Decision No. 6230-(79/140), as revised on August 24, 2000, as amended effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received. Included in this performance criterion are all current liabilities that are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and that require the public sector (obligor) to make one or more payments in the form of assets (including currency) at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract. In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers’ credits, and leases) will be subject to the ceiling. Excluded from this performance criterion are normal short-term import credits. The performance criterion will be evaluated on a continuous basis as the cumulative change in the amount of new nonconcessional debt contracted or guaranteed from the end of the previous fiscal year (March 31).

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

E. Ceiling on the Stock of External Payments Arrears

14. **Definition.** During the period of the arrangement, the stock of external payments arrears of the public sector (central government, Central Bank of Lesotho, and all enterprises with majority state ownership) will continually remain zero. Arrears on external debt-service obligations include any nonpayment of interest and/or principal *in full and on time* falling due to all creditors, including the IMF and the World Bank.

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

F. Floor on the Central Government Social Expenditures

16. **Definition:** There will be a floor on the central government social expenditures from domestic resources. The observance of this floor is an indicative target. Social expenditures comprise spending on the following: school feeding program, old age pension, African Pioneer Corps and HIV/AIDS.
17. **Supporting material:** Data on social spending will be compiled by the Ministry of Finance and Development Planning and will be provided on a quarterly basis, to be submitted no later than six weeks after the end of each reporting period.

G. **Adjusters**

18. The quantitative performance criteria specified under the program are subject to the following adjusters:

A. **Southern African Customs Union Revenues**

- The program targets for the NDA in any quarter will be adjusted downward (upward) by the full amount of any excess (shortfall) in receipts from the Southern Africa Customs Union (SACU) relative to the programmed levels specified in Table 1 of the MEFP as well as any SACU advance receipts in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

- The program targets for the DFR in any quarter will be adjusted downward (upward) by the full amount of any excess (shortfall) in receipts from the Southern Africa Customs Union (SACU) relative to the programmed levels specified in Table 1 of the MEFP as well as any SACU advance receipts in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

- The program targets for the NIR in any quarter will be adjusted upward (downward) by the full amount of any excess (shortfall) in receipts from the Southern Africa Customs Union (SACU) relative to the programmed levels specified in Table 1 of the MEFP as well as any SACU advance receipts in that quarter, where such advance receipts constitute amounts that would otherwise have been received in a subsequent quarter.

19. **Supporting material:** The Central Bank of Lesotho will provide data on SACU receipts on a quarterly basis within the first month of the quarter.

B. **Budgetary Support net of Debt Service**

- The ceiling on the NDA will be adjusted downward (upward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

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2 General budget support consists of grants and loans received by the Central Government for financing its overall policy and budget priorities.
• The ceiling on the DFR will be adjusted downward (upward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

• The floor on the NIR of the Central Bank of Lesotho will be adjusted upward (downward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

20. **Supporting material**: Data on budget support and debt service will be compiled by the Ministry of Finance and Development Planning and will be provided on a quarterly basis, to be submitted no later than six weeks after the end of each reporting period.

C. **Unused Metolong loan balance**

• The ceiling on the NDA will be adjusted downward (upward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

• The ceiling on the DFR will be adjusted downward (upward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

• The floor on the NIR of the Central Bank of Lesotho will be adjusted upward (downward) by the full amount of the excess (shortfall) in budgetary support net of external debt service relative to the programmed levels specified in Table 1 of the MEFP.

21. **Supporting material**: Data on the Metolong project loan balance under the government’s accounts will be compiled by the Central Bank of Lesotho and will be provided on a quarterly basis, to be submitted no later than six weeks after the end of each reporting period.

22. The above supporting data and reports required for program monitoring by IMF staff will be transmitted by the authorities to the IMF Resident Representative to Lesotho.