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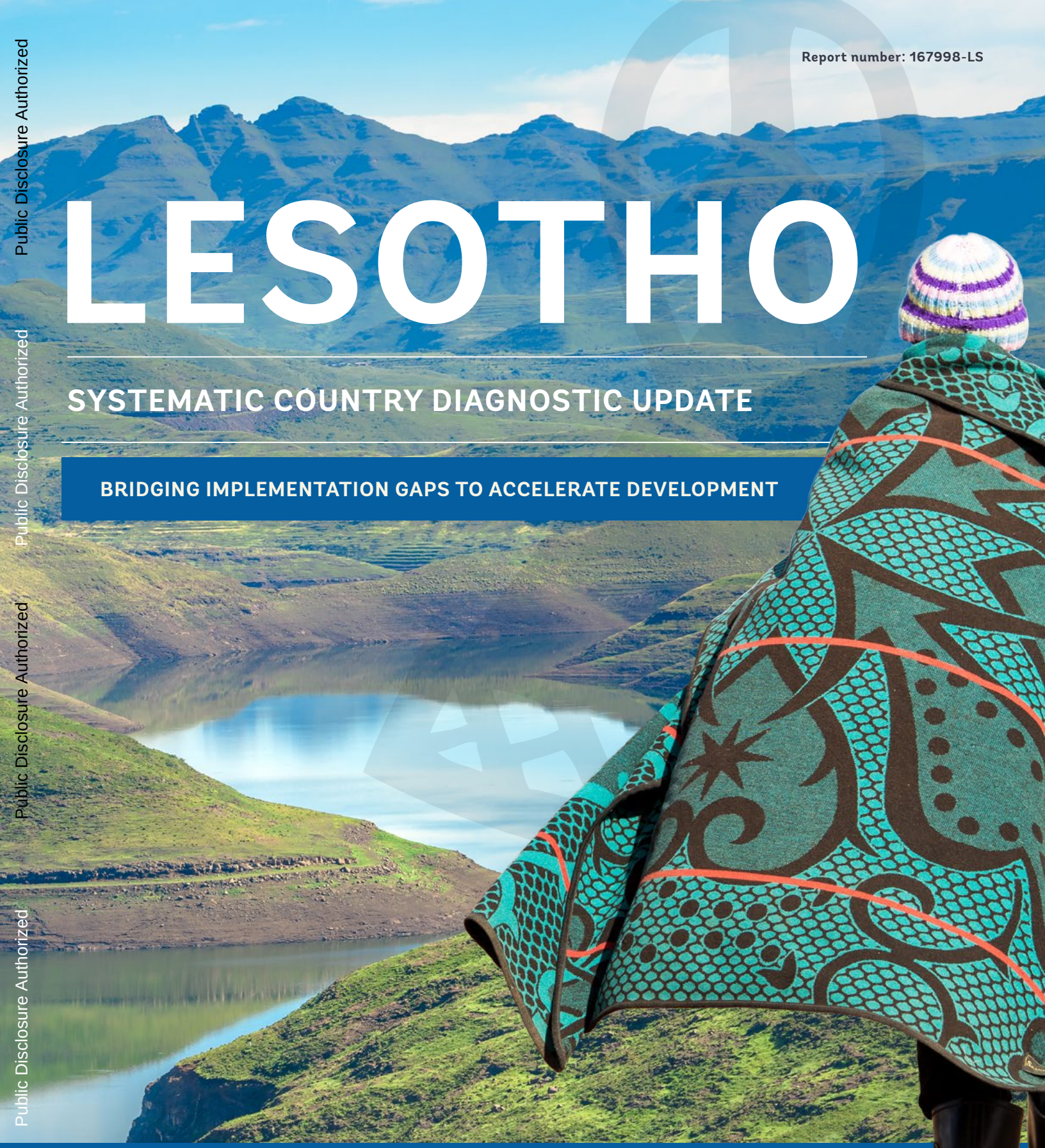
LESOTHO

SYSTEMATIC COUNTRY DIAGNOSTIC UPDATE

BRIDGING IMPLEMENTATION GAPS TO ACCELERATE DEVELOPMENT



DECEMBER 2021

WORLD BANK GROUP
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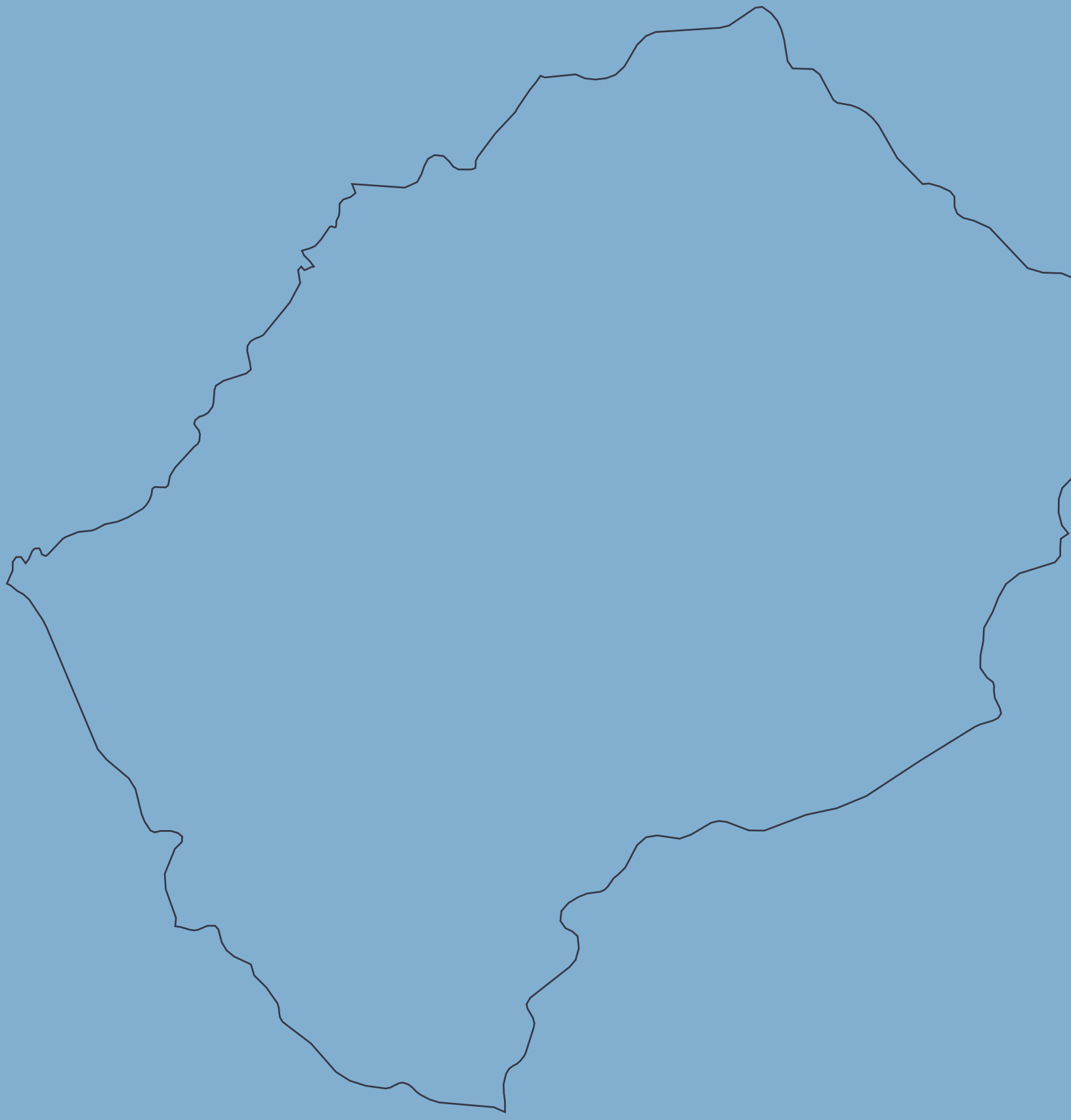

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SYSTEMATIC COUNTRY DIAGNOSTIC UPDATE

BRIDGING IMPLEMENTATION GAPS TO ACCELERATE DEVELOPMENT

DECEMBER 2021 • AFRICA REGION

WORLD BANK GROUP

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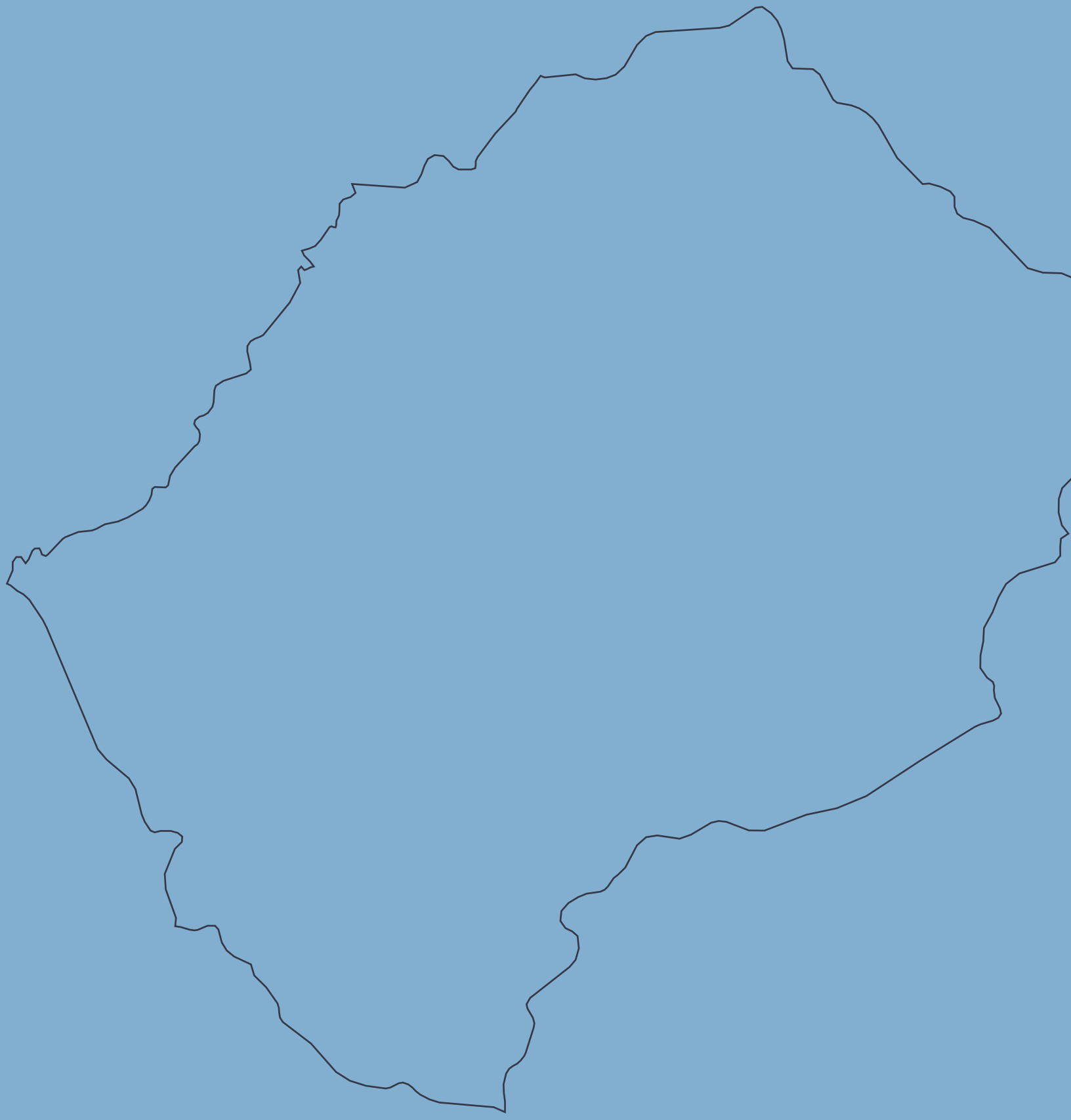
ABBREVIATIONS AND ACRONYMS

ABC	All Basotho Convention
AD	Alliance of Democrats
ADB	African Development Bank
AfCFTA	African Continental Free Trade Area
AGOA	African Growth and Opportunity Act
AIDS	Acquired Immunodeficiency Syndrome
ASPIRE	Atlas of Social Protection Indicators of Resilience and Equity
BIT	Bilateral Investment Treaties
BNP	Basotho National Party
BOS	Bureau of Statistics
CEmONC	Comprehensive Emergency Obstetric and Newborn Care
CBL	Central Bank of Lesotho
CGP	Child Grant Program
CHAL	Christian Health Association of Lesotho
DC	Democratic Congress
DFS	Digital Financial Services
DP	Development Partner
DRM	Disaster Risk Management
DSA	Debt Sustainability Analysis
ECCD	Early Childhood Care and Development
ENSO	El Niño Southern Oscillation
EPA	Economic Partnership Agreement
EU	European Union
FDI	Foreign Direct Investment
GBV	Gender-Based Violence
GDP	Gross Domestic Product
GNI	Gross National Income
GoL	Government of Lesotho
HCI	Human Capital Index
HIV	Human Immunodeficiency virus
HRM	Human Resources Management
HRMIS	Human Resource Management Information System
ICT	Information and Communications Technology
IFMIS	Integrated Financial Management Information Systems
IIA	International Investment Agreements
IMF	International Monetary Fund
ITU	International Telecommunication Union
LCD	Lesotho Congress for Democracy
LMIC	Lower Middle-Income Country
LNDC	Lesotho National Development Corporation
LRA	Lesotho Revenue Authority

LTDC	Lesotho Tourism Development Corporation
M	Lesotho Maloti
MAFS	Ministry of Agriculture and Food Security
MDA	Ministries, Departments, and Agencies
M&E	Monitoring and Evaluation
MoET	Ministry of Education and Training
MoF	Ministry of Finance
MFN	Most Favored Nation
MoGYSR	Ministry of Gender, Youth, Sports and Recreation
MoH	Ministry of Health
MoHA	Ministry of Home Affairs
MIS	Management Information System
MoLCD	Ministry of Law and Constitutional Development
MPO	Macro Poverty Outlook
MoPS	Ministry of Public Service
MoSD	Ministry of Social Development
MSME	Micro, Small and Medium Enterprise
NCD	Non-Communicable Disease
NGO	Non-Governmental Organization
NIMP	National Irrigation Masterplan
NISSA	National Information System for Social Assistance
NPL	Non-Performing Loan
NSDP II	National Strategic Development Plan II
OAP	Old Age Pension
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PFM	Public Financial Management
PIM	Public Investment Management
PMDU	Prime Minister's Delivery Unit
QMMH	Queen Mamohato Memorial Hospital
RCL	Reformed Congress of Lesotho
REER	Real Effective Exchange Rate
SACCOs	Savings and Credit Cooperative Societies
SACMEQ	Southern and Eastern Africa Consortium for Monitoring Educational Quality
SACU	Southern African Customs Union
SADC	Southern African Development Community
SARS	South African Revenue Service
SCD	Systematic Country Diagnostic
SEZ	Special Economic Zones
SOE	State-Owned Enterprise
SSA	Sub-Saharan Africa
STEM	Science, Technology, Engineering and Mathematics
TB	Tuberculosis
TVET	Technical and Vocational Education and Training
UNCTAD	United Nations Conference on Trade and Development
VHW	Village Health Worker
WASH	Water, Sanitation and Hygiene
WSS	Water Sanitation Services
WHO	World Health Organization
WBG	World Bank Group



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The report was finalized under the collective guidance and leadership of Country Director Marie Francoise Marie-Nelly; Africa Region Chief Economist Albert Zeufack; IFC Country Manager Adamou Labara; MIGA Country Head Hoda Atia Moustafa; Manager (Operations) Asmeen Khan; Program Leaders Wolfgang Fengler, Aleksandra Posarac, and Bekele Debele; former Program Leader Erwin De Nys; former Acting Program Leader Edouard Al-Dahdah; Practice Managers Pierella Paci, Mathew Verghis, and Omowunmi Ladipo; Lesotho Resident Representative Yoichiro Ishihara; Consultant Lolette Kritzinger-van Niekerk; Senior External Affairs Officer Zandile Ratshitanga, and Communications Consultant Nthati Moorosi. The report benefited from feedback provided at different stages by the following peer reviewers: Facundo Cuevas, Joel Turkewitz, Samuel Freije-Rodriguez, Simon Davies, Smita Kuriakose, Somik Lall, and Trang Van Nguyen. Logistical assistance during the preparation of this report was ably provided by Relebohile Mohlakoana, Mmaserole Mabuela, and Obadiah Mokhomo. Peter Kjaer Milne (an independent consultant) edited the report. The report was designed and typeset by Anatolie Ursu. Finally, the team would like to thank everyone at the WBG who contributed towards making the completion of this report a successful exercise.

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EXECUTIVE SUMMARY

Since 2015, Lesotho has been subjected to a myriad of uninsured climate, environmental and economic risks, which have negatively affected growth and poverty reduction

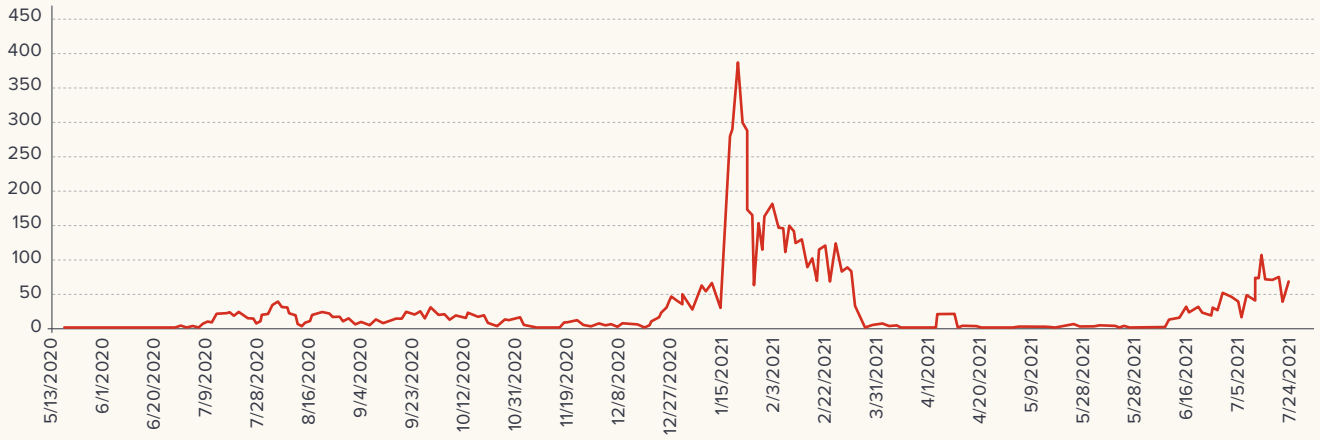
1. **A small, mostly mountainous, and largely rural country of about 2 million people, Lesotho is highly vulnerable to frequent and severe weather events, particularly flooding and drought, which have material impacts on lives, the economy, livelihoods, poverty, and inequality.** In 2015/16, Lesotho experienced an El Niño Southern Oscillation (ENSO)-induced drought, which was the driest on record and the largest drought recorded in terms of affected population. As a result, although poverty fell between 2002 and 2017, the pace was slow, with the official national poverty rate falling by about 7 percentage points from 56.6 to 49.7 percent. Largely due to frequent climate shocks, including the 2015/16 drought, progress in reducing poverty has been much slower in rural areas where the poverty rate fell marginally from 61.3 to 60.7 percent compared with a reduction from 41.5 to 28.5 percent in urban areas. In the absence of the 2015/16 drought, rural poverty would have been 6 percentage points lower, and the pace of national poverty reduction would have nearly doubled between 2002 and 2017. This is because frequent climate shocks have contributed to a decline in agricultural productivity, which is largely rain-fed and a source of livelihood for most of the population. Droughts, the most frequent source of risk, drive food prices higher, further worsening food insecurity. This is exacerbated by environmental degradation. Poorly integrated management of natural resources leads to exploitation of resources and the degradation of ecosystems and ecosystem services, undermining water availability, ecotourism, and agricultural productivity. Degradation of landscapes and ecosystems, partly for wood fuels, also limits the resilience of communities to shocks.

2. **Extreme weather events have had a negative impact on the macro-fiscal situation of the country.** The economy has been in recession since 2017 and household consumption has declined sharply, falling 17 percent in real terms since its peak in 2013. This decline marks a dramatic reversal of the sustained increase in private consumption levels since independence in 1966. The 2019 Lesotho Disaster Risk Financing Diagnostic estimates, based on the cost of responding to all perils, the average annual cost of disaster response at US$19.3 million or 1.6 percent of the total budget expenditure in the 2019/20 fiscal year. Droughts also affect the electricity sector, given that local power generation is primarily from hydropower, and imported electricity is highly dependent on water resources, and this is also likely to further constrain private investments.

3. **Unfolding in an already weak macroeconomic situation, the economic shock due to the COVID-19 pandemic presents additional challenges to be managed in the near to medium term.** Lesotho is facing a tough fiscal outlook as Southern Africa Customs Union (SACU) transfers, revenue collection, remittances, private investments, and exports all take a hit. Overall, this together with the weak regional and global economic outlook is expected to result in a continuation of the recession in 2020, with real Gross Domestic Product (GDP) estimated to have contracted by 15.3 percent in the Q4 2020. On an annual basis, real GDP is estimated to have contracted by 11.1 percent in 2020 compared with a contraction of 0.4 percent in 2019. This is on the back of the country having introduced, similar to other countries, unprecedented measures

Box E.1. Impact of the COVID-19 pandemic

Daily changes in positive cases
(13 May 2020 - 24 July 2021)



COVID-19 crisis in Lesotho at a glance
(as of July 24, 2021)

Test conducted:	130,767
Positive cases:	12,880
Recoveries:	6,621
Deaths:	363
GDP contraction, 2020:	11.1%
Relief package:	US$141.9 mln (7.7% of GDP)

Poverty

US$ 1.90/person/day (in 2011 PPP) poverty rate projection for 2020, according to the Wolrd Bank's Macro Poverty Outlook (MPO)

April 2020:	27.3%
April 2021 MPO (revised to better account for the pandemic):	31.2%

to contain the spread of the pandemic, putting pressure on fiscal space. In a context of historically slow progress in reducing poverty, the COVID-19 pandemic is reversing the modest gains that have been made, with at least 62,000 Basotho estimated to have slipped into poverty in 2020 (as measured by the international poverty line of US$1.90 per day). The unemployment rate was high even before the pandemic, at 22.5 percent in 2019 (strict definition), rising to 38.3 percent (when the expanded definition is used). Thus, resilient and inclusive recovery from the pandemic requires supporting micro, small and medium enterprises (MSMEs) and protecting jobs as well as livelihoods, including support to the textile industry that is highly reliant on functional global value chains and provides employment to the poor, especially women. It also requires, in addition to short-term policy responses and as the pandemic subsides, undertaking longstanding structural reforms to lay the foundation for resilient economic recovery.

The challenges and binding constraints identified in the first SCD remain valid today

4. **The 2015 Systematic Country Diagnostic (SCD) emphasized the need to shift from a public sector-driven to a private sector-driven, export-oriented, and job-creating economic growth model.** It proposed three pathways to sustainably achieve the World Bank Group's twin goals of eliminating global extreme poverty and promoting shared prosperity, namely: (i) redefining the role of the state through fiscal consolidation and public sector modernization for effectiveness and efficiency; (ii) promoting a competitive and export-oriented private sector by establishing incentives to support an outward-looking orientation; and (iii) strengthening individual and group assets by increasing the opportunities and returns to self-employment by raising the productivity of smallholders and microenterprises, improving human capital (education and health), and strengthening the social protection system.

5. **This SCD Update revisits the constraints and priority interventions identified in the 2015 SCD and posits that most of the challenges and binding constraints identified in the first SCD remain valid today.** It uses new analytical work conducted since 2015 (see Annex 1) to reflect on the main developments in Lesotho since then, and to update the prioritization of constraints as relevant. The new analytical work undertaken does not substantially alter the diagnostics presented by the 2015 SCD. Rather, the analytical work completed since 2015 reinforces findings of the earlier analytical work that informed the 2015 SCD. Slow progress across priority interventions proposed in the 2015 SCD is highlighted in Table E. 1.

6. **The private sector remains small and weak. This is despite nascent success in integration into the world economy, especially through the African Growth and Opportunity Act (AGOA).** While net export performance remains an important driver of growth in Lesotho, exports remain low, uncompetitive, undiversified, and with limited value addition. There is evidence of erosion of export competitiveness in the United States (US) market, where Lesotho is no longer the leading apparel exporter under AGOA. Limited private sector development has reduced the inclusiveness of Lesotho's economic growth. While structural transformation has the potential to spur economic growth, it has slowed following the leveling-off of the garment industry boom and decelerating growth in the services sector.

7. **As a result, Lesotho's economy remains out of balance; it is running on one engine.** Domestic demand and a large public sector continue to drive economic activity. The share of the public sector in the economy has barely changed. On paper, Lesotho is performing well when considering the level of investment, which has averaged 29 percent of GDP a year since 2010, and has remained high even during the recent period of political upheaval. However, most of this investment is led by government, with public sector investment levels ranking among the highest in the world. Government also remains the largest employer, accounting for one-third of total employment, while the private sector has created only limited job opportunities.

8. **The dominance of the public sector has steadily increased government debt levels, which reached 64.7 percent of GDP in December 2020.** Reliance on SACU transfers, which averaged 35 percent of GDP over the previous 15 years, has historically created space for the Government of Lesotho (GoL) to finance these high investment levels and public employment. But these transfers are volatile and have declined in recent years, exacerbating macro-fiscal vulnerabilities. SACU transfers are expected to decline further due to the COVID-19 pandemic. While remittances from migrant workers play a crucial socioeconomic role, they further reinforce a consumption-driven economy. Shortcomings in public investment management—identified back in 2012—are still leading to sub-optimal public investment decisions. This is evident in the failure of the high levels of government spending to promote inclusive growth and provide access to quality services for the poor, or provide access to services in a spatially blind manner.

Table E.1. Highlights in the evolution of key priority interventions identified in the 2015 SCD

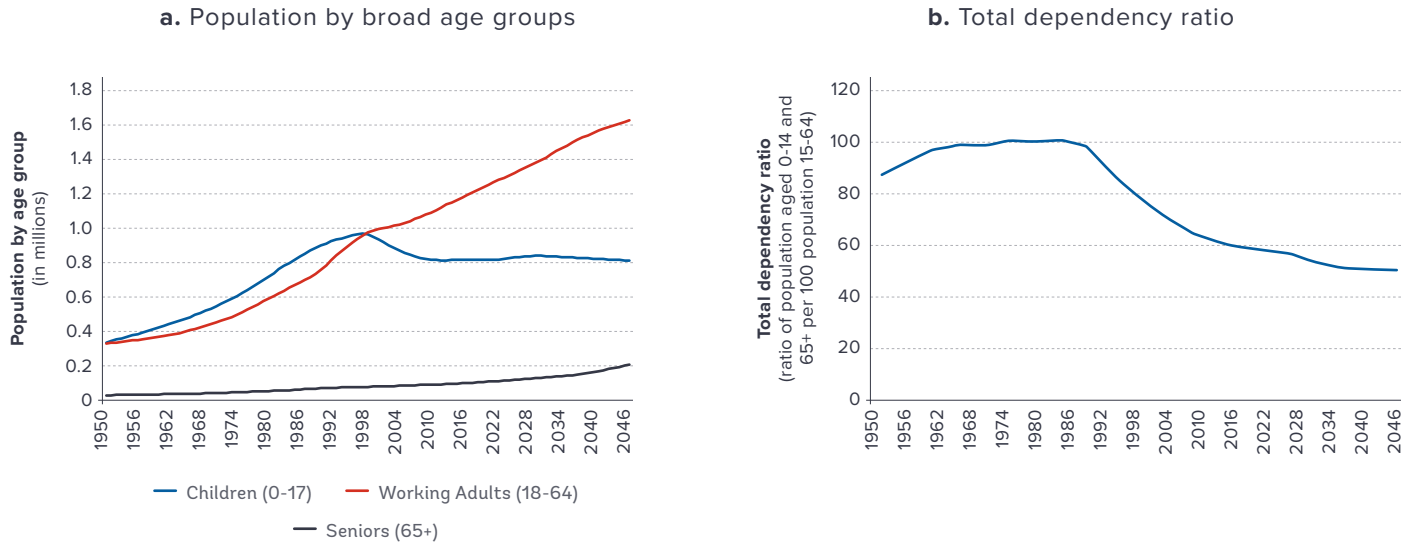
2015 SCD: Priority interventions	Evolution since 2015
1. Reducing the size of the state, rebuilding buffers and improving service delivery by achieving fiscal consolidation and modernizing the public sector	☑ The size of the public sector remains large. ☑ Fiscal consolidation is yet to take hold. ☑ Several years of low transfers from the SACU have eroded Lesotho's buffers. SACU transfers are projected to decline further in the near to medium term due to the COVID-19 pandemic. ☑ Progress toward modernizing the public sector has been slow.
2. Facilitating a competitive, export-oriented private sector by aligning incentives and developing key infrastructure	☑ The overall doing business environment has deteriorated, with gaps in key productive and connective infrastructure remain wide, especially in rural areas. ☑ The quality of governance is deteriorating in a range of areas. ☑ Political instability/weak political consensus weakens the business environment. ☑ Exports lack diversification, still concentrated on very few products, mainly the textiles and apparel, and diamonds sectors. ☑ Lesotho is no longer the leading apparel exporter to the United States under the AGOA trade preferences arrangement.
3. Increasing the returns to self-employment by raising productivity of smallholders and microenterprises	☑ Around 53 percent of businesses are excluded from the financial system. ☑ Labor productivity in industry and services (a sector in which microenterprises are concentrated) has declined over time. ☑ Productivity is particularly low in subsistence agriculture (smallholders). ☑ Limited job creation: Unemployment rate of 22.5 percent in 2019, with youth unemployment at 29.1 percent.
4. Improving health and education outcomes by reducing the disease burden and raising and aligning skills	☑ Human capital levels have improved since 2010 but with an HCI of 0.40, the score is low for the country's income level. Learning performance remains among the lowest in Southern Africa. ☑ Health outcomes are poor especially among the poor and rural population, with high levels of stunting and a growing burden of non-communicable diseases (NCDs). ☑ Lack of skills is a major concern for the private sector, with signs of a potential mismatch between the skills pursued by the youth and those demanded by the private sector.
5. Reforming social protection to reduce fragmentation, and improve targeting, efficiency and linkages	☑ There has been progress in reforming social protection, but more progress is needed, notably in implementing a means-tested tertiary bursary program, as well as in expanding coverage of the poor.

There is an opportunity to build on past success to accelerate progress

9. **Lesotho is completely surrounded by South Africa, which makes it highly dependent on its neighbor's economy and policies; however, Lesotho's geography and demography also provide important opportunities for the country's development.** First, South Africa is the continent's second-largest economy, and provides Lesotho with access to markets and advanced infrastructure that create links with the rest of the world. Second, Lesotho enjoys preferential access to key international markets through, for example, the Southern Africa Customs Union (SACU), the Southern African Development Community (SADC), the African Continental Free Trade Area (AfCFTA), and the African Growth and Opportunity Act (AGOA) which, if leveraged, could support export-led growth. Third, Lesotho has abundant water resources that, if better managed, could ensure reliability and quality of water supply services, and support economic growth and livelihoods. Fourth, demographic trends are favorable, with an increase in life expectancy and the supply of working age people alongside declining dependency ratios (Figure E. 1). These demographic trends, together with a relatively harmonious labor relations environment, can help Lesotho reap the benefits of the demographic dividend if the economy grows. Fifth, the country enjoys significant financial and technical support from the development partner community. Nonetheless, despite these favorable conditions, Lesotho's development challenges persist.

10. **There are opportunities to shift to private investment and exports for job creation.** For instance, Lesotho achieved notable success in the past through expanding the export manufacturing sector under AGOA. The country can build on this success to revitalize the manufacturing sector by ensuring that the sector regains its competitiveness and leveraging close economic ties with South Africa and AfCFTA. Opportunities also exist in the non-textile and apparel sectors including opportunities in leather, automotive parts, horticulture, tourism, and the digital economy. An increase in value added from agro-based industries, and agricultural trade and distribution services, as well as a shift from traditional exports to higher-value agricultural products in international trade, presents another opportunity to unleash the potential of the agri-food sector for boosting exports and job creation. Furthermore, shifting market trends due to the impacts of the COVID-19 pandemic offer new opportunities as global value chains are being transformed.

Figure E.1. Lesotho has the potential to harness the demographic dividend



Source: United Nations Population Division, World Population Prospects 2019.

11. **There is also an opportunity to build on achievements made in the health, education, and social protection sectors since 2015 to accelerate progress on human capital outcomes.** In the health sector, major investments have been undertaken by the Ministry of Health (MoH) in partnership with development partners (DPs), including the opening of Queen Mamohato Hospital in 2015. Linked to this, equity in health outcomes is on the right track, with a decline in fertility, and maternal, neonatal, infant and under-5 mortality along with their inequity levels. In the education sector, notable achievements include: increasing emphasis on early childhood development and education (ECDE) services by the Government of Lesotho (GoL); signs of improvements in mathematics and science education; progress in strengthening communities' involvement in the management of schools; and several existing initiatives and extracurricular programs to support boys and girls to stay in school. In the social protection sector, Lesotho can build on the advances made in: expanding the National Information System for Social Assistance (NISSA) social registry and targeting system; harmonization of payment systems; a new Management Information System (MIS); and plans to introduce a proxy-means-testing mechanism for the Tertiary Education Loan Bursary program for improving the equity of the distribution of bursaries to young people.

12. **Several opportunities to strengthen climate risk management and resilience exist.** These include building on progress made in developing various bills, polices, strategies and plans to strengthen disaster risk management, as well as progress made in advancing disaster risk financing. Recently, several initiatives have worked to strengthen hydro-metrological services. Steps have been taken to develop renewable energy resources and this is expected to contribute to both mitigation of, and adaptation to, climate change, while also increasing energy security. The COVID-19 pandemic has provided an opportunity to accelerate certain Disaster Risk Management (DRM) actions, including coordination of emergency operations.

Compared with the last SCD, more attention needs to be paid to bridging public sector implementation gaps

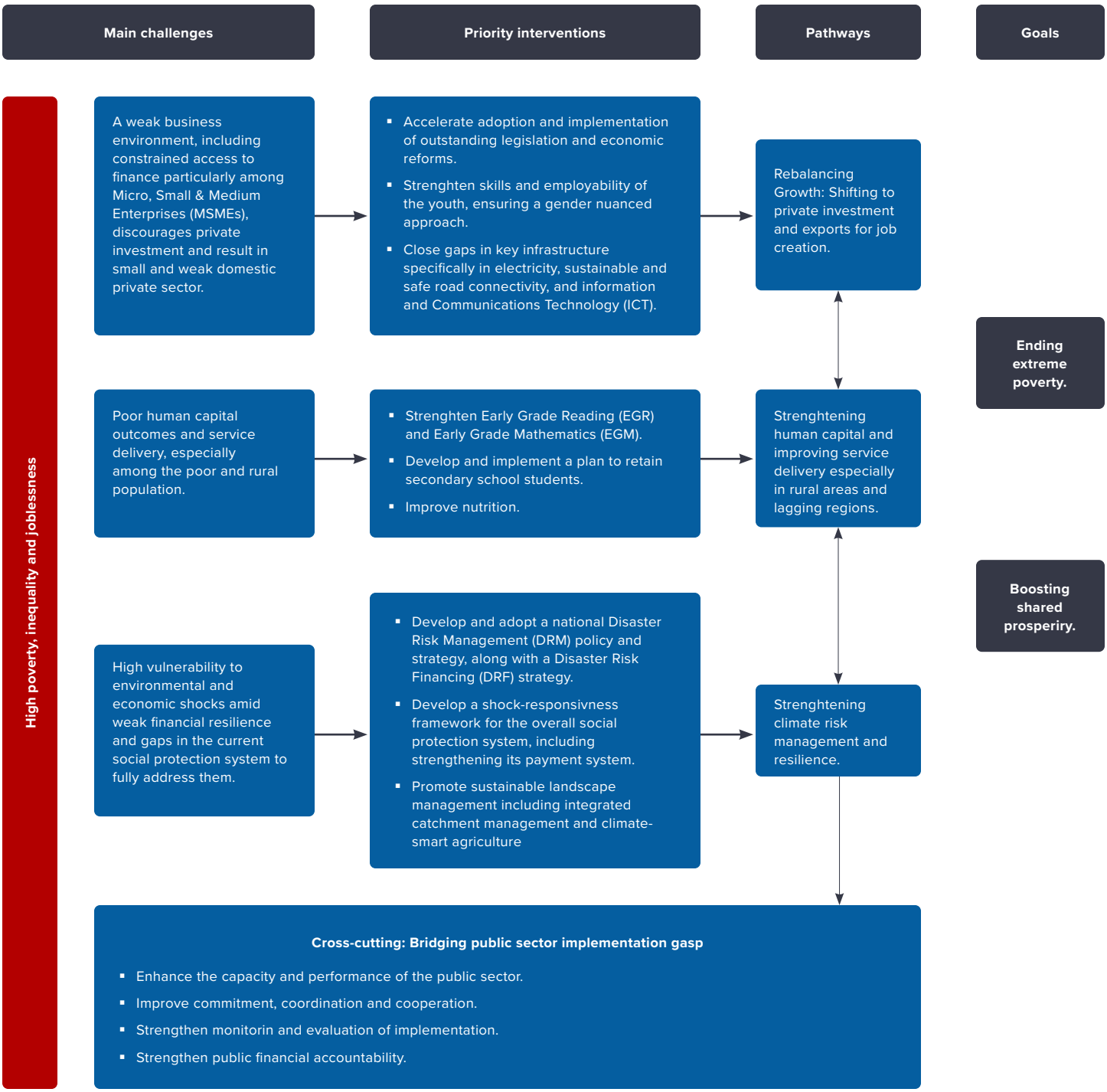
13. **The weak development performance reflects gaps in public sector implementation.** While the overall development narrative of the 2015 SCD remains valid, there is growing evidence pointing to the need to address implementation challenges facing the country, and improve the efficiency and effectiveness of public spending. Implementation gaps reduce the efficiency and effectiveness of public policies and spending. In most cases, the laws, policies and institutions that are meant to support the efficient and effective delivery of development outcomes do exist. However, they are often either not implemented, or distorted. This suggests a challenge of form without function, a kind of 'isomorphic mimicry' in which policy documents and development plans that meet international standards ultimately camouflage deep dysfunction in the actual delivery of services. Isomorphic mimicry partly explains why progress toward building real capability and improving development outcomes has been slow despite high public spending, including significant financial and technical support that Lesotho receives from the development partner community: the focus on the form has overlooked significant implementation gaps. The gaps in implementation are mainly due to foundational constraints related to a fragile political environment and deterioration in the quality of governance, as well as heavy economic reliance on external resources that enables high levels of public spending but weakens policy ownership. Instability of government coalitions in recent years, which is associated with a high turnover of ministers and principal secretaries between elections, has led to weak coordination between government ministries/agencies and development partners, and delayed the implementation of key reforms.

14. **This SCD Update, therefore, proposes a focus on the 'how' rather than the 'what' through bridging implementation gaps.** It argues that implementing better, along with addressing fundamental structural challenges, would improve the quality and efficiency of public spending and accelerate progress, moving Lesotho from aspiration to action

to attainment. Broadly, this requires taking concrete steps to, among others: (i) enhance the capacity and performance of the public sector; (ii) improve commitment, coordination and cooperation; (iii) strengthen the monitoring and evaluation of implementation; and (iv) strengthen public financial accountability. In bridging implementation gaps, Lesotho has an opportunity to build on progress made in the recent past: for instance, the National ID and Civil Registry System provides the seeds for more efficient, transparent, and citizen-centered service delivery. In addition, the Prime Minister's Delivery Unit (PMDU) provides the institutional capacity and leadership to unblock the critical constraints to private investment and job creation through strengthening inter-ministerial and inter-agency coordination, and focusing on delivery of the agenda on investment climate and economic reforms.

15. **This SCD Update identifies four interconnected, broad priority policy areas that could potentially make the greatest contribution to eliminating extreme poverty and boosting shared prosperity.** These are: (i) across all areas, bridging public sector implementation gaps. Implementing better is key to accelerating progress in addressing the challenges and binding constraints to development. In particular, it is key to accelerating progress in the other three broad policy areas, which this Update identifies to include: (ii) rebalancing growth by shifting to private investment and exports for job creation; (iii) strengthening human capital and improving service delivery, especially in rural areas and lagging regions; and (iv) strengthening climate risk management and resilience. The priority interventions within each of these areas are summarized in Figure E. 2.

Figure E.2. Updated priority policy areas



Source: Authors' own representation

1.

LESOTHO'S MACROECONOMIC DEVELOPMENTS SINCE 2015

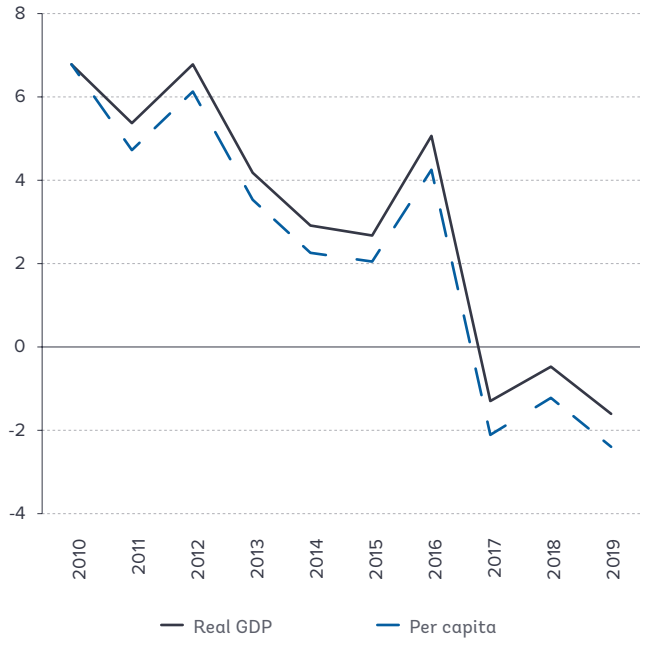
As highlighted in the first SCD in 2015, Lesotho's growth model remains unsustainable, with high reliance on debt-financed public investments. High levels of public investment have failed to translate into higher and more inclusive growth: the macroeconomic position has deteriorated since 2015, with the economy in recession since 2017 and household consumption levels falling 17 percent since 2013. The deterioration in macroeconomic performance is partly because the main challenges and constraints identified in the 2015 SCD remain valid today, as progress toward addressing them has been slow. The private sector has weakened on the back of a deterioration in the overall business environment. As a result, the state continues to play a dominant role in the economy, with evidence of inefficiencies in public spending. The COVID-19 pandemic has exacerbated the growth challenge. Real GDP is estimated to have contracted by 15.3 percent in the fourth quarter of 2020 largely due to the negative shock imposed by the pandemic, coupled with high levels of uncertainty over developments in South Africa and around the globe.

16. **The macroeconomic position has deteriorated since 2015; in fact, the economy has been in recession since 2017.** Economic growth slowed from an average compound annual growth rate of 3.9 percent in real terms between 2010 and 2014 to an average contraction of 1.5 percent between 2015 and 2020. The economy was in recession for four years from 2017 to 2020, driven by contractions in the construction, transport and storage, and wholesale and retail trade sectors. In per capita terms, real gross domestic product (GDP) has fallen by over 5 percent since 2016 (Figure 1a) and convergence with other Southern African Customs Union (SACU) countries is still a long way off. Furthermore, real GDP growth is far below the 7 percent convergence target set by the Southern African Development Community (SADC). The deterioration of the macroeconomic position has been accompanied by a contraction in household consumption, which has shrunk by 17 percent in real terms since its peak in 2013. This marks a sharp reversal of the sustained increase in private consumption levels since independence in 1966 and positions Lesotho as an outlier among its peers (Figure 1b).

17. **Inflation has remained stable.** The headline consumer price index averaged 5 percent growth, with remarkably little variation during the 2010s. The current account position has improved since 2015, on the back of a notable increase in textile and diamond exports, while worker remittances have also held up. Gross international reserves have come under pressure in the past five years. Over the 2015–19 period, international reserves have been on average 20 percent lower than during 2010–14. The fall in reserves in 2016–17 coincided with large debt repayment outflows on the financial account, coupled with two years of current account deficits above 5 percent of GDP.

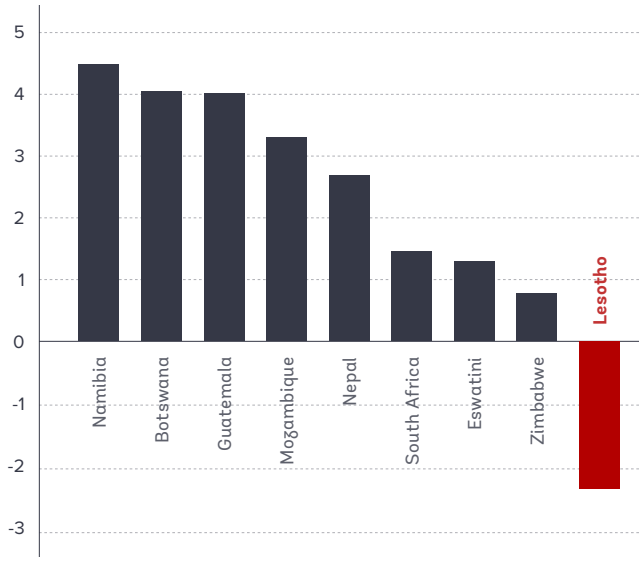
Figure 1. The economy has been in recession since 2017

a. Real GDP growth 2010–2019
(Annual percentage change)



Source: Lesotho Bureau of Statistics.

b. Average real household consumption 2015-2019
(Annual percentage change)



Source: World Development Indicators.

1.1. What Has Driven Growth?

1.1.1. The supply side: expansion in the size of the public sector and in manufacturing

18. **In the 1990s, the economy was driven mainly by subsistence agriculture supported by inflows of remittances from South Africa, especially from migrant mineworkers.** This has since shifted in the 2000s (Figure 2a), with growth driven by increasing net exports from, particularly, diamonds, textile and apparel manufacturing, and water to South Africa. In the 2010s, growth was dominated by the services sector as depicted in government consumption.

19. **Expansions in the size of the public sector and in manufacturing have been the largest contributors to recent economic output.** In contrast, wholesale and retail trade, and finance and insurance have shrunk in real terms since 2015, after a period of strong growth in 2010–14 (Figure 2b). The manufacturing sector contracted by 21 percent between 2010 and 2014 but rebounded by 34 percent between 2014 and 2019, largely due to expansion in the apparel sector supplying South Africa. In earlier years, AGOA boosted the textile and apparel manufacturing sector, after which it became an engine of growth and job creation. However, in recent years, Lesotho's textile industry has faced strong competition in the United States (US) market from Asian producers and increasingly Ethiopian and Kenyan producers, which has subsequently led to a decline in export volumes to the United States. Now, Lesotho is no longer the leading apparel exporter to the United States under the AGOA trade preferences arrangement, with Kenya having taken the top spot.[1] Overall, values of exports to the United States have declined while Kenya, for instance, has managed to increase its value of exports to the United States.

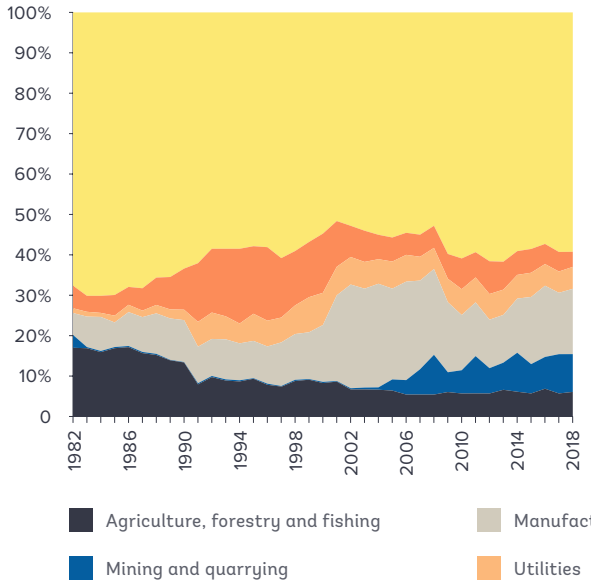
20. **Agriculture is a major source of livelihoods for most of the rural population, with about 71 percent being involved in agriculture to some extent,[2] but agriculture has struggled to be a source of exports, income, and rural growth.** Agricultural output growth was low at about 0.8 percent average annual growth between 2010 and 2019, and highly erratic (Figure 3). This is primarily due to several inter-related challenges, including, among others, the limited size of arable land (only about 11 percent of Lesotho's total land area is arable), unfavorable farm structures (average land holding is 1 hectare per family), weak extension services, lack of irrigation, inadequate rural infrastructure, and limited access to credit and investment capital. The situation is further exacerbated by land degradation and massive soil erosion as a result of the extensive, extractive cultivation system and over-utilization of the rangelands. In addition, climate change has increasingly affected crop and livestock productivity, with the country being highly vulnerable to climatic shocks, mainly from droughts, frost, and floods.

1. AGOA is a non-reciprocal trade agreement enacted in 2000 that provides duty-free export to the United States from eligible countries in Sub-Saharan Africa. The purpose of AGOA is to support economic development in Sub-Saharan Africa and deepen US trade and investment ties to the region. AGOA extends duty-free benefits previously available only under the country's Generalized System of Preferences (GSP) program. Newly added AGOA products include apparel, footwear, motor vehicle components, agricultural products, chemicals and steel. AGOA also offers a Third-Country Fabric provision, which allows low-income countries in Africa to export apparel using imported yarns and fabrics.

2. FAOStat 2018.

Figure 2. The shift from agriculture to services and manufacturing continues

a. Services dominate the economy

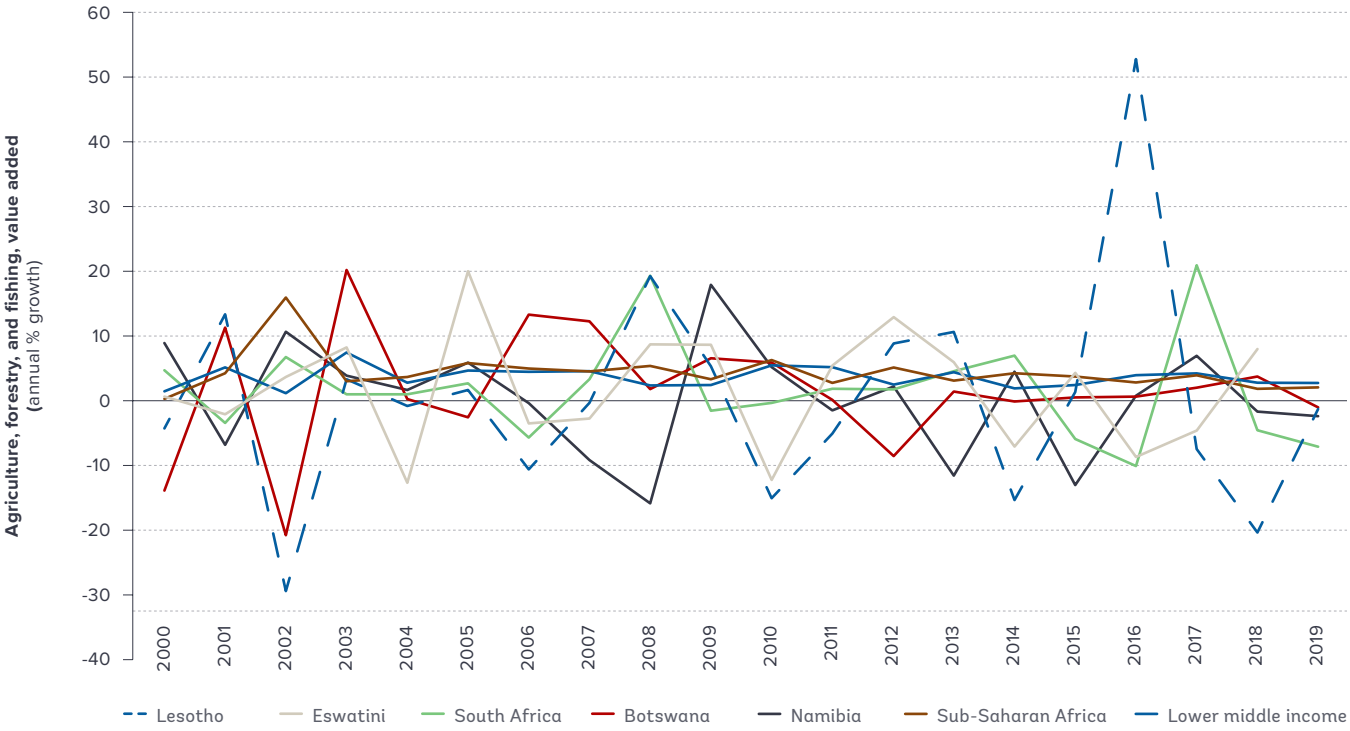


b. Expansion in the size of the public sector has contributed the most to recent economic output

	Real change in activity (M, millions)	Proportion of total economic expansion
2010-2014		
Finance and insurance	1,085	29%
Wholesale and retail trade	736	19%
Information and communication	367	10%
2015-2019		
Public administration	834	236%
Manufacturing	373	106%
Mining and quarrying	78	22%
Electricity and water	-171	-48%
Wholesale and retail trade	-324	-92%
Construction	-342	-97%

Source: Lesotho Bureau of Statistics.

Figure 3. Agricultural output is low and erratic



Source: World Development Indicators.

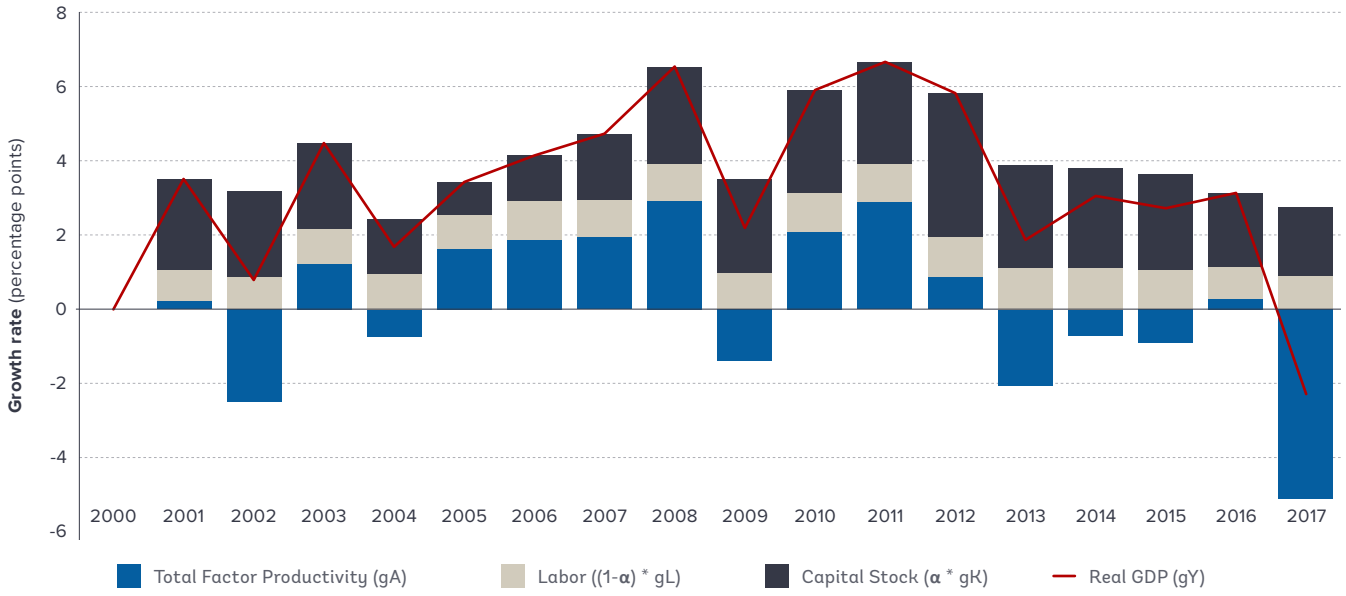
21. **The poor performance of agriculture in Lesotho does not mirror the yield and labor productivity gains seen in the rest of Sub-Saharan Africa.** The low level of production, together with limited marketing information and skills, weak private sector engagement, inadequate agricultural policies, and inefficiencies in public spending have hampered agricultural commercialization and agribusiness development, and failed to provide a pathway out of poverty for Lesotho's rural poor. The decline in the agriculture sector's contribution to GDP is also likely to have had an indirect economic impact through other sectors, as it is a supplier of inputs to manufacturing businesses and a core market for rural, non-farm services. As such, enhancing productivity in this sector could increase rural incomes and strengthen linkages to other sectors (e.g., manufacturing and services) to support rural poverty reduction.

1.1.2. The demand side: government consumption and net exports

22. **The economy remains highly government consumption-driven, a sign of an unsustainable growth model.** A growth-accounting exercise confirms the contribution of declining total factor productivity and capital stock (investment) in the slowdown in economic growth (Figure 4), and that the economy is driven primarily by net exports and government consumption rather than private consumption and investment.

23. **Investment levels have remained high compared with peers, even during the recent period of political upheaval, with government leading most of the investment.** Gross fixed capital investment averaged 29 percent of GDP between 2010 and 2019 (Figure 5a). Most of this investment was led by government, with Lesotho's public sector investment levels ranking among the highest in the world. Public investment is about 14 percent of GDP and puts Lesotho at the top of its peer group (Figure 5b).

Figure 4. The economy remains highly government consumption-driven

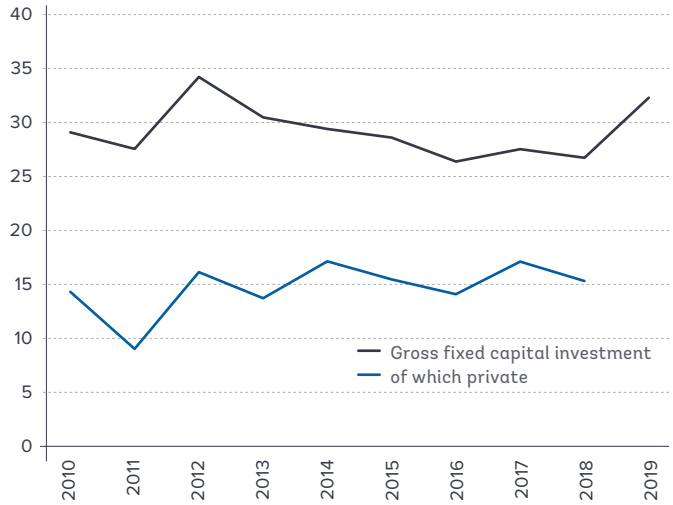


Source: World Bank staff estimates.

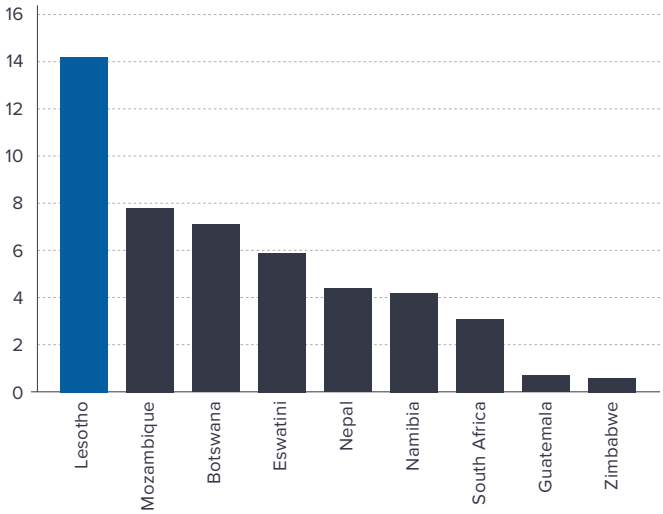
24. **High public investment has compensated for low foreign direct investment (FDI), which has declined since 2015.** After falling below 1 percent of GDP in 2010, FDI increased to about 5 percent of GDP in 2015 due to the expansion in mining and in textiles and clothing under AGOA. However, since 2015, FDI has been on a downward trend. Lesotho's FDI is largely driven by equity and investment fund shares (particularly by commercial banks), and the downward trend is attributable to higher FDI outflows as a result of rising foreign assets held by commercial banks. Commercial banks have increased their foreign investments abroad due to the liquidity they enjoy domestically, as well as better yields and instruments abroad. Furthermore, FDI inflows to Lesotho have been steadily declining due to an undeveloped domestic debt market.

Figure 5. Investment levels are high, led by the public sector

a. Gross fixed capital investment, 2010–19
(Percent of GDP)



b. Public investment compared with peers
(Percent of GDP, average of 2010–18)



Source: World Development Indicators and International Monetary Fund (IMF).

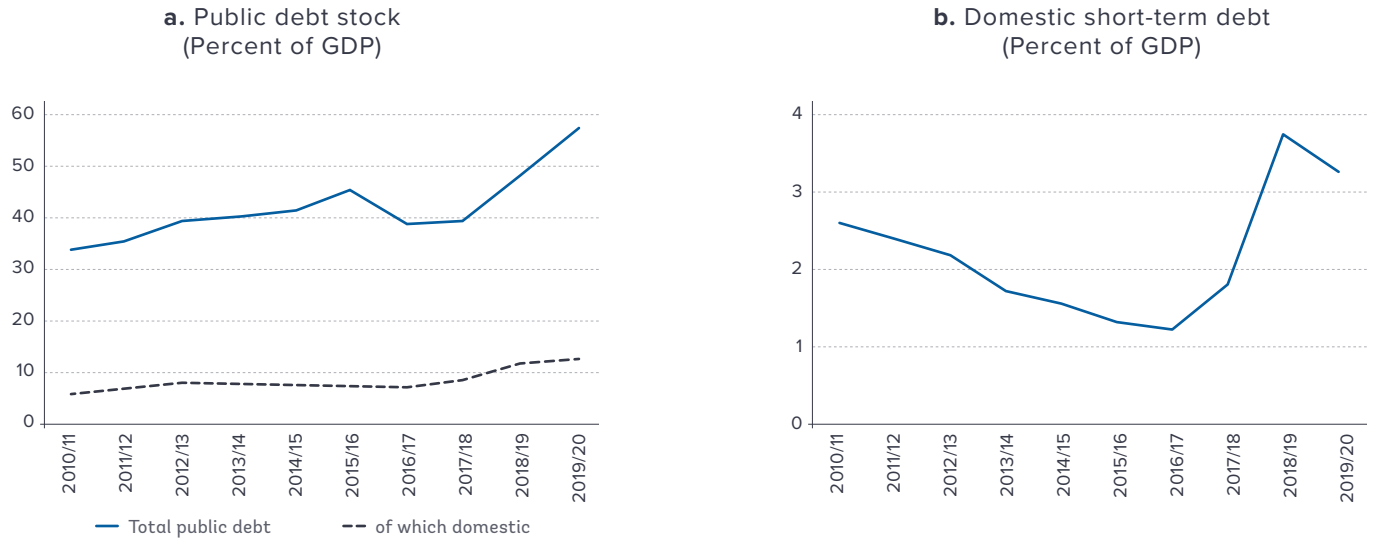
Government debt levels are steadily increasing

25. **The dominance of the public sector in the economy is associated with increasing debt levels.** The debt-to-GDP ratio increased to 57 percent at the end of 2019/20. The equivalent figure was 34 percent at the end of 2010/11 and 41 percent at the end of 2014/15 (Figure 6a). This increase in debt has been a result of persistent fiscal deficits since 2015/16. These deficits have been mostly financed from additional external borrowing, with the stock of external debt increasing by 15 percent of GDP between end-2017/18 and end-2019/20. This new borrowing has been less concessional than previously, with concessional debt as a proportion of total external debt falling from 85 percent between 2010/11 and 2014/15 to 79 percent between 2015/16 and 2019/20 (Figure 6b).

26. **Domestic borrowing has seen a sharp increase from a low base.** Domestic borrowing, which is almost exclusively in the form of Treasury bills (T-bills) and Treasury bonds, rose from 7 percent of GDP in 2016/17 to 12.5 percent in 2019/20. Most of this borrowing was in the form of short-term T-bills, reversing the trend since 2010/11 of short-term lending being a declining share of domestic borrowing. Domestic markets remain limited, as few companies have listed and participate in the Maseru Stock Market. Nevertheless, domestic interest rates have been falling, making this growing dependence on domestic borrowing less costly.

27. **The most recent joint World Bank/IMF Debt Sustainability Analysis (DSA) revised Lesotho's risk rating from 'low' to 'moderate' risk of distress.** This revision is a return to trend, with the 'low' rating of 2017 reflecting revised GDP data and a stronger GDP outlook, which has since weakened. An emerging issue noted since 2017 is the underfunding of pension liabilities, estimated at 3.5 percent of GDP. From the perspective of breaching DSA thresholds (and, hence, moving from a 'moderate' to 'high' risk of debt distress), Lesotho is most vulnerable to an export shock, with the DSA conducted in 2020 showing the present value of debt of the GDP threshold of 40 percent being breached from a 1 standard deviation shock to exports. Most borrowing is used to finance government-implemented projects, but it is unclear if these projects generate the returns needed to service the debts they create. Most of Lesotho's external borrowing is from bilateral and multilateral lenders to finance specific capital investment projects.

Figure 6. Government debt levels are rising



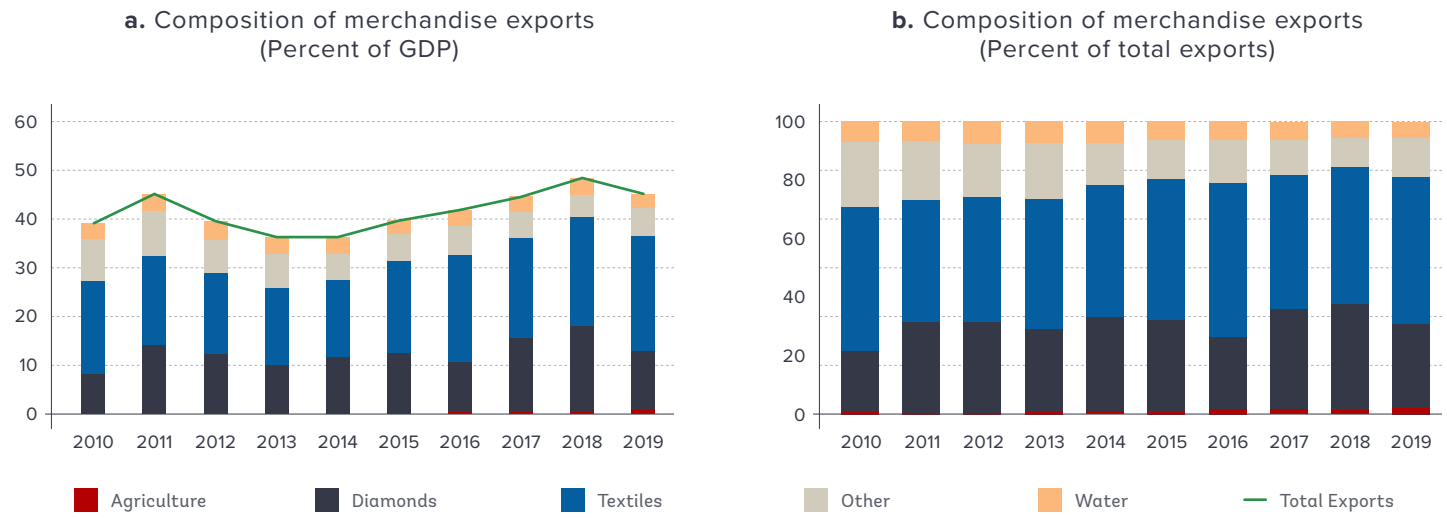
Source: Central Bank of Lesotho.

Increased levels of net exports have been driving recent economic growth, but they lack diversification

28. **As a small landlocked country, net export performance is an important driver of growth in Lesotho.** Since 2015, total merchandise exports have been on an upward trajectory. Total merchandise exports increased from an average of 38.5 percent of GDP in the period 2010–15, to an average of 42.5 percent in the period 2015–19 (Figure 7a). However, exports are still concentrated in just a few products, mainly textiles, apparel and diamonds. Textiles and apparel account for almost half of exports, followed by diamonds at almost one-third (Figure 7b). Textile and apparel exports increased significantly mainly due to the extension of AGOA in 2015 to 2025, as most of Lesotho's textiles and apparel are exported to the United States. However, while exports of textiles and apparel to the United States have fallen, exports to South Africa have increased. The value of non-textile, apparel and footwear manufacturing exports has fallen since 2015, reflecting the closure of specific factories.[3] Diamond exports increased partly because more diamond mining companies started operating, while some expanded or started exploratory operations between 2015 and 2019. Favorable global diamond prices in 2015 and 2019 also had a positive impact on diamond exports. Lesotho's diamonds are exported to the European market and auctioned in Antwerp, Belgium. Water exports to South Africa remained constant as determined by the agreement between the two countries.

29. **Lesotho's ratification of the African Continental Free Trade Area (AfCFTA) agreement in November 2020 presents an opportunity for the country to look beyond the traditional and dominant markets of South Africa and the United States as one of the measures to diversify the economy.** Through the AfCFTA, African countries can diversify exports, accelerate growth, and attract FDI. The AfCFTA reduces tariffs among member countries and covers policy areas such as trade facilitation and services, as well as regulatory measures such as sanitary standards and technical barriers to trade (World Bank 2020c).

Figure 7. Exports have increased, driven by apparel and diamond exports



Source: Central Bank of Lesotho.

3. A small number of firms in other manufacturing production have closed down, resulting in the ending of television, radio, lightbulb, and car seat cover exports. A small number of firms in other manufacturing production have closed down, resulting in the ending of television, radio, lightbulb and car seat cover exports.

1.1.3. Strong economic ties to South Africa remain important for growth

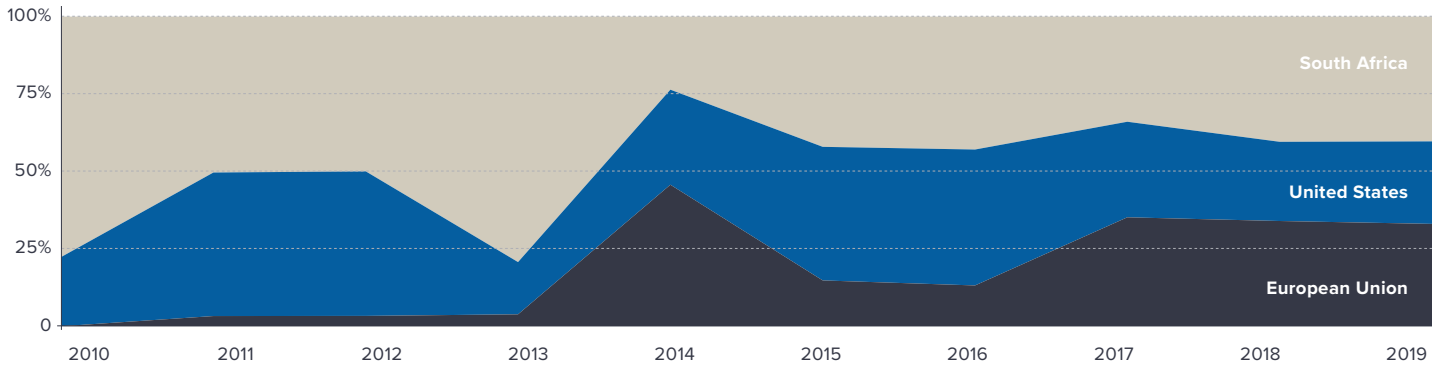
30. **Lesotho has close economic linkages to South Africa.** It is only as an export market where South Africa is not the overwhelmingly dominant partner, with the United States (for garments) and the European Union (for diamonds) providing alternative export markets (Figure 8). The rise of Lesotho's diamond exports has lowered South African dominance as an export market, but South Africa remains the principal source for Lesotho's imports. In 2010, 75 percent of Lesotho's exports by value went to South Africa, but by 2019 that proportion had fallen to 39 percent. This was largely due to the significant increase in diamond exports to the European Union since 2010. In terms of imports, an average 77 percent of Lesotho's imports were registered as coming from South Africa between 2010 and 2019. Taiwan, China is still an important trading partner, in particular for the importation of raw or intermediate materials used in the garment industry, while both China and India have been slowly increasing their market shares.

31. **South Africa accounts for around 66 percent of international lending to Lesotho.** Total liabilities owed to South African residents were equivalent to around 17 percent of GDP as of end-2019. While lending to Lesotho's banks has been declining since 2010, lending directly to non-banks, which includes non-bank financial corporations (pension funds, insurance companies, fund managers), as well as the non-financial sector (firms, households and government), has been rising, from 3 to 7 percent of GDP. This growth has been entirely from additional lending by South African-based financial institutions. Most of this additional lending has been directly to Basotho households, rather than firms or government.

32. **Most of Lesotho's worker remittances come from South Africa.** Annual remittance flows to Lesotho are estimated to have averaged around 24 percent of GDP in the 2010s, one of the highest rates in the world. Traditionally, Basotho mine workers employed in South Africa were the principal source of remittances, with employment as high as 120,000 in the late 1980s. These remittance payments are mainly passed through formal banking channels established by the mining companies. However, mineworker numbers had fallen to less than 22,000 by the end of 2019 and increasing numbers of Basotho are working both formally and informally in agricultural and domestic activities in South Africa. Data suggest that around 70 percent of total Basotho working in South Africa are outside the formal mining sector. Remittance payments from this group pass through less formal channels, including as cash and physical goods carried over the border.

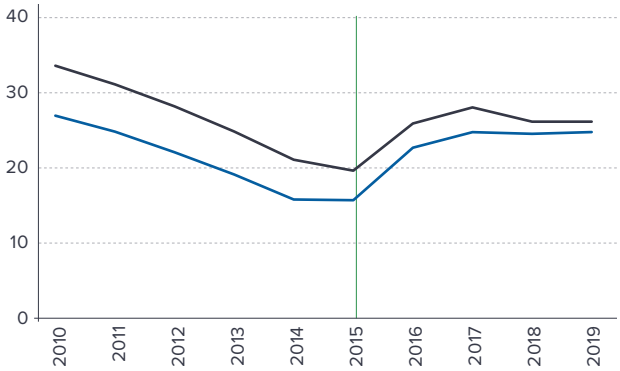
Figure 8. Lesotho has close economic ties to South Africa

a. Exports by destination, share of total exports

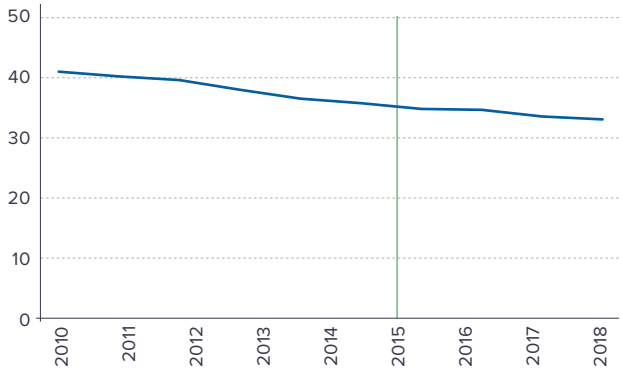


Source: International Monetary Fund Direction of Trade Statistics.

b. Estimated remittance inflows to Lesotho (Percent of GDP)



b. Basotho mineworkers in South Africa (average number per year)



Source: World Bank, Central Bank of Lesotho.

1.2. What Has Constrained Growth?

1.2.1. A weak business environment

33. **The investment climate is lagging in several areas and the overall doing business environment has deteriorated.** This is reflected in several indices of economic competitiveness. For example, Lesotho ranks 131st out of 141 on the 2019 World Economic Forum's Global Competitiveness Index, ranking especially low in health, infrastructure and innovation capacity.

34. **A weak business regulatory environment hampers competition.** The investment policy and legal regime is complex, fragmented and sclerotic. There is neither an Investment Promotion Law, an Investment Promotion Agency, nor incentives for FDI. In the absence of an explicit investment legal framework specifically addressing both FDI and domestic investment, investor protection remains weak. The screening and approval of FDI are conducted through a process akin to a licensing regime where every potential FDI is subject to a one-off policy, subjective treatment, and shifting GoL priorities, while its entry, establishment, operation and exit are based on unclear criteria and ad-hoc legal agreements. Weak tenure security adds to this challenge and is due to an outdated and dysfunctional system of property rights transfer, acquisition, registration and protection, particularly for agricultural land.[4] Property rights are weak to non-existent in commercial, industrial and agricultural land outside of Maseru and Maputsoe. Weak security of tenure creates risks for investors and means that farmers are unable to provide enough collateral to secure loans. Furthermore, the dominance of state-owned enterprises (SOEs) or joint-venture agreements between SOEs and foreign investors in key sectors limits competition as it deters or further crowds out new FDI.[5] Restructuring SOEs to transfer some of their functions to the private sector, while enhancing SOE governance and efficiency, remains important.

35. **The development of local competitors has been limited.** Key sectors, such as wholesale, retail, mining and textiles, are largely controlled by expatriate groups. Large foreign-owned manufacturing firms have not facilitated the development of local entrepreneurial skills and technology transfer. To date, few Basotho manage or own textile firms. In addition, there are just a small number of foreign-owned firms within most sectors in the formal economy. Within four subsectors of manufacturing—apparel, construction, footwear, and food products—the four largest firms employ over half of all workers. The same is true for three subsectors within the services sector—retail-specialized stores, retail household equipment, and private security activities (World Bank 2018). This suggests that, while there are many individual entrepreneurs within the MSME grouping and several large firms, there is a 'missing middle' into which small firms are unable to grow.

36. **Access to credit for MSMEs has been a significant challenge in Lesotho.** As at the end of 2019, the private credit-to-GDP ratio was about 19 percent and the bank deposits-to-GDP ratio was 32 percent (2018). The financial sector is dominated by banks, with total assets constituting 69 percent of the total financial sector's assets at the end of 2019. The monetary financial institutions (MFIs) and savings and credit cooperative societies (SACCOs)

4. Lesotho has fewer than 300 land titles issued for agricultural land, and the process of land transfer and registration takes over five years.

5. Examples include: the LNDC in property management, asset management, commercial real estate, SME finance, Special Economic Zones (SEZs) and capital holding sectors; the Lesotho Tourism Development Corporation (LTDC) in tourism, entertainment and real estate; the Dairy Board in dairy; Maluti Beer in beverages; and Letzeng Diamonds in mining.

play a limited role in reaching underserved segments, specifically lending to micro and small enterprises. Access to finance remains limited for MSMEs owing to lack of a credit history, high collateral requirements, a missing legal framework for movable collateral-based (though efforts to develop one have been undertaken), dysfunctional credit guarantee schemes and an insolvency regime that is not functioning. The credit bureau is operational but has very limited coverage, with less than 16 percent of adults covered. The Secured Interest in Movable Property Act and its implementing regulations were recently published in the Government Gazette (August 2020), though there is a need to establish the collateral registry and increase capacity of the court system in order to improve access to credit. Furthermore, while Lesotho has reached parity in financial inclusion, women tend to rely more on informal savings and credit, and have fewer assets to use as collateral for the credit they would need to scale up small businesses. Access to early-stage finance for startup firms is limited and entrepreneurs have no information about, or access to, existing financing opportunities in the region.

37. **A shortage of skills is an impediment to private sector development.** Skills mismatches adversely affect youth employment prospects. For example, while many learning institutions offer courses related to textiles and apparel, the skills taught do not align with those required by industry (World Bank 2018). Support programs are fragmented, with most providing rudimentary training and very limited follow-on technical or financial support. Hence, the impact of support programs is relatively small, and their future sustainability is unclear. There are currently very limited opportunities for networking, information-sharing and interactions among entrepreneurs, and examples of collaboration among the various programs are few. Furthermore, addressing the underrepresentation of women in digital startups remains important for promoting diversity and inclusivity in the sector. Many entrepreneurship programs do not promote digital skills or ICT usage, which is a missed opportunity to embed digital skills.[6] This is critical since the COVID-19 pandemic is re-shaping remote working arrangements, and individuals without access to digital devices, digital skills, or the knowledge of how to leverage digital technologies for their businesses are especially vulnerable.

38. **Limited connectivity weakens integration into value chains.** As a small, landlocked country, Lesotho's domestic market is small, while limited virtual and physical connective infrastructure hampers the integration of local producers into global value chains. Cities have been shown to be effective in realizing agglomeration effects and thereby generating economies of scale for the private sector.[7] Agglomeration effects are expected to increase with higher urbanization rates. Currently, only one-third of the population lives in urban areas. While improvements in transport infrastructure have enhanced connectivity, Lesotho's geology, topography, and climate present unique challenges for developing its transport sector. Transport by road is the dominant mode of accessibility and mobility, and road freight is predominantly provided by the private sector.[8] The road network remains unevenly distributed, being mostly concentrated in the lowlands and foothills, which constitute 25 percent of Lesotho's total area. The drop in the Logistics Performance Index (LPI), from 133/160 in 2014 to 139/160 in 2018, underscores persistent connectivity challenges. Overall, these physical connective infrastructure gaps adversely impact the efficiency of trade facilitation, with poor linkages between production sites and border posts. Enhancing connectivity and integration into value chains could benefit from better leveraging proximity to South Africa's more modern and developed infrastructure.

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6. A small number of private sector initiatives, such as the Vodacom Innovation Park, Standard Bank's Enterprise Hub, and GrindNation, are exceptions, since their programs offer access to computers, equipment and internet connectivity.

7. For a summary, see Gates to the World: African Cities, World Bank 2016.

8. Lesotho has no domestic air transport but is connected internationally through a scheduled service between Maseru and Johannesburg's OR Tambo International Airport. The only rail transport is a freight service between Maseru's container terminal hub and Bloemfontein in South Africa, with two freight trains running daily mainly carrying cement, maize, fuel and freight containers. This constitutes one-third of Lesotho's international trade in bulk goods.

39. **Improvements in digital infrastructure and ICT-enabled services have the potential to enhance the integration of Lesotho into regional and global value chains, but the adoption and use of technology are lagging.** Despite progress in improving digital infrastructure, Lesotho has a low standing on the World Bank's Digital Adoption Index (DAI), which measures the level of adoption of technology by businesses, government, and citizens. Comparing Lesotho's score and position with comparator countries suggests a key issue is the low level of internet connectivity, with only one-third of Basotho using internet regularly, pointing to a wide digital divide that has been difficult to close. Basotho consumers have been rapid adopters of new technology in the form of mobile phones and mobile payments, but limited digital skills hold back the extent of their adoption, and the greater use of digital products and services. The country also suffers from an exodus of skilled people, who are more likely to have digital skills, to South Africa, constituting a drag on competitiveness and lessening the interest of companies hoping to grow their operations in Lesotho.

40. **Lesotho's private sector makes limited use of digital technologies, constraining its integration into value chains.** Data from the World Bank's Enterprise Surveys[9] show that only 15 percent of formal manufacturing and services firms in Lesotho have a website, compared with 31 percent of firms in Sub-Saharan Africa. Few Basotho firms engage in e-commerce to attract international customers. While a small local ICT industry has emerged, it is hampered by the small size of the local market. The limited demand and customer base constrain the ability of digitally enabled or ICT-driven firms (including MSMEs) to play a critical role in driving the digitization of small and large firms alike, improving their chances of survival during the COVID-19 pandemic.

41. **Lesotho has the opportunity to harness the digital economy as an enabler of connectivity, growth and innovation.** The World Bank 2020 Lesotho Digital Economy Diagnostic (World Bank 2020b) argues that the digital economy is underutilized and Lesotho's adoption and use of technology are lagging in part due to weak competition in the broadband market. At the same time, there is also slow progress in the development and use of public and private digital platforms, a rigid enabling and regulatory environment to support further innovation and market entry in the digital financial services (DFS) sector, insufficient implementation of digital skills, and a nascent digital entrepreneurship ecosystem. To tap into the potential that the digital economy holds, the diagnostic identifies three broad priority areas as opportunities for Lesotho. These are: (i) improving the enabling environment for the digital economy; (ii) driving digital transformation and demand by strengthening public sector platforms and infrastructure; and (iii) strengthening the digital ecosystem through digital skills and entrepreneurship. Overall, the diagnostic emphasizes the need to shift the emphasis from supply to demand-side measures. It finds that a holistic approach to the use of the digital economy that improves digital skills and literacy, access to digital payments and other DFS, and support to digital entrepreneurs can promote inclusive growth.

9. http://www.enterprisesurveys.org/data/exploreeconomies/2016/lesotho

1.2.2. A large public sector, coupled with inefficiency of public spending

42. As argued in the 2015 SCD, "the sheer size of the state, coupled with misaligned expenditures, including a high wage bill, is one of the fundamental obstacles to the sustainability of inclusive growth, more diversified growth itself, and building assets among the poor." This is still constraining growth today.

43. **A high proportion of revenues goes to cover government salaries.** The budget speech for FY2021/22[10] suggested the compensation of employees accounted for 17.5 percent of GDP in 2019/20. The budget speech further projects the compensation of employees to account for 18.3 percent of GDP and 41.6 percent of total expenditures for 2020/21. At this level, Lesotho's public sector wage bill is one of the highest in the world,[11] and large in relation to the country's income level. The high wage bill is due to high and rising wage levels, and high numbers of public employees (Figure 9b). Government workers enjoy a substantial wage premium vis-à-vis their private sector counterparts with similar qualifications and experience.[12] For example, 80 percent of education expenditure is on teacher salaries, while outcomes in the sector have been low and inequitable.[13] Increases in public wages push up wage demands

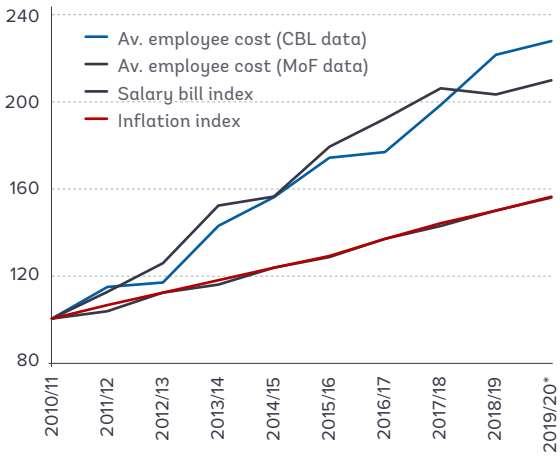
Figure 9. Average public sectors salary costs have increased considerably faster than inflation

a. Inflation rates, and announced salary increases for public servants (Percent)

	Inflation	Announced salary adjustment	No. of public servants
2010/11	3.6	3.5	43,700
2011/12	5.0	5.0	43,800
2012/13	6.1	3.0	43,300
2013/14	5.0	6.0	43,700
2014/15	5.4	4.0	44,200
2015/16	3.2	6.0	44,000
2016/17	6.6	4.0	43,900
2017/18	5.2	3.0	43,700
2018/19	4.8	4.0	43,200
2019/20*	5.2	no change	42,300
2020/21*	6.5	5.0	42,800

Source: Central Bank of Lesotho, Budget speeches, various years.

b. Growth in the government wage bill and average employee cost (Index 2010/11 = 100)



Source: Ministry of Finance budget data, Central Bank of Lesotho.

10. Tabled to Parliament on the February 17, 2021.
11. Note on the Management of the Wage Bill for the Government of Lesotho (World Bank 2019).
12. Ibid.
13. Lesotho Education Public Expenditure Review (World Bank 2019).

in the private sector, while increases in the number of public sector jobs lead to tighter labor market conditions and increased wage pressure. As a result, although the country's labor regulations are broadly in line with other SADC countries, they translate into generous terms given the country's relative income level. The minimum wage is a relatively high share of per capita income (almost 80 percent, double that of South Africa at 40 percent of per capita income), and severance pay in weeks of salary is higher than all other countries in the region except Botswana.

44. **Weak basic payroll and human resource management (HRM) controls drive high wages and impacts the GoL's ability to effectively manage staff performance.** The recent Human Resource Management Information System (HRMIS) assessment found that there are no controls in major transaction and approval processes, as well as issues with data quality.[14] Efforts to complete a one-time cleanup of payroll/HR data and put in place strengthened HR business processes are ongoing, including efforts to verify the existence and uniqueness of individuals on the payroll with the National ID and Civil Registry. The Ministry of Public Service (MoPS) has also initiated efforts to implement and automate more robust business processes, including through procurement of a new HRMIS with interfaces to the National ID and Civil Registry and Integrated Financial Management Information Systems (IFMIS). This will strengthen the efficiency of public spending and lay the foundation for better staff deployment and performance management.

45. **Inefficiencies are also evident in public spending in agriculture.** Despite the significant role of agriculture in Lesotho's rural space, at less than 3 percent of total spending, public spending on the sector is inadequate and inefficient. The share of spending is far below the Comprehensive Africa Agriculture Development Programme (CAADP) target of 10 percent. Agricultural spending is highly dependent on international financing and bilateral development partner funding. Spending in agriculture is inefficient. Key areas of public spending inefficiencies in the agriculture sector include: (i) the fertilizer and input subsidies program , with the National Fertilizer and Input Subsidy Program involving a 50 percent subsidy on seed, fertilizer and mechanical operations;[15] (ii) low and poorly managed infrastructure investment, for example, public expenditures in irrigation remain abysmally low at 0.5 percent of total public expenditures in agriculture; and (iii) a high share of salaries in sector spending compared with total agricultural spending, with salaries representing as much as 91 percent of the Ministry of Agriculture and Food Security (MAFS) District Office and 71 percent of the Livestock Department expenditure.

46. **Spending on goods and services, as well as grants, has been slowly falling as a share of GDP.** Domestic travel and transport accounts for about 20 percent of goods and services spending. Efficient management of the GoL's vehicle fleet has been a concern for the past two decades. Recent policy announcements discuss downgrading vehicle types and better controlling vehicle use to reduce costs. Spending on grants has been falling, while social benefits have been broadly flat.[16] Budget transparency of grants could be strengthened, with sizable expenditures being recorded under this category that, ultimately, are spent on staff salaries, suggesting an even larger public sector wage bill than officially recorded. The largest component of social benefits is payments under the old age pension, which accounts for about 75 percent of this budget area. In October 2019, the GoL launched an old age pension verification scheme to stop payments to deceased pensioners.

47. **Inefficiencies are also evident in public social spending, which is relatively high, but outcomes remain poor suggesting spending on social services could be better targeted and more efficient.** Lesotho allocates a relatively large amount of its public resources to education, health, and social protection, but resources are not allocated equitably. For example, in 2018, education spending accounted for 8.9 percent of GDP. The health budget allocation was at 6.2

14. Lesotho Human Resource Management Information System Assessment (Government of Lesotho 2019).

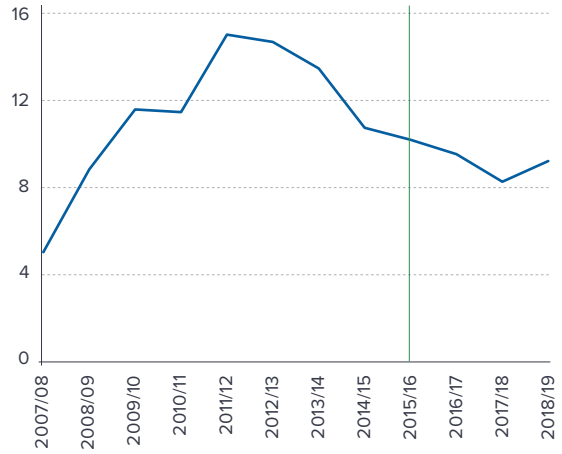
15. The program primarily targets cereal production aimed at strengthening food security.

16. 'Grants' covers a wide range of transfers, including grants paid to extra-budgetary units, as well as student loan and bursary payments.

percent of GDP for 2019/20. Public expenditure on social protection is 6.4 percent of GDP. Despite this generous spending on these sectors, however, outcomes remain poor, signaling efficiency gaps. To illustrate, the share of spending on post-secondary level education generally benefits the non-poor, such as the tertiary education bursaries, as the poorest children rarely complete secondary education and access tertiary education. When it comes to social protection, coverage of the poor is limited, and the administrative systems are antiquated and lead to expensive implementation. Overall, the efficiency of social spending could be improved by better accountability of service provision, and targeting of resources to rural, poor households.

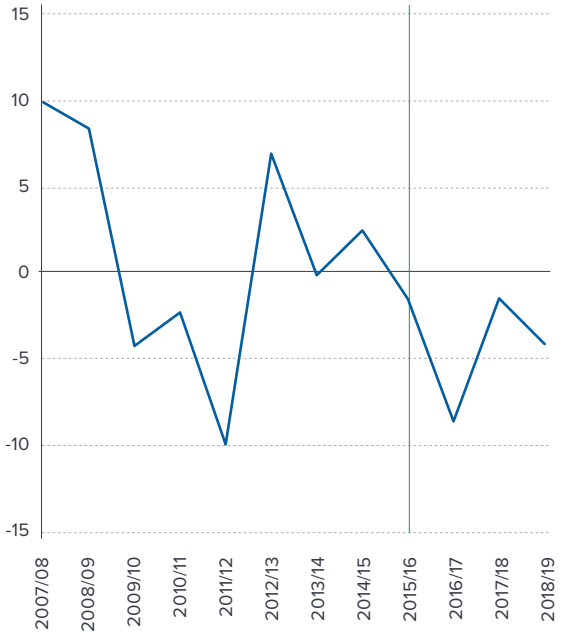
48. **Spending on foreign interest payments has overtaken payments on domestic debt.** Around three-quarters of Lesotho's debt stock is external, largely on concessional terms, and mostly denominated in US dollars. A combination of factors has led to the interest costs for external debt exceeding the interest costs for domestic debt: the depreciation of the South African rand against the US dollar has pushed up the maloti value of US dollar denominated interest payments; grace periods for some concessional external loans have been ending; and nominal interest costs on domestic borrow have fallen sharply. Average interest rates on public debt have been flat at around 2 percent per year. The overall fiscal balance has been volatile year-to-year, reflecting volatility in SACU transfers, but average deficits have grown larger in recent years (Figure 11). The estimate for the cash balance for 2019/20 published with the 2020/21 budget forecasts a -5.7 percent of GDP deficit. Over the years, fiscal deficits have been financed through domestic and external borrowing, the accumulation of domestic arrears, and the drawdown of government deposits at the Central Bank of Lesotho.

Figure 10.
Government capital investment has been falling (Percent of GDP)



Source: Central Bank of Lesotho.

Figure 11.
Overall cash balance (deficit/surplus) (Percent of GDP)



Source: Budget books, various years.

49. **Capital investment has been falling as a proportion of GDP in recent years.** From a peak of over 14 percent of GDP in 2011/12, capital spending declined to an average of 9 percent of GDP between 2015/16 and 2018/19 (Figure 10).[17] A persistent challenge lies in executing the capital budget, which continues to underspend, with the implementing capacity of line ministries, cash shortages at the Treasury, and for development partner-financed projects complications with tendering and procurement processes[18] being some of the reasons behind this underspending. Road building is important, with in particular the Leshoele-Mathokoane and Mpiti-Sehlaba-Thebe roads being the largest projects in recent years.

50. **Capital investments are sometimes poorly targeted and improperly procured.** The budget includes capital investments and PPP projects not assessed through the public investment management (PIM) system (e.g., construction of sports stadiums, representing 6.5 percent of GDP, was approved outside PIM processes), and not all capital spending is on budget. For example, in the FY2020/21 budget, only 77 percent of new capital investment projects were appraised by the Public Sector Investment Committee (PSIC) and selected from the Public Sector Investment Plan (PSIP) aligned with the National Strategic Development Plan (NSDP) II. Absence of a strong legal and regulatory PPP framework constrains investments in privately financed infrastructure and social services. PPP Regulations were prepared and submitted in 2020 by the Ministry of Finance (MoF) to the Office of Parliamentary Council (OPC).

51. **Public procurement, equivalent to about 35 percent of GDP, is a key determinant of the Government's effectiveness in delivering essential services, programs and projects.** However, the legal and policy framework for procurement is not comprehensive and needs to be updated. For example, there are no provisions for emergency procurement, resulting in inefficiencies when procurement must be executed expeditiously, and at times this has led agencies to procure goods and services using alternative and non-transparent methods. Updating the legal and policy framework taking into consideration the weakness highlighted in Table 1 is critical. The Public Procurement Bill has been approved by the Cabinet for submission to parliament. Meanwhile, Lesotho received a 'D' grade in the Procurement Pillar of its 2016 Public Expenditure and Financial Accountability (PEFA) review, the lowest score possible. Among the main shortcomings were discretionary selection criteria, a lack of standardized procedures, and insufficient monitoring and evaluation.[19]

52. **Ensuring discipline and accountability in public financial management (PFM) remains a critical challenge.** Despite a recently upgraded IFMIS, key processes occur outside the system and the number of unreconciled transactions continues to grow. Strong expenditure controls that ensure resources are spent according to government priorities and prevent the build-up of arrears have become more critical in the context of declining government revenues resulting from the COVID-19 pandemic and the long-term decline in SACU revenues. Strong commitment from the MoF to enforce the use of IFMIS to capture all transactions (revenue and expenses) and reconcile bank statements on a daily basis is required to maximize the benefits from the upgraded system.

53. **Regarding decentralization, the challenge is to manage the risks to fiscal discipline while achieving the long-term goal of strengthening local governments to manage their own financial resources.** Decentralization has been an important theme in governance reforms, with the 2014 National Decentralization Policy. Given the level of budget resources involved in the functions being decentralized to the local level, Lesotho needs to complement the fiscal decentralization by simultaneously strengthening local governance systems and local administration at the district level. At the central government level, the GoL has a strong and transparent budget framework with a modern budget management system

17. It is important to note that while Figure 5 refers to Gross Fixed Capital Formation (or investment), Figure 10 refers to Government Capital Expenditures (or budget).

18. For example, the disbursement rate for the African Development Bank's Lesotho portfolio was only 45 percent.

19. European Union. 2017. Public Expenditure and Financial Accountability (PEFA) Assessment 2016. Washington, DC: PEFA Secretariat.

Table 1. Key procurement and public investment management weakness

PROCUREMENT	PUBLIC INVESTMENT MANAGEMENT (PIM)
☑ The Public Procurement Advisory Department in the MoF lacks the power to enforce compliance with existing procurement laws and regulations	☑ Investments are not to linked to national priorities, but instead used for narrower political and/or business considerations
☑ Lack of standard bidding documents	☑ Insufficiently rigorous project appraisal process
☑ Weak monitoring and evaluation processes	☑ Deficient procurement systems allow corruption to undermine project execution
☑ Procurement manual is confusing and subject to discretionary interpretations	☑ Insufficient project implementation oversight
☑ No procurement qualifications	☑ Limited ex-post monitoring and evaluation
☑ Opaque contract award systems	☑ Insufficient budgeting for maintenance

Source: Authors' representation.

implemented to facilitate national planning and budget formulation, with systematic efforts made to enhance the effectiveness of the central treasury system. In contrast, district councils, the Maseru Municipal Council, as well as community councils, typically manage their finances using manual books of accounts without the benefits of an integrated financial management system.

54. **Reporting on the fiscal impact and performance of SOEs needs to be strengthened, along with measures to address the large size of SOEs in the economy.** While efforts to improve reporting by state-owned (six) and invested (14) enterprises have resulted in the publication of the first SOE Annual Report (FY2016/17), transparency and accountability of individual SOEs' performance are not yet efficient or comprehensive. The GoL remains invested in SOEs that are not strategic and it lacks a legal framework for SOEs that ensures policies, procedures, responsibilities and accountabilities are clear. The fragmented and incomplete understanding of the SOE sector, its value to the economy and the country, poor reporting performance, and current weak oversight and management are exacerbated by the lack of an adopted SOE Policy and SOE Act.

55. **In sum, as highlighted in the 2015 SCD, the state continues to play a dominant role in the economy.** The high level of public investment raises some interesting questions given Lesotho's declining GDP and private consumption levels. For instance, is this high level of investment generating returns? Lesotho undertook a Public Investment Management Efficiency Review in 2012, which identified several issues common with public investment in many emerging economies, such as: (i) project selection is not always closely linked to national priorities and often projects might be included for political reasons; (ii) many large-scale projects do not go through a rigorous appraisal process, reflecting limited demand and low capacity for rigorous project appraisal; (iii) a lack of effective monitoring of projects and programs by the MoF during implementation and ex-post; (iv)

a tendency for line ministries to continue projects and programs even when their net benefits have been put in doubt by changing circumstances; and (v) the MoF has not yet been empowered to carry out its central gate-keeping functions in practice.

56. **High public sector spending has been amplified by the COVID-19 pandemic, as the GoL is required to deliver essential services that protect lives and livelihoods, while facing decreased government revenues.** Responding to the pandemic has put pressure on government systems across all sectors. Government coordination is crucial during the recovery and rebuilding phases. Furthermore, the lockdown in Maseru from March to May 2020 revealed challenges in ensuring business continuity during periods of social distancing. There is a need to improve government readiness for home-based work, and the remote functioning of government systems and back-office functions, including government-to-government (G2G) services. The pandemic has highlighted the benefits of a stronger, and more flexible and responsive civil service. The crisis has also highlighted the urgency of digitizing services and government-to-people (G2P) transfers to ensure that services are not only more user-friendly but can reach citizens during periods of crisis. In addition, the issue of equity of access to digitized services needs to be considered, together with modernization efforts across income levels, and the rural-urban divide in connectivity and device affordability.

1.2.3. Heavy reliance on volatile and falling SACU revenues

57. **Lesotho is highly dependent on SACU transfers and worker remittances.** Total government revenues averaged 54.9 percent of GDP between 2010 and 2014, and fell to 45.6 percent of GDP between 2015 and 2020 (Figure 12a), almost entirely due to lower SACU revenues and development partner (DP) grants. Tax revenues have been remarkably stable at around 22 percent of GDP over the past decade. In contrast, SACU revenues have fluctuated between a high of 27.8 percent of GDP and a low of 14 percent of GDP. Grants fell from an average of 6.2 percent of GDP between 2010 and 2014 to 3.0 percent of GDP between 2015 and 2020 (Figure 12b). Royalties and dividends from diamond mining were equivalent to 29.6 percent of mining value added, producing government revenues of 1.3 percent of GDP.[20] This reflects the shareholdings that the GoL holds in all diamond mining companies. Remittance flows to Lesotho are estimated to have averaged around 24 percent of GDP in the 2010s, one of the highest levels in the world.

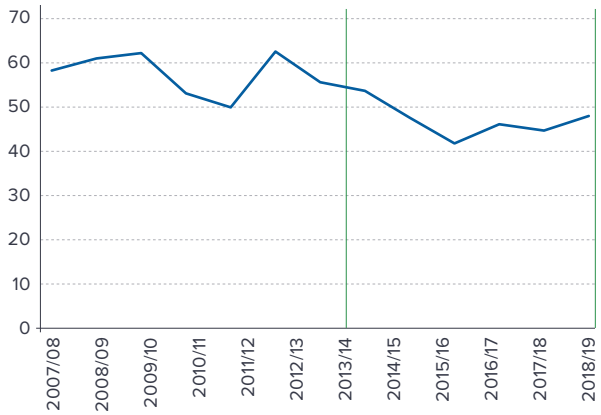
58. **Volatile SACU revenues have contributed to an increase in government arrears.** Although the volatility of SACU receipts has fallen, government spending remains highly correlated with SACU revenues. SACU revenue windfalls lead to higher public wage bills and other recurrent expenditures that cannot be cut when SACU revenues decline, rather than being saved to build up buffers. For example, while Lesotho's dependence on SACU revenues to cover its import bill has been slowly declining, it tends to spend whatever money from SACU is received. If SACU transfers increase, then imports also increase in the same year. As such, the economy is prone to amplified boom-and-bust cycles due to this procyclical fiscal policy.[21] With SACU revenues below historical averages and government expenditure persistently high, the GoL has run into fiscal difficulties, leading to the emergence of government domestic arrears, which are estimated at M1.2 billion (3.3 percent of GDP) as of January 2020. The perception of the GoL being a 'late payer' increases public procurement costs and deters private sector investment.

20. FY2016/17 and FY2017/18.

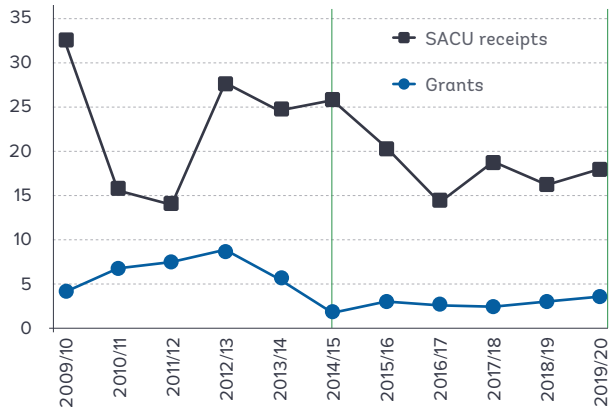
21. Declines in SACU revenues are usually followed by large or sharp spending cuts and increases in SACU revenues are followed by increased fiscal spending.

Figure 12. Lesotho is dependent on SACU receipts

a. Total revenue 2009/10 – 2019/20 (Percent of GDP)



b. Grants and SACU receipts 2009/10 - 2019/20 (Percent of GDP)



Source: Central Bank of Lesotho, Ministry of Finance.

59. **Overreliance on SACU revenues reflects Lesotho's inability to increase domestic revenues.** This is exacerbated by the limited diversification of revenue sources and the generally weak mobilization of domestic revenues. Other concerns are the relatively high dependence on remittances and the lack of export diversification—exports are still concentrated on a few products, mainly textiles, apparel, and diamonds. Thus, exploring the scope for diversifying domestic revenue sources, considering that Lesotho is a small state, remains important. In addition, creating a buffer against the volatility of SACU revenues is essential for reducing the volatility of economic growth, as well as enhancing fiscal consolidation.

1.2.4. Climate risks and environmental degradation

60. **Lesotho is highly exposed to hydrometeorological hazards, including droughts, floods, storms, strong winds, heavy snowfall, and severe frost.** Variability of weather conditions is related to the El Niño Southern Oscillation (ENSO), as was the case during the regional 2015/16 drought. Floods from extreme rainfall in Lesotho occur relatively frequently and adversely impact the population, economic activity, and the environment. There is no record of moderate or severe earthquakes affecting Lesotho in recent decades. However, probabilistic hazard and risk assessments show that earthquake risk is not negligible. Lesotho is particularly vulnerable to climatic events, given a combination of factors such as the high proportion of high-altitude rangeland and the highly erodible soils in the lowlands, loss of arable land from human migration to the lowlands, high poverty levels, and competition between crops and livestock for land. Urbanization, which is projected to reach 46 percent by 2050, will reshape disaster risk in coming years. While urbanization is positively regarded, unmanaged urbanization and weak land regulation can lead to informal development and urban sprawl. The relationship between rural and urban areas and the pace of rural-out migration, need to be fully understood to ensure that appropriate land management policies are in place. Limited territorial planning, land management, urban sanitation, drainage, and the general infrastructure gap can make Lesotho vulnerable to fast-onset hazards such as flooding.

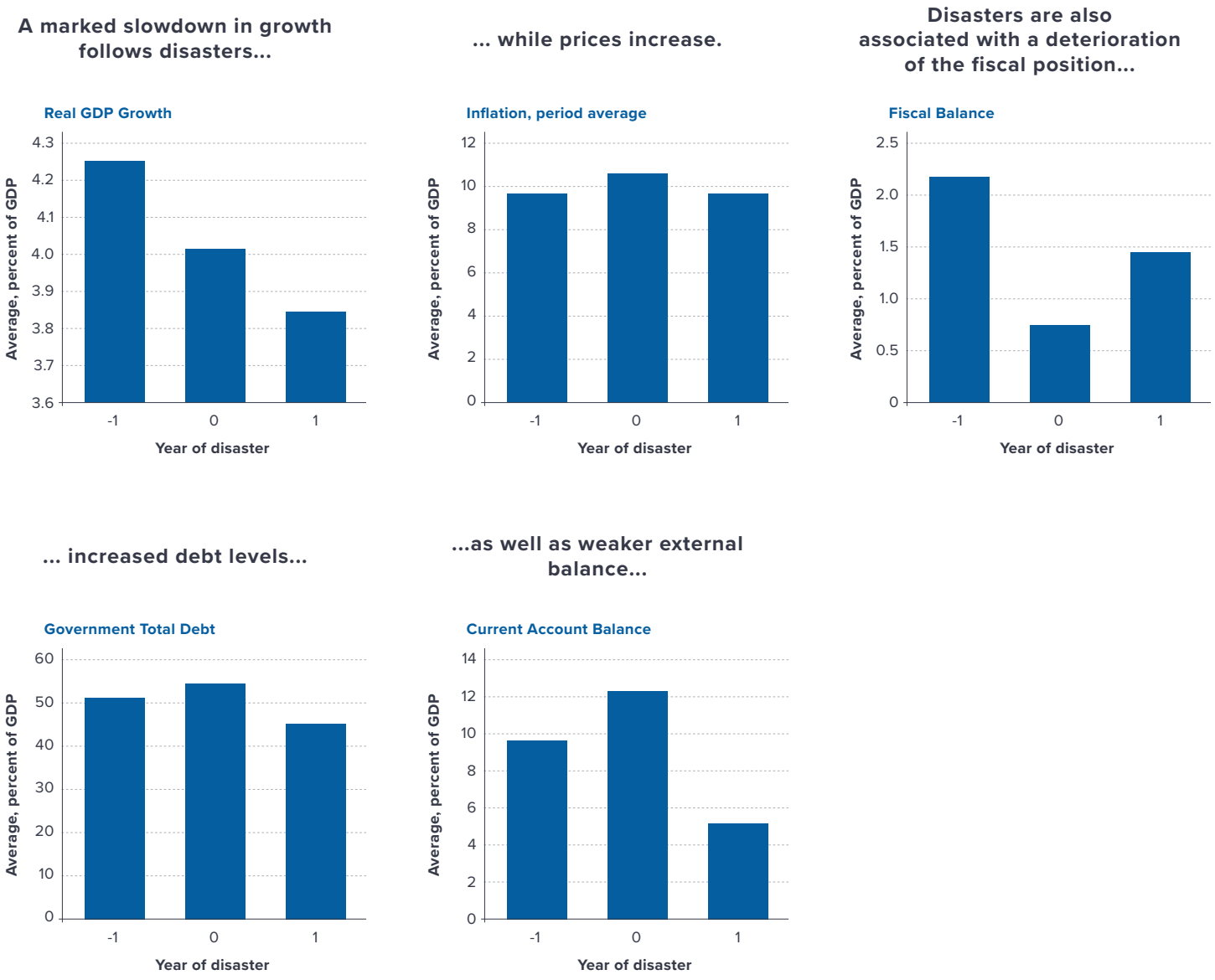
61. **Existing climate hazards pose substantial risk to water infrastructure and service delivery.** Climate change will further stress water resources—one of Lesotho's most valuable resources, contributing about 8 to 10 percent to its GDP. According to the Lesotho Water Security and Climate Change Assessment Report,[22] in the absence of augmentation measures, demand for domestic and industrial water supply will not be reliably met under a series of future climate scenarios. Total unmet water demands are expected to reach 40 percent by 2050, with demand for industry projected at almost 60 percent. This will destabilize farming systems, decrease agricultural productivity and raise the vulnerability to food insecurity of those relying on subsistence farming. While irrigation could offer some opportunities for building resilience to droughts, it remains highly underdeveloped. The potential irrigable area in the country is estimated at 53,524 ha,[23] but currently only about 2,600 ha have been developed for irrigation, of which a mere 1,200 ha are actually under irrigation.[24] The GoL has prepared a National Irrigation Masterplan (NIMP) (approved by the Cabinet in January 2021) that provides an investment framework for irrigation in the short, medium and long term in areas of high agricultural potential. Implementation of the NIMP will be critical for achieving the dual objectives of commercialization and climate resilience in Lesotho's agriculture.

62. **Water insecurity will adversely affect the stability of Lesotho's power generation and undermine the development of the country's vast hydropower potential.** Lesotho's main source of power generation is the 72 MW Muela hydropower plant managed by the Lesotho Highlands Development Authority (LHDA). Droughts reduce water availability at the Muela dam. Increased electricity needs for water pumping and irrigation put pressure on the electricity demand. As indicated in the Lesotho Renewable Energy Investment Plan endorsed by the GoL in 2017, the use of solar and wind resource could alleviate the risk engendered by severe droughts.

63. **Land degradation and soil erosion are exacerbated by climate change and threaten Lesotho's reputation as a water tower.** Increases in temperature and rainfall variability are forecast to result in an increase in evaporation losses, and a decrease in runoff and groundwater recharge. The quality and quantity of water generated in Lesotho's wetlands will decline, ultimately impacting the volume of water Lesotho has for domestic consumption and regional export.

22. https://hubs.worldbank.org/docs/imagebank/Pages/docProfile.aspx?nodeid=26730092
23. National Irrigation Masterplan, 2021.
24. Bureau of Statistics, 2011/12.

Figure 13. Adverse weather events negatively impact the macro-fiscal situation, 1980–2018



Source: Authors' calculations based on data from EM-DAT and World Development Indicators.

Rangeland conditions may deteriorate—and ultimately be destroyed—leading to a change in the quality of livestock and livestock products. The present indigenous forests may change into semi-arid types, while agricultural production will decline, possibly leading to food shortages. Unsustainable land use practices, coupled with an expected increase in climactic weather events, weaken the country's resilience to climate change and threaten livelihoods. Furthermore, the wetlands ecosystems are under threat of degradation and susceptible to climate change effects, despite their importance for water security and livelihoods. In terms of water security, for example, wetlands play a critical role in maintaining the hydrological functions necessary for the quality and quantity of water that has been harnessed through the Lesotho Highlands Water Project for transfer to South Africa, thereby earning the country royalties.

64. **Adverse weather events have had a negative impact on the macro-fiscal situation of the country.** Event analysis shows that disasters have adverse macroeconomic impacts in Lesotho, including significant impacts on economic growth, the fiscal position and the external balance, warranting a scaling-up of measures to enhance resilience against climate and disaster risks (Figure 13). The fiscal cost of climate and disaster risks is driven, to a large extent, by chronic food insecurity: prior to the COVID-19 pandemic, around one-quarter of the population was facing severe food insecurity as a result of a widespread drought. Land degradation has decreased rangeland carrying capacity and quality, and this has had negative impacts on livestock productivity and its contribution to livelihoods and the economy.[25] The current annual cost of land degradation is estimated at US$57 million, equivalent to 3.6 percent of the country's GDP (World Bank 2019a). Future disasters in a context of limited economic diversification could impose further fiscal pressure on the GoL and inflate its imports bill. The 2019 Lesotho Disaster Risk Financing Diagnostic estimates the average annual cost of disaster response at US$19.3 million, or 1.6 percent of the total budget expenditure in the 2019/20 fiscal year. This is based on the cost of responding to all perils. Overall, the fiscal space for both ex-ante and ex-post climate risk and resilience-related investments is limited and, as a result, the GoL will have to rely on ex-post financing, including budget reallocation and humanitarian funding, for disaster response. While DPs' support is critical after disasters, both the amount to be made available and the activities to be funded can be uncertain and slow to materialize. DPs' support is usually mobilized only for extreme events, which may leave the country financially exposed, especially in the event of more frequent disasters.[26] Disasters have stretched the GoL's limited resources at a time when state revenues have been hit by lower commodity prices, reduced earnings from SACU, and declining remittances from South African-based workers.

65. **Lack of robust institutions and coherent sectoral-level climate change and resilience policies lead to ineffective coordination.** The multi-sectoral nature of climate change and resilience requires that Lesotho develop a common framework for the management of climate change, the planning and design of resilient infrastructure, and the effective management of water, land and other critical resources. However, the lack of such a common framework and weak institutional arrangements/mandates lead to siloed interventions and responses to these challenges.

25. The 2019 Land Degradation Neutrality (LDN) report indicates that over the past 20 years, Lesotho has lost over 100,000 ha of arable land, resulting in a 25 percent decrease in usable land to produce food and fodder.

26. This paragraph was adapted from World Bank 2019d.

1.3. Macroeconomic Outlook

66. **The latest publication of national accounts from the Bureau of Statistics shows a significant contraction in the economic growth in 2020.** From a pre-COVID-19-pandemic estimate of +0.4 percent growth in 2020 and +2.5 percent in 2021, the latest preliminary estimates are for a contraction of 9.5 percent in 2020. According to the World Bank's October 2021 Macro Poverty Outlook (MPO) economic growth is expected to rebound to +3.2 percent in 2021, +3.0 percent in 2022, and then +2.8 percent in 2023. However, these forecasts are subject to an extreme level of uncertainty, as the pandemic plays out both within Lesotho and across the region, and on global levels of demand for Lesotho's exports.

67. **A revised COVID-19 budget for FY2020/21 was presented.** On paper, the budget anticipates a 4 percent fall in revenues, adjusts total spending up by 9.6 percent, with the resulting change in the fiscal balance from +3.0 percent to -4.1 percent of pre-COVID-19 GDP. Most additional spending is classified under 'centralized items' with line ministry recurrent budgets largely unchanged, while government-funded capital spending is revised down by 20 percent. The FY2020/21 budget (both original and revised) is supported by higher-than-average SACU transfers (M9.0 billion, compared with M6.2 billion and M5.5 billion in the preceding two years).

68. **Policy responses to the pandemic include both a health response and economic mitigation measures.** A M700 million (about 2 percent of GDP) fund has been set aside for the National COVID-19 Response Integrated Plan 2020, more than half of which is being used for health-care personnel, and the purchase of critical goods and services, with the remainder covering logistics, security, and border management. Economic mitigation measures are also being considered, including M1.2 to M1.5 billion for emergency assistance and expanding social protection, respectively. Existing cash transfers, such as the Child Grant Program (CGP), were also topped up. Public assistance was expanded for three months, to add vulnerable groups such as children, elderly disabled, and those working in the informal sector. Industrial workers were provided with wage subsidies for three months from May to July; LNDC-supported firms were provided with rental holidays for one month; and tax-compliant businesses were provided with tax deferrals, while income tax filing deadlines were extended until the end of September 2020.[27]

69. **Emerging trade data show a V-shaped fall in Lesotho's exports to the United States.** While exports to the United States were 13 percent higher in Q1 2020 compared with Q1 2019, Q2 2020 saw a sharp deterioration, with exports in this period down 59 percent year-on-year. Globally, the United States imported 42 percent[28] less textiles and apparel in May 2020 than in May 2019, matching other data on retail sales,[29] showing sales of clothing in the United States falling over 50 percent compared with 2019. Nevertheless, retail sales have begun to pick up, with sales in May 2020 up 176 percent on April 2020, but still 62 percent below June 2019. The two-month lag between shipment from Lesotho and clearance into the United States will mean a delay between US sales increasing and imports from Lesotho being registered in the trade statistics.

70. **After a sharp decline in April 2020, exports to South Africa have rebounded.** From an average of M335 million per month between 2017 and 2019 (of which are around two-thirds are apparel), exports to South Africa fell to only M25 million in April and M136 million in May 2020. Exports for June to August 2020 averaged M320 million per month, suggesting a quick bounce back. However, the latest World Bank Global Economic Prospects (June 2020) forecast that the South African economy will contract by 7.1 percent in 2020—the

27. See https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#L for further details.

28. Source: https://otexa.trade.gov/PDFs/Press_Release_May_2020_Data.pdf

29 Source: https://www.census.gov/retail/index.html

deepest contraction in a century and 8 percent weaker than previously forecast. This will impact Lesotho's export demand, and much will depend on whether Lesotho's suppliers, in particular for apparel, will suffer as firms downsize their Lesotho operations and shift production to their South African factories, and whether there are supply disruptions in apparel from East Asia, providing an opportunity for Lesotho firms to fill the gap.

71. **Diamond exports have been less affected.** Production curtailments by mining companies due to the national lockdown, travel restrictions, and the temporary closure of some mining operations did see diamond exports fall to near zero in March and April 2020. However, exports in May and June have been in line with 2019 levels, and for 2020 as a whole, exports to June were 4.1 percent higher than in 2019. Nevertheless, export values in both 2019 and 2020 are down on the record highs of 2018. While weak global demand is expected to exert downward pressure on diamond prices, export volumes from Lesotho's producers, which largely operate outside of De Beers/Anglo American, may well stay at historical levels as mines remain able to cover their operating costs even with lower prices.

72. **There is an extremely high level of uncertainty given developments in South Africa.** The early lockdowns in much of Southern Africa delayed the spread of the virus. However, the easing of lockdown restrictions has been followed by a rapid increase in cases in South Africa, and the emergence of cases in Lesotho. Of Lesotho's main exports (garments, diamonds, water), only water is likely to be unaffected, with demand for garments in particular likely to be severely impacted. In addition, a sharp recession in South Africa, and the resulting decline in imports into South Africa, especially for motor vehicles, will impact SACU transfers in coming years, with FY2022/23 likely to see a large negative adjustment.

73. **The financial sector is exposed to second-round impacts of the pandemic and existing vulnerabilities in the non-bank financial institutions sector could further worsen.** The overall banking sector is well-capitalized, with the capital adequacy ratio at 21.5 percent and non-performing loans (NPLs) at 4.1 percent at end June 2020.[30] There might be an upside risk to NPLs due to the adverse impact of the pandemic on households (that already had high levels of over-indebtedness prior to the pandemic) and businesses in 2020 that might not yet have transpired because of the prudential measures taken by the Central Bank of Lesotho (CBL) (banks have been asked to suspend loan repayment by borrowers). However, the CBL has indicated that, so far, the situation remains stable (also after the prudential measures were lifted at the end of September 2020) in terms of capital adequacy, liquidity buffers and asset quality. Only the profitability of the banks evaporated in 2020, as a result of shrinking interest margins, increasing provisioning, and lowering transaction fees. Asset quality concerns are higher in the non-bank financial institutions sector, particularly large financial cooperatives that are already facing solvency issues with very high levels of NPLs.

30. Central Bank of Lesotho.

Box 1. Economic impact of the COVID-19 pandemic

Lesotho's economy was already in recession even before the advent of the COVID-19 pandemic. Real GDP contracted by 3.1, 1.2, and 0.4 percent in 2017, 2018 and 2019, respectively. It further contracted by 1.8 percent in the first quarter of 2020 before any COVID-19 case was reported in the country. The first positive COVID-19 case was reported in May 2020 and economic growth contracted by 21.5 percent in the second quarter of 2020, as a consequence of the nationwide lockdown implemented in late March that brought the economy to a halt. Economic growth further contracted by 9.8 percent in the third quarter and by 15.3 percent in the fourth quarter of 2020. On an annual basis, preliminary estimates indicate a contraction of 9.5 percent for the entire 2020.

Inevitable spillovers from the South African economy, especially due to high prevalence of COVID-19 and unsolved structural impediments to growth in South Africa, such as electricity shortages and political unrest that led to recent looting, destruction of infrastructure and alleged insurrection, are expected to pose challenges to Lesotho. The pandemic has worsened the already dire economic performance in South Africa, and this is expected to spill over into Lesotho through the supply shortages of goods and services, lower remittances, and lower SACU receipts.

The fiscal deficit widened in FY2020/21 due to higher government expenditures associated with COVID-19 mitigation measures introduced by the Government, as well as declining revenues due to lower economic activity. The preliminary estimates depict a fiscal deficit of 12.6 percent of GDP in FY2020/21. To finance this widening deficit, the public debt levels have risen to 50.3 percent of GDP in FY2020/21 due to higher borrowing associated with the policy responses to the COVID-19 pandemic. On the inflation front, average annual inflation rate registered 5.0 percent in 2020, largely due to higher food and energy prices, amid supply-demand challenges imposed by closure of borders and domestic lockdown measures during 2020. The current account deficit narrowed from 4.1 percent of GDP in 2019 to 3.6 percent in 2020, as exports of goods and services declined faster than imports of goods and services, as well as higher SACU revenue inflows since April 2020. It is expected to widen further in the medium term. The Central Bank of Lesotho (CBL) eased the monetary policy stance by reducing the policy rate by a cumulative 275 basis points from March to July 2020 to react to the COVID-19 shock. The fiscal deficit is expected to narrow to 3.7 percent of GDP in 2020 largely due to higher SACU inflows, but is expected to widen in the medium term. Health and social-related expenditures are expected to rise in line with COVID-19 mitigation measures, while capital expenditure is expected to decline due to reallocation.

Economic growth is expected to rebound to 3.2 percent in 2021 and gradually recover to 3.0 and 2.8 percent in 2022 and 2023, respectively. Agriculture is expected to grow moderately in the medium term as agricultural subsidies and good rains are expected to contribute to crop production. Furthermore, medicinal cannabis farming, as well as horticulture farming, projects are also expected to provide impetus to grow. The projected recovery in the medium term is set to be led by a rebound in manufacturing, construction, and mining activities. The construction activities associated with the second phase of Lesotho Highlands Water Project (LHWP-II) started in the first half of 2021, and these are expected to have a positive impact on growth. Services are also expected to add impetus to the growth momentum over the medium term.

Inflation is expected to follow developments in the regional food and energy prices due to supply-demand challenges imposed by restricted movements and the closure of borders, and will accelerate steadily to 5.5 percent by 2023. Uncertainties surrounding the efficacy, affordability and timeliness of COVID-19 vaccines continue to pose a huge risk to macroeconomic outlook.

The recovery of exports and overall economic growth largely depends on external demand conditions, as well as the re-opening of the global economy. The expected recession in the neighboring South African economy largely attributed to the recent instability that involved looting, destruction of infrastructure and alleged insurrection are most likely expected to dampen Lesotho's growth prospects through various channels, such as shortages of goods and services, and lower remittances.

2.

POVERTY REDUCTION AND SHARED PROSPERITY

Lesotho made progress in reducing poverty between 2002 and 2017, but the pace was slow, with progress far slower in rural areas. Even among those who have escaped poverty, many remain vulnerable to falling back into poverty. Poverty reduction has been slow in part because a relatively small share of economic growth is passed through to consumption: growth has played a relatively small role in poverty reduction despite Lesotho's high average growth rates from 2002 to 2017. Also slowing down poverty reduction are low human capital outcomes, poor labor market outcomes, vulnerability to environmental and economic shocks and declining remittances. These challenges are heightened in rural and mountainous areas where poverty is high, and access to basic services and infrastructure is low. The spatial pattern of access to basic services and infrastructure suggests that accelerating poverty reduction and shared prosperity in Lesotho hinges disproportionately on addressing key constraints to improving living standards in lagging rural regions. Such an approach will also support further inequality reduction: while Lesotho is now the least unequal country among its neighbors, it nonetheless remains among the 20 percent of the most unequal countries in the world.

74. **Lesotho made progress in reducing poverty between 2002 and 2017, but the pace was slow and, as a result, poverty remains widespread, especially in rural areas.**[31] The official national poverty rate fell by only about 7 percentage points over a 15-year period, declining from 56.6 to 49.7 percent (Figure 14a).[32] In absolute terms, about 47,000 Basotho escaped poverty during this period and close to 1 million Basotho lived below the national poverty line in 2017 (Figure 14b). Progress in reducing poverty has been much slower in rural areas. Poverty increased in the rural mountains and the Rural Senqu River Valley (Figure 14c). At the level of districts, Thaba-Tseka and Mokhotlong are the poorest districts, with poverty rates of 69.2 and 61.2 percent in 2017, respectively. Not only has progress been slow, a high share of the population remains vulnerable to falling into poverty.[33] In 2017, more than 75 percent of the population were either poor or vulnerable to falling into poverty. In rural areas, this rises to over 90 percent. Most of the households that have escaped poverty are characteristically similar to those that have failed to escape poverty, placing them at risk of falling back into poverty.[34] Furthermore, with an international US$1.90/day (in 2011 PPP terms) poverty rate of 27.2 percent in 2017, poverty in Lesotho is relatively high for a lower middle-income country (LMIC).

31. The discussion in this section is based largely on the Lesotho Poverty Assessment conducted by the World Bank in close collaboration with the Lesotho Bureau of Statistics and published in December 2019. The main data sources for the Poverty Assessment were the 2002/03 Household Budget Survey (HBS), the 2017/18 Continuous Multipurpose Household Survey and the Household Budget Survey (CMS/HBS). In this section, 2002 refers to the 2002/03 survey year and 2017 to the 2017/18 survey year. The report can be accessed using the following link: https://openknowledge.worldbank.org/handle/10986/33030

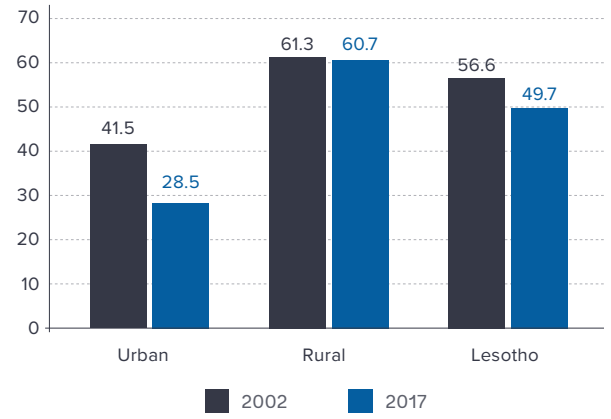
32. The official national poverty line was set at M648.88 in 2017/18 survey prices.

33. The analysis of economic vulnerability is based on the Gunther and Harttgen (2009) method is used to determine economic vulnerability. Details on how the method was adapted are provided in the Poverty Assessment.

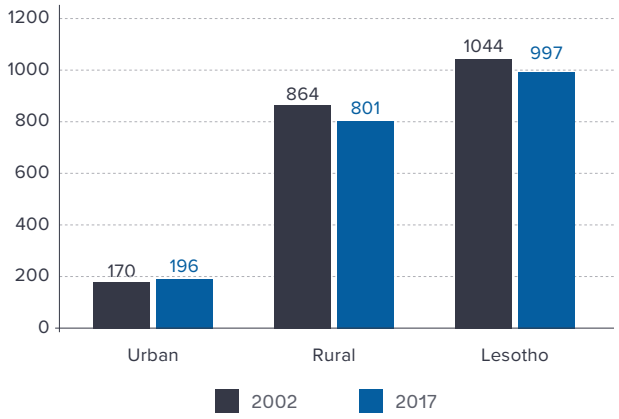
34. The likelihood of being vulnerable to poverty is found to be inversely associated with household size, education levels, income from wages and non-agricultural businesses, and access to private sector wage jobs or government jobs.

Figure 14. Poverty has declined but remains widespread, especially in rural areas

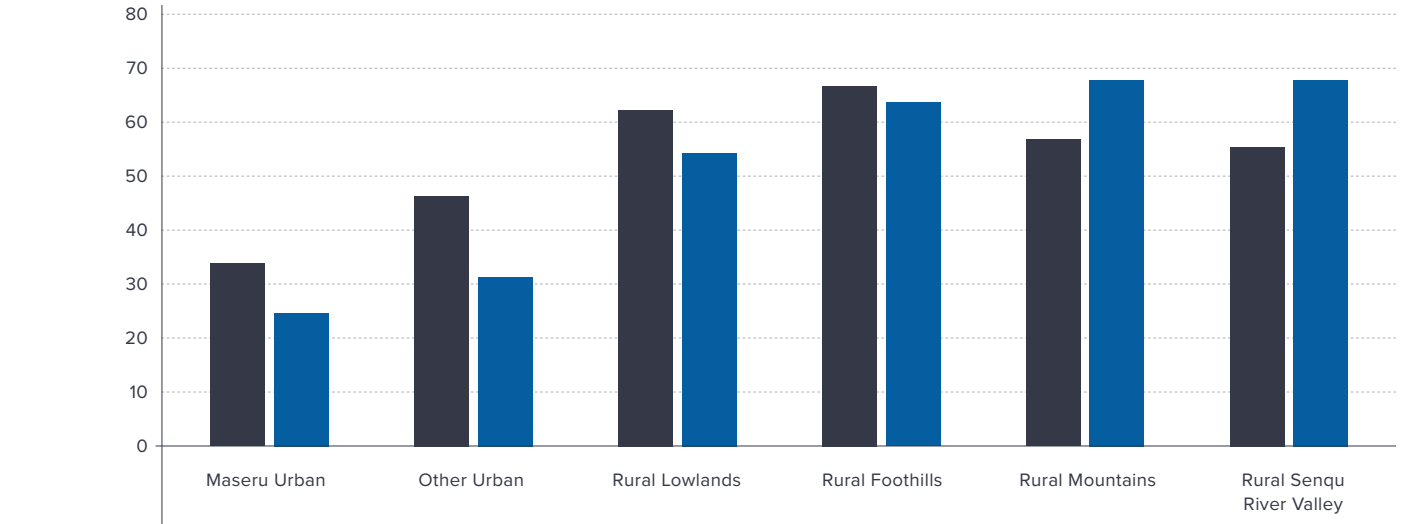
a. National poverty rates, 2002–17



b. Number of poor, 2002–17



c. Rural and mountainous regions are the poorest



	Maseru Urban	Other Urban	Rural Lowlands	Rural Foothills	Rural Mountains	Rural Senqu River Valley
2002	33.7	46.3	62.4	66.8	56.9	55.5
2017	24.7	31.4	54.4	63.6	67.8	67.9

Source: World Bank 2019b: Lesotho Poverty Assessment: Progress and challenges in reducing poverty.

75. **Progress has also been slow in reducing non-monetary poverty, especially in rural areas.** While access to basic public services has improved, it remains unevenly distributed across regions, with the spatial pattern of access closely following the urban-rural divide. Rural regions tend to have smaller shares of people with access to basic services. Furthermore, access to basic services is unevenly distributed between the poor and non-poor. These gaps manifest in a high incidence of multidimensional poverty which, similar to monetary poverty, is also higher in rural areas. The poor are simultaneously deprived in multiple dimensions, and this reinforces and perpetuates poverty, particularly in rural areas.

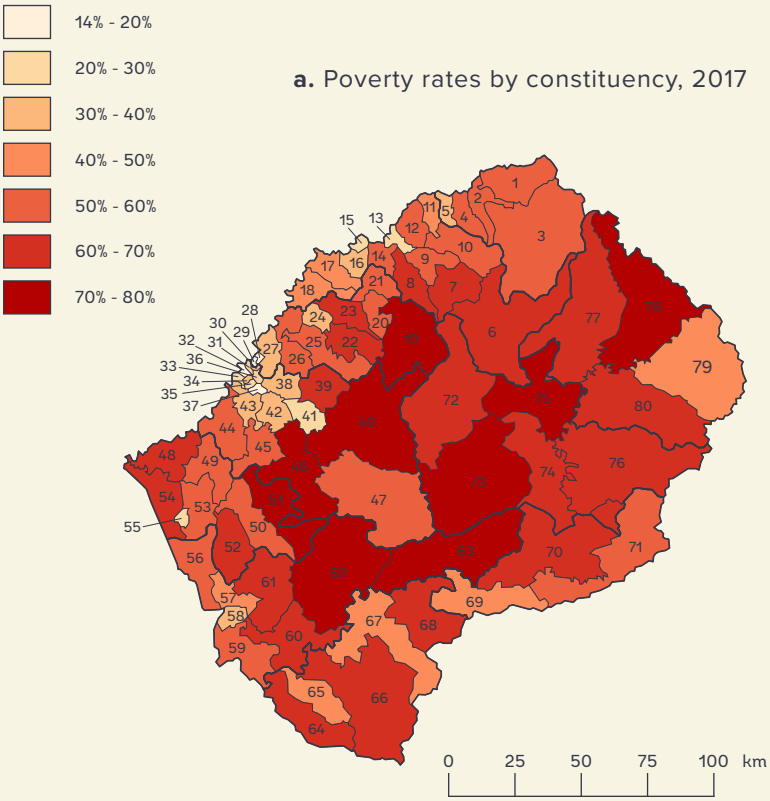
76. **Further progress in rural poverty reduction will require reaching lagging rural areas where poverty and vulnerability are most deeply entrenched.** A 2017 national poverty map of Lesotho shown in Figure 15a confirms the rural and mountainous nature of poverty. Furthermore, it suggests that peripheral areas are associated with reduced poverty rates at the constituency level. Given that Lesotho is surrounded by South Africa, this means that areas closer to the border with South Africa tend to exhibit lower poverty rates. This could be capturing, among other factors, accessibility to economic opportunities and better developed markets in South Africa. Because of stronger poverty reduction in urban than in rural areas, the rural share of poverty decreased more slowly that the decrease in the rural share of the population between 2002 and 2017 and, as a result, the poor remain disproportionally concentrated in rural areas. By region, the rural lowlands account for the highest share of the poor, partly due to the region's relatively high population share—32.2 percent in 2017, down from 38.9 percent in 2002. Constituencies in rural and mountainous areas have the highest number of poor (Figure 15b). For example, the constituency of Semena in Thaba-Tseka District had the highest concentration of poor in 2017. The concentration of poor in rural areas is troubling because about 66 percent of the population live in rural areas.

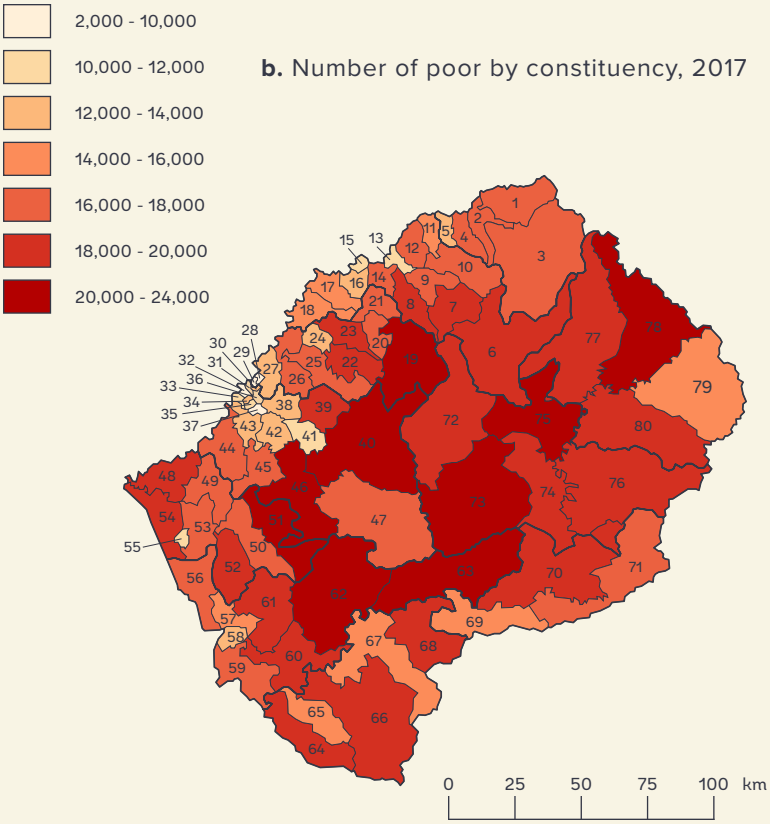
77. **Gender, household size and composition, educational attainment and employment are important determinants of poverty status.** Individuals living in female-headed households are more likely to be poor than those living in male-headed households. The poverty risks faced by female-headed households are even higher in rural areas, consistent with gender differences in access to public services, as well as the social norms around the status of women that might affect their economic participation. Furthermore, poverty risks are higher if the household head is a single parent. By marital status, widows and widowers exhibit the highest rates of poverty. In terms of household size and composition, the incidence of poverty increases with the size of a household and the number of children a household has, as well as household dependency ratios.[35] Regarding educational attainment and employment, poverty rates generally decline with higher education levels and the pace of poverty reduction increases with higher education levels, highlighting the role of education as a socioeconomic equalizer. Employment is associated with lower poverty rates, but poverty rates are relatively high even among the employed. Individuals living in households with a head employed in the agriculture sector exhibit the highest poverty rate, highlighting the heightened poverty risk for agricultural households.

78. **While Lesotho has become more equal, it nonetheless remains one of the most unequal countries in the world.** Consumption growth between 2002 and 2017 was inclusive for the very poorest segments of the population and this led to a decline in inequality. The annualized growth rate of the bottom 40 percent—also referred to as shared prosperity—was 2.2 percent between 2002 and 2017, much faster than mean annual growth of 0.3 percent. The difference between growth of the bottom 40 percent and the mean—the shared prosperity premium—was 1.9 percentage points, indicating that the distribution is becoming more equal. This boost in shared prosperity has led to a decline in inequality. In 2002, Lesotho was one of the few countries in the world with a Gini coefficient above 50. Since then, pro-poor growth has helped to induce a fall in inequality, and the per adult equivalent Gini coefficient stood at 44.9 in 2017. Lesotho is now the only country in SACU with a Gini coefficient well below 50 (Figure 16a), although it still remains among the 20 percent most unequal countries worldwide (Figure 16b). In addition to high inequality of outcomes, Lesotho faces high inequality of opportunity. Factors such as gender, place of birth, parents' education, health shocks and environmental shocks contribute to almost half (46 percent) of the current level of inequality. Intergenerational mobility is relatively low, exacerbating high inequality.

35. The dependency ratio is the number of dependents younger than 15 or older than 64 divided by the number of household members of working age. Dependency ratios are higher among the poor as they tend to live in households that are larger and have more children.

Figure 15. The poor remain disproportionally concentrated in rural and mountainous areas





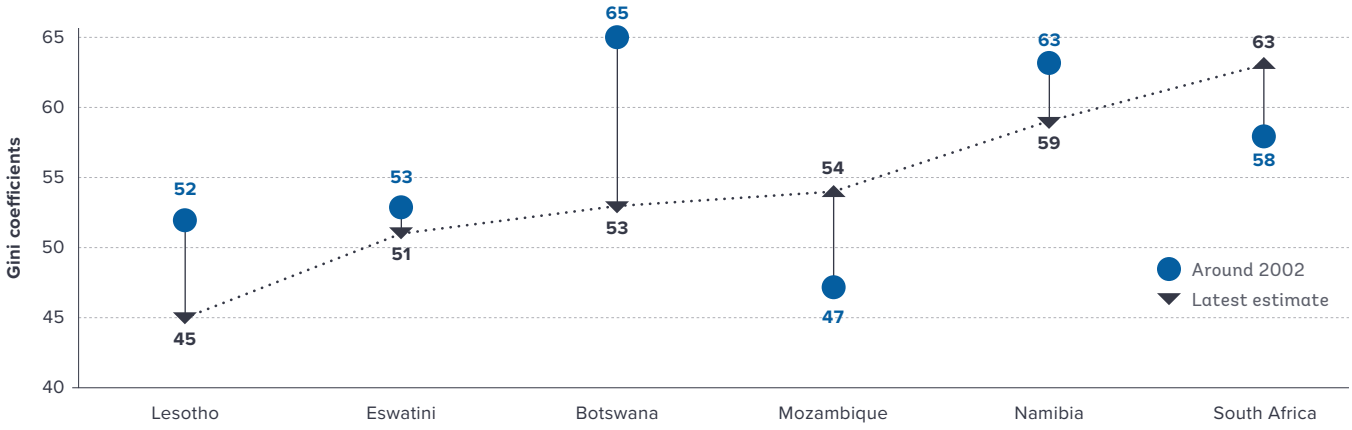
	ID	NAME
Botha-Bothe	1	Mechachane
	2	Hololo
	3	Motete
	4	Qalo
	5	Botha-Bothe
Leribe	6	Malibamats'o
	7	Mphobong
	8	Thaba-Phats'oa
	9	Mahobong
	10	Pela-Ts'oeu
	11	Matlakeng
	12	Leribe
	13	Hlotse
	14	Tsikoane
	15	Maputsoe
	16	Likhetlane
	17	Peka
	18	Kolonyama
Berea	19	Mosalemane
	20	Makhoroana
	21	Bela-Bela
	22	Malimong
	23	Khafung
	24	Teya-Teyaneng
	25	Ts'oana-Makhulo
	26	Thupa-Kubu
	27	Berea
	28	Khubetsona
	29	Mabote
Maseru	30	Motimposo
	31	Stadium Area
	32	Maseru
	33	Thetsane
	34	Qoaling
	35	Lithoteng
	36	Lithabaneng
	37	Abia
	38	Thaba-Bosiu
	39	Machache
	40	Thaba-Putsoa
	41	Maama
	42	Koro-Koro
	43	Qeme
	44	Rothe
	45	Matsieng
	46	Machaleng
	47	Maletsunyane

	ID	NAME
Mafeteng	48	Thaba-Phechela
	49	Kolo
	50	Matelile
	51	Maliepetsane
	52	Thabana Morena
	53	Likhoele
	54	Qalabane
	55	Mafeteng
Mohale's Hoek	56	Taung
	57	Qhalasi
	58	Mohale's Hoek
	59	Mekaling
	60	Qaqatu
	61	Mpharane
	62	Ketane
	63	Hloahloeng
Quthing	64	Tele
	65	Moyeni
	66	Sebapala
	67	Mt. Moorosi
	68	Qhoali
Q. Nek	69	Qacha's Nek
	70	Lebakeng
	71	Tsoelike
Thaba-Tseka	72	Mants'onyane
	73	Thaba-Moea
	74	Thaba-Tseka
	75	Semena
	76	Mashai
Mokhotlong	77	Malingoaneng
	78	Senqu
	79	Mokhotlong
	80	Bobatsi

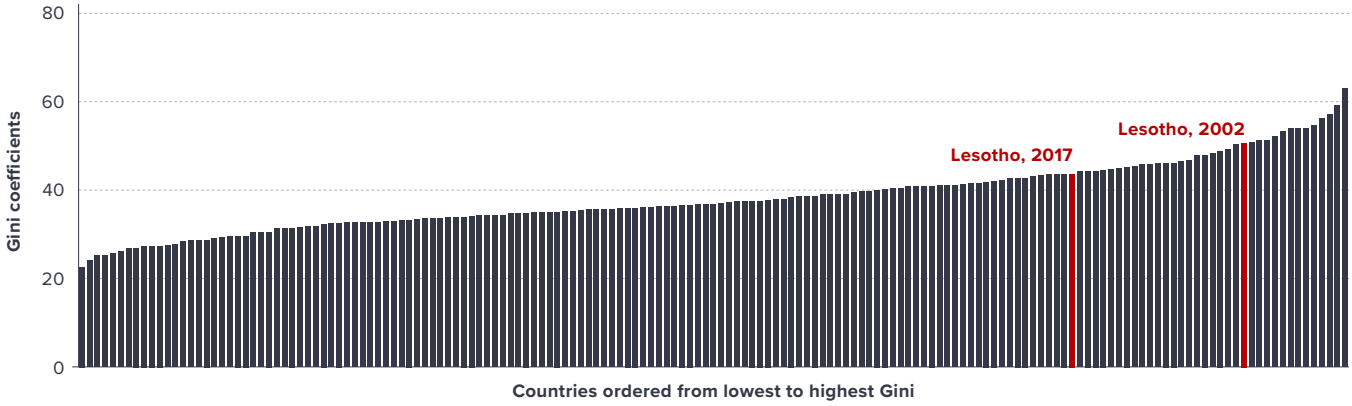
Note: Poverty is measured at the official national poverty line.
Source: Authors' representation based on World Bank (2019b): Lesotho Poverty Assessment: Progress and challenges in reducing poverty.

Figure 16. Inequality has fallen but remains relatively high

a. Regional comparison of Gini coefficients



b. International inequality comparison



Source: World Bank (2019b): Lesotho Poverty Assessment: Progress and challenges in reducing poverty.

2.1. What Has Slowed Poverty Reduction?

2.1.1. A relatively small share of economic growth is passed through to consumption

79. **The reduction in inequality drove poverty reduction between 2002 and 2017.** About three-quarters of the poverty decline in this period can be attributed to a more equitable distribution of consumption (changes in inequality), while growth in mean consumption per adult equivalent can explain only one-quarter of the decline in poverty. The picture is reinforced when using the poverty gap to make the decomposition, suggesting that the very bottom of the distribution saw significant gains in living standards between 2002 and 2017. It is important to note that, overall, consumption growth was more favorable among the urban population, contributing to the growing urban-rural divide. The median consumption in rural areas stagnated and the 40 percent wealthiest rural households saw a decline in their consumption in part due to the drought experienced in 2017.

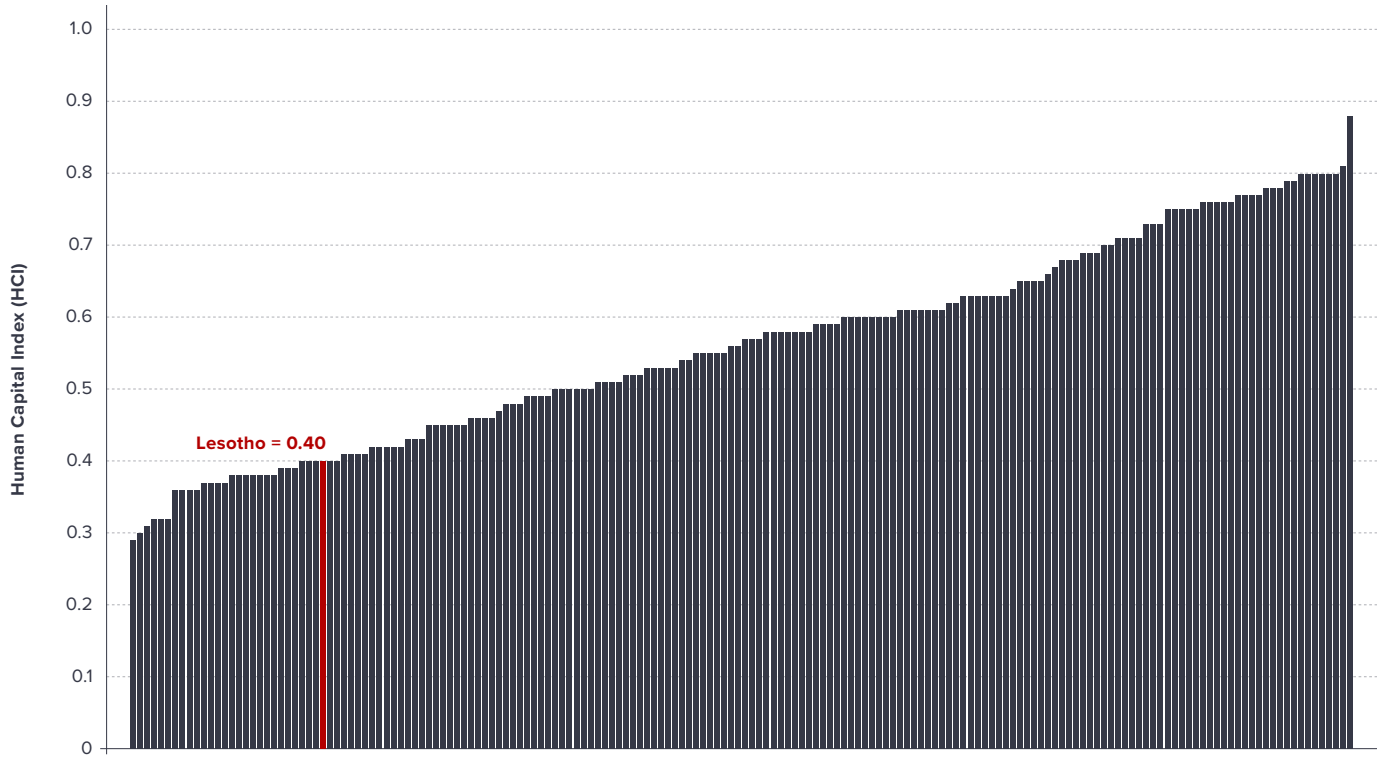
80. **The relatively small role that economic growth has played in poverty reduction is despite Lesotho's high average growth rates from 2002 to 2017.** This suggests a low poverty elasticity of growth, which is a measure of the effectiveness of growth in reducing income or consumption poverty. Several factors influence the poverty elasticity of growth, such as the level of inequality, the quality of growth (e.g., sectoral composition and labor intensity), and macroeconomic factors (e.g., inflation and exchange-rate dynamics), as well as structural factors (e.g., the share of agriculture in GDP and the distribution of assets such as education levels). With regards to inequality, the growth elasticity of poverty decreases with inequality (Ravallion 1997). Given that inequality has fallen in Lesotho, all other things being equal, this should improve the effectiveness of growth to reduce poverty. However, this does not seem to be the case, suggesting that other determinants of the poverty elasticity of growth have played a stronger role. One possible explanation for the small contribution is that growth only benefited the top of the distribution. However, this also does not appear to be the case, given that consumption was more evenly distributed in 2017 than in 2002. Instead, the reason seems to be that only a relatively small share of real GDP growth per capita was passed through to consumption.

81. **Growth may have failed to reduce poverty significantly because it went to sectors with limited trickle-down effects.** Final household consumption expenditures' share of total GDP decreased markedly between 2002 and 2017, suggesting that growth in household consumption may not have mirrored growth in GDP. The sector that saw the largest increase in share of GDP was financial and insurance activities, which may not have trickled down to the rural poor. In contrast, the sectors that the poor tend to generally rely on most, such as agriculture and textiles, saw stagnation or declines in their shares of total GDP. These observations point to challenges in converting income growth into sustainable poverty reduction. For sustained reductions in poverty, it is vital that growth in GDP per capita translates into increased consumption. In any case, initial inequality was high, making growth significantly less poverty-reducing (Ravallion 2004). Poverty persisted despite modest growth rates, as well as declining inequality, because even though consumption increased for the bottom, it was not enough to lift most of the poor out of poverty, especially in rural areas.

2.1.2. Poor human capital outcomes and service delivery

82. **Lesotho has made progress in improving human development outcomes, but outcomes in education and health remain well below Lesotho's level of development and where they need to be.** While public spending on human development is generous, it could be more efficiently allocated and used. Significant challenges exist around the efficient, effective, and equitable delivery of education and health services, together with the delivery of other basic public services. The Human Capital Index (HCI) estimates for 2020 showed that a child born in Lesotho today will be only 40 percent as productive when s/he grows up as s/he could have been if s/he had enjoyed complete education and full health by the age of 18. While this shows an encouraging improvement from the 2010 estimate of 34 percent, the deficiencies in human capital are still considerable. Overall, while some improvements have been made over the past decade, human capital outcomes remain low compared with other LMICs (Figure 17). For instance, Lesotho performs worse in terms of child survival than other countries in Sub-Saharan Africa and LMICs. At 76.2 deaths per 1,000 live births, the under-five mortality rate is far more than the average for LMICs at 49 deaths per 1,000 live births. Overall, significant changes are needed to improve the quality, efficacy, efficiency, and equity in delivery of health, education, and social protection services in Lesotho.

Figure 17. Human Capital Index



Source: World Bank Human Capital project 2020.

36. The analysis in this section is largely drawn from the forthcoming World Bank note "Investing in Human Capital in Lesotho: A Framework for A Coordinated Multi-Sectoral Approach" prepared in 2020/21 by the World Bank's Human Development team working on the Lesotho human development program.

High levels of poverty and inequality affect human capital outcomes and are a bottleneck to accessing services

83. **Lesotho suffers from the triple burden of malnutrition (i.e., undernutrition, overnutrition and micronutrient deficiency), adversely affecting child development.**[37] This compromises children's cognitive and non-cognitive development, placing them at a disadvantage from an early age and reducing their potential to contribute to the socioeconomic development of the country.[38] This is exacerbated by the high prevalence of HIV/AIDS, which continues to pose a big threat to Lesotho's human capital, with a high prevalence rate of 23.6 percent among adults aged 15 to 49. The impact of HIV/AIDS on women has been significantly worse, with women accounting for about 59 percent of those living with the virus.[39] Despite an increase in the use of modern contraceptive methods among adolescent girls,[40] pregnancy among teenage girls (ages 15 to 19) is high at 17.8 percent, which affects child survival and development outcomes.[41] The pressures of poverty and food insecurity, especially in rural areas, push many young girls into early/forced marriage or intergenerational ('sugar daddy') relationships, making them more likely to contract HIV. Tragically, HIV prevalence is 19 percent among girls and young women who have been physically forced to have sex. Traditional roles that reinforce women's economic dependence on men and discourage women from talking openly with men about birth control contribute to this. This could increase with the COVID-19 crisis, as has happened elsewhere during pandemics. The cultural, economic, social, and legal barriers that obstruct girls' and women's empowerment (Kalimo 2018) must, therefore, be addressed to ensure that adolescent girls have access to reproductive health care and a healthy future.

84. **The poor tend to have the worst human capital outcomes.** Children from poor households are less likely to stay and complete basic education, i.e., primary and secondary school, largely due to the high cost of schooling. While primary school is free in Lesotho, poverty remains a key factor affecting the dropout rate, as there are still indirect costs related to school attendance (such as transportation, school uniforms) that households must bear. Unlike primary education, junior secondary education is not free and the burden of paying for education is disproportionately high for the poorest households.[42] Children from rural mountains are less likely to complete senior secondary education (Figure 18a and Figure 18b). Constituencies with higher poverty rates tend to have higher dropout rates among males and females in secondary education. Many children are orphaned and made vulnerable by the impact of HIV/AIDS on their families and communities, which significantly reduces their likelihood of staying in school. For children and youth who stay in school, they fail to learn enough by the time they leave school, and the correlation between poverty and poor learning outcomes is even more stark. Once young people leave school, only a few move into higher levels of education, even though there is a strong correlation between education attainment and labor market outcomes. Although Lesotho has a developed social protection system that makes regular transfers to its beneficiaries, covering vulnerabilities throughout the lifecycle, a large share of the social assistance benefits goes to non-poor households. Coverage of social protection services of the poorest is limited and benefit levels are low. Universal and untargeted programs, such as school feeding and old age pensions, do however provide support for vulnerable groups.

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37. According to the Cost of Hunger Study in Africa (COHA), over 19 percent of child mortality is associated with undernutrition, 17.7 percent of all repetitions in schools is associated with stunting, and stunted children achieve 3.6 years less in school. Micronutrient deficiency is a major contributor to childhood morbidity and mortality, intellectual and cognitive development, and learning outcomes in school.

38. Two recent studies assessed the quality of ECCD services in Lesotho—the 2018 Multiple Indicator Cluster Survey (MICS) and the Measurement of Early Learning and Quality Outcomes (MELQO) 2019—and found that only 15 percent of children were developmentally on track in the literacy-numeracy domain. That is, they could do two of the following: identify/name at least ten letters of the alphabet; read four simple and popular words; know the name and recognize the symbols of all numbers from 1 to 10.

39. The United Nations Joint Programmed of HIV/AIDS (UNAIDS). 2019. UNAIDS Data 2019. Geneva.

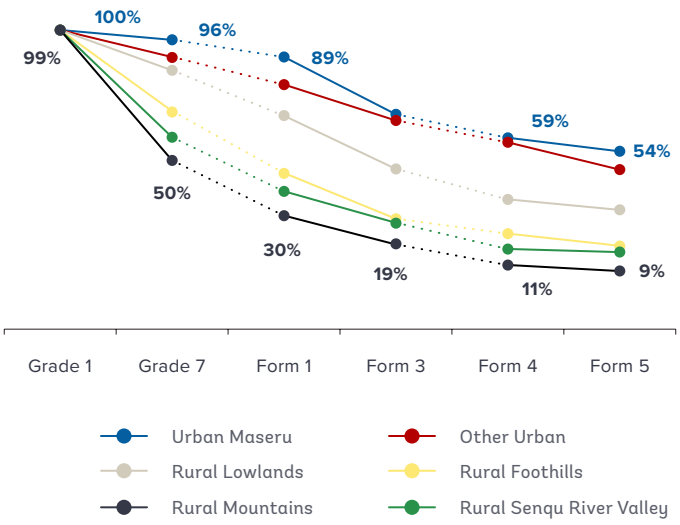
40. Multiple Indicator Cluster Surveys (MICS) 2018.

41. Multiple Indicator Cluster Surveys (MICS) 2018.

42. Household spending on junior secondary education accounts for 17 and 16 percent of household consumption for households in the poorest and poor households, respectively, compared with 7 percent for the richest households.

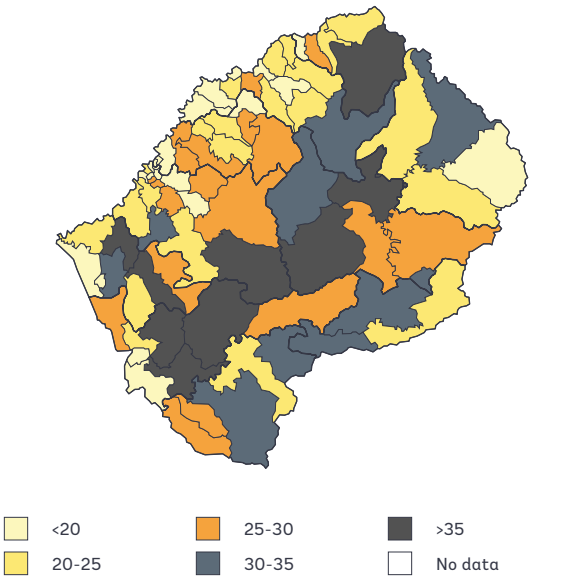
Figure 18. Disparities in access and retention in education

a. Access and retention by ecological zone



Source: Lesotho Education Sector Analysis, 2020.

b. Secondary dropout by constituency



Source: Dropout data are based on World Bank analysis of EMIS, 2019 data.

85. **Poor water supply, sanitation, and hygiene (WASH) service delivery adversely affects human capital formation, especially among the poor and rural population, with inequities in access to WASH early in the life of a child perpetuating the intergenerational transmission of poverty.** While official water supply coverage is high by Sub-Sahara African standards, many water points are non-functional and/or water is intermittent, negatively affecting human capital and disease prevention, including in the current COVID-19 pandemic. Only 5 percent of the population have access to basic hygiene (with water and soap). Less than half the population has access to sanitation. Young children are particularly vulnerable. Diarrhea accounts for 25 percent and is the leading cause of death of children under age 5 in Lesotho. Of these, an estimated 65 percent is attributable to poor sanitation and 73 percent is attributable to unsafe water supply. Diarrhea increases the incidence of malnutrition and stunting which, at an estimated 33 percent of children under age 5, is already high.

86. **The rural population has poor road access, negatively affecting human capital outcomes.** A good and efficient transport system would support an improvement in school attendance and a reduction in dropout rates, being influenced by the extent and quality of access, especially in rural remote mountainous regions. Available data suggest road accidents impact the young school-going age and the most economically active segment of the population (5 to 29 years old),[43] with 81 percent of deaths and injuries in Lesotho impacting this segment of the population. Fatalities per 100,000 population in Lesotho (28.9) are higher than the Sub-Sahara African average of 26.6.

87. **Poor access to electricity slows equitable and sustainable rural development.** The national electricity access rates stand at 38 percent, with 60 percent for urban and peri-urban households and 18 percent for rural households. Recent progress to improve access rates[44] have been achieved largely due to the push by the GoL to accelerate

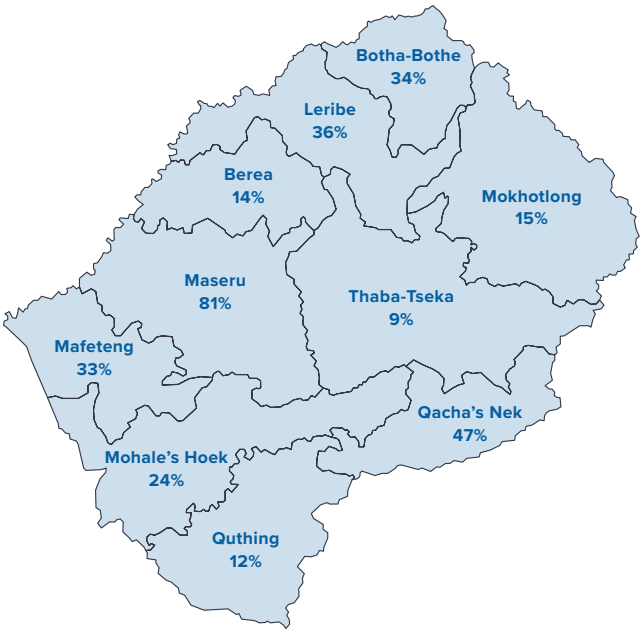
43. WHO Status Report on Road Safety 2018.

44. About 60 percent of currently connected households were provided with access in the last 5 years, and 80 percent in the last 10 years.

grid electrification through an annual budget for electrification and funding from the Universal Access Fund (UAF).[45] If annual GoL electrification targets, at 15,000 grid connections per year, have been achieved, their economic impact on the newly electrified areas have been modest, as small entrepreneurship was not incentivized in these areas. Most of the public rural electrification projects undertaken in the past decade lack sustainability at design. To accelerate grid and off-grid electrification in a least-cost, impactful and coordinated way, the Cabinet adopted the Electrification Master Plan (EMP) in June 2019. Although the grid extension to unserved households was slower in 2020 due to the lower revenues from the UAF, the GoL has advanced implementation of the EMP by adopting the mini-grids regulations in January 2021,[46] providing the regulatory framework for private investment and operation of mini-grids in Lesotho.

88. **The distinct advantage that digitization provides to increasing service delivery in rural and hard-to-reach areas, and promoting inclusion overall, has not yet been realized.** The state of connectivity of government agencies, schools and health-care facilities remains low, and this is a missed opportunity for improved service delivery. Lesotho does not have a National Research and Education Network (NREN), as is already stated in NSDP II. A NREN could lower costs for internet bandwidth and improve access to educational resources. In general, digital technology infrastructure and adoption exhibit clear spatial and gender differences. For example, in 2017, more than half of the urban population used the internet, but only 17.6 percent of the rural population were connected (World Bank 2020b). Digital adoption also exhibits gender differentials: although more females than males are enrolled in university education in Lesotho, very few females enroll in ICT-related programs at higher education institutions and, of those that do, even fewer choose computer science as their specialization.

Figure 19. Poor access to electricity slows equitable and sustainable rural development



Attribute	Total	Share electrified (%)
Households	537,457	40%
Businesses (small shops)	10,750	40%
Schools	1,452	54%
Health Facilities	294	78%
Principal Chief's Offices	22	32%
Local Courts	33	88%
Community Council Offices	47	30%
Other Government Offices	77	21%
Agricultural Resource Centers	22	36%
Police Stations	60	68%
Post Offices	47	85%
Hostels and Barracks	131	83%
Guest Houses and Hotels	285	91%
Churches	1,665	26%

Source: Lesotho Electrification Master Plan (EMP), GoL June 2019.

45. The UAF collects roughly M18 million annually used to promote national electrification. The UAF is funded by levies (M0.02 for domestic and M0.03 for industrial) on every unit of electricity purchased by LEC customers on the grid. The main purpose of the UAF is to (a) subsidize the capital costs of new areas for electrification; (b) provide concessionary financing to developers toward the construction and upgrading for electrical systems for new areas of electrification; (c) facilitate education and training to local communities in the safe and efficient use of electricity; and (d) facilitate research relevant to the supply of electricity in rural areas. The UAF is currently funding only on-grid electrification efforts, mainly extensions of the existing LEC grid network.

46. Mini-Grids Power Generation, Distribution and Supply Regulations, published on the Lesotho Government Gazette No7 – Vol.66 on January 27, 2021.

Capacity constraints and weak accountability

89. **The low capacity of teachers, alongside inadequate systems to promote better accountability by teachers, is a key factor leading to poor learning outcomes of students.** In recent learning assessments,[47] teachers perform only slightly better than students. The capacity of the Ministry of Education and Training (MoET) to develop and provide structured and effective in-service training and follow-up support for teachers is weak. Most in-service training provided at scale tends to be once-off and there are serious concerns about the quality of the programs, materials and capacity of trainers. Furthermore, systems to promote better accountability by teachers are inadequate. Despite a large percentage of the education sector budget going to teachers (81 percent of recurrent expenditure for primary education and 99 percent for secondary education), there were teacher strikes in 2018/19 primarily related to a wage dispute, resulting in schools being closed for prolonged periods and likely contributing to an increase in dropout rates observed in the past two years.[48] Aside from these school closures, no institutional systems exist to periodically measure teachers' content knowledge and pedagogy, teacher absenteeism, the amount of time teachers spend in the classroom teaching, and tracking teacher deployment, training, and professional development. Without such accountability systems in place, it is challenging to assess whether teachers are being efficiently and effectively used to support teaching and learning.

90. **The social protection system suffers from constraints mainly related to limited program coordination, together with weak information management and IT systems.** Administrative systems to support social assistance programs remain largely manual, though the Ministry of Social Development (MoSD) has been working on the integration of the administrative mechanisms of all social safety nets. Currently, program enrolments are managed at different governmental levels. Most programs lack digital management information systems (MIS) or have limited capacity for updating at decentralized levels. MoSD staffing is especially weak in the areas of IT, data management and M&E. With more integrated and digital systems, social protection could more easily expand to cover more poor households. Today, 13.5 percent of the poor report not receiving any transfers. Moreover, the payment of social assistance transfers in Lesotho is costly and payment systems are not secure. Most social assistance payments are cash-based and made via district offices, the G4S security company cash in transit services, and even by helicopter to remote regions. As such, these remain relatively expensive, partly as a result of Lesotho's topography, which includes hard-to-reach areas, and the limited penetration of rural banking.[49] Beyond payment costs, some payments are also late. To improve the efficiency of payment mechanisms and to ensure the transfer of funds on a predictable and agreed schedule, programs are increasingly looking to move from cash to electronic payments (mobile money, bank transfers, etc.).

91. **Gaps exist in the financial sector, affecting its potential to support the country's development.** The distribution networks of the financial sector are dominated by agents of mobile network operators (MNOs),[50] while banks have a very limited distribution network.[51] The distribution network is founded on the National Payment Infrastructure, which provides a solid basis for further development of the financial sector. In terms of geographic distribution, data from the CBL suggest that 71 percent of total access points are concentrated in the following three districts: Leribe, Berea, and Maseru. Access to the SADC regional cross-border payment system, the SADC Integrated Regional Electronic Settlement System (SIRESS), allows for Person-to-Person and Person-

47. The 2018 Examination Council of Lesotho Baseline Assessment conducted in a national sample of 142 schools and 262 primary school teachers.

48. Schools have also been closed since March 2020 due to the pandemic (except grades where students take examinations, which opened on and off from September 2020), resulting in education service delivery being severely disrupted over the past three years.

49. Economic Policy Research Institute 2020.

50. It is important to note that there are no data for transactions on access points.

51. Despite the relatively small distribution network of banks compared with MNOs, it is noted that banks increased their agency network from 23 agents at the end of 2019 to 297 agents at the end of September 2020.

to-Business transfers. Access to this payment infrastructure is limited to South African banks, hence limiting development of remittances and e-commerce solutions for non-bank payment service providers (PSPs). However, a SADC retail payment system is under implementation and this will connect banks and non-banks with settlement done via accounts held in SADC RTGS. Furthermore, there is a lack of interoperability between financial service providers, which hinders the transfer of funds between mobile accounts and bank accounts. The CBL is moving forward in creating the architecture, business model and operational scheme of a national switch that would settle card and non-card digital payments, and would allow for interoperability between the different PSPs.

92. **In the health-care system, there is a lack of qualified staff, low preparedness to deal with patients, and drug shortages within health facilities.** For example, only six out of 20 secondary hospitals (where nearly half of deliveries occur) provide comprehensive emergency obstetric and newborn care (CEmONC) to ensure safe delivery.[52] A lack of qualified staff, the poor state of hospital facilities and a general negative perception of service quality,[53] contribute to a low average bed occupancy rate of 32 percent in public district hospitals. The low quality and sub-optimal utilization of facilities at the district level serve to overwhelm tertiary level facilities, which average a 74 percent bed occupancy rate.

93. **The Ministry of Health (MoH) faces several challenges with the development, revision and approval of policies, as well as enactment of legislation.** There are several health bills and strategic documents (plans) in various stages of development. There have also been delays in translating some draft policies into guidelines related to minimum benefit packages of health services and referrals. These draft documents diagnose poor management of health-service outsourcing (including public-private partnerships, or PPPs), and low capacity in terms of human resource that prevent the MoH from reaping the envisaged benefits of such arrangements. They indicate that the current functional Health Information Management System, which is mainly supported by DPs, needs further strengthening. Finally, the first active public health law in Lesotho was adopted back in 1970. In the meantime, there have been significant changes in public health issues, demographics, and available scientific knowledge. The active law still refers to outdated institutional and governance structures, and to a less complex legal regime, nationally and internationally. A revised public health bill is warranted to update the institutional arrangements, local authorities' health services functions and powers, health emergency preparedness and response, and disease prevention, as well as licensing and accreditation.

94. **As a small country, Lesotho should be better able to implement nationwide programs, but spatial disparities persist.** While geography (a small, mostly mountainous country completely surrounded by South Africa) and connectivity constrain service delivery, there are other constraints, notably weak decentralization. While decentralization has been an important theme in governance reforms, culminating in the adoption of the 2014 National Decentralization Policy, the policy has not yet been fully implemented. As noted in NSDP II, a guiding framework for decentralization has not been developed, and funding for local government structures is inadequate and unpredictable. The relationship between the central government and decentralized structures in terms of funding, implementation and monitoring of development programs and projects has still to be clearly defined and operationalized for effective delivery of services. Overall, decentralization can contribute, if proper political and fiscal institutions are put in place, to improving service delivery. It is important to note that improvements in service delivery do not depend on the intensity of decentralization policies, but rather on their quality, meaning above all their capacity to promote local accountability.

52. CEmONC Report 2015.

53. Lesotho PER 2017.

2.1.3. Labor market outcomes are disappointing

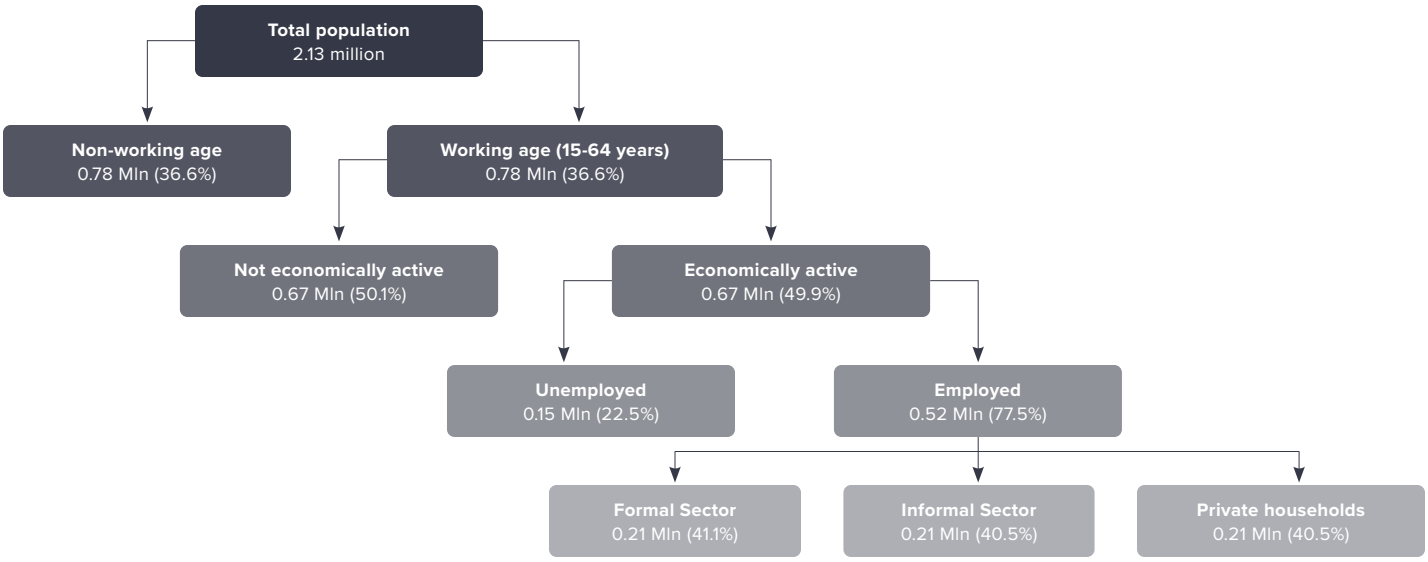
95. **Job prospects have not significantly improved. According to the recent Labor Force Survey of 2019, the national unemployment rate is 22.5 percent (Figure 20) and 38.3 percent according to the standard and expanded definitions, respectively.** The unemployment rate is higher among youth, at 29.1 percent, driven by skills mismatches and low wages. Women are less likely to participate in the labor force, have a higher probability of being unemployed, and tend to earn less than men. For instance, the female youth unemployment rate was 31.1 percent in 2019 and the male unemployment rate was 27.1 percent. Among employed women, most are relegated to insecure and low-paying jobs in the informal sector, including subsistence agriculture in rural areas and domestic work or street vending in urban areas. The employment challenge is more severe among Basotho living in rural areas, those with low levels of education, and young women.

96. **In recent years, productivity growth has slowed substantially, and labor productivity is low especially in subsistence agriculture.** Productivity of labor is negatively affected by HIV/AIDS. Weak total factor productivity also appears to reflect inefficient inter-sectoral allocations, with labor concentrated in the economy's least productive sectors. Mining is one of the fastest-growing sectors of Lesotho's economy, but it is capital-intensive, with little impact on employment. Furthermore, the sector is constrained by low labor productivity. Labor productivity is particularly low in subsistence agriculture, a sector that is important for the livelihoods of most Basotho. Low productivity in subsistence agriculture means agricultural work does not guarantee lower poverty levels. The public sector dominates the economy, but it does not employ many of the poor. Furthermore, it is unlikely that the public sector will continue to expand enough to absorb the large future cohorts of working age people, especially given recent and future declines in fiscal revenues.

97. **The returns to education are high, with education facilitating access to better jobs, reflecting its impact on labor productivity.** The returns to education, especially post-secondary, are high, increasing the probability of being in the labor force and out of unemployment. Education levels play a role in securing employment outside agriculture and qualifying for permanent jobs. The highest returns to education accrue to those who study in technical schools or those who have post-secondary education. An increase in educational attainment in urban areas between 2002 and 2017 meant more people in urban areas could access better paying, more stable and higher productivity jobs. In fact, skilled non-agricultural jobs provided the main sources of income to lift urban households out of poverty.

98. **Access to productive and stable employment is associated with a reduced likelihood of being poor, but employment does not guarantee escaping from poverty.** Whether individuals are out of the labor market or in the labor market matters less for poverty than the type of jobs they have. A large portion of Lesotho's population consists of working poor who earn very low wages. Many enterprises operate only seasonally, and rural enterprises show this intermittent pattern more frequently than urban ones. Workers with seasonal contracts are the poorest, followed by those with casual contracts and temporary jobs. The portion of wage-earning workers increased more rapidly among poor households than non-poor households, indicating that getting a wage-paying job may be instrumental in moving up the consumption ladder, but might not always be enough to escape poverty.

Figure 20. Employment cascade, 2019



Source: World Banks calculations using preliminary estimates from BOS.

2.1.4. Vulnerability to environmental and economic shocks is high

Households have few coping strategies at their disposal to manage shocks and, as a result, shocks significantly slow poverty reduction

99. **Basotho face a myriad of uninsured environmental and economic shocks.** Data from 2012/17 suggest the frequency of weather and price shocks is high, reflecting abnormally bad weather conditions due to an El Niño-induced drought and high inflation during the survey period. Unsustainable land management practices, leading to degradation of the natural resources base, exacerbate vulnerability to shocks, especially among the rural poor who are more dependent on natural resources for their livelihoods.

100. **When shocks occur, households have few available coping mechanisms.** This is particularly true for shocks that affect many households in the same community or market at once. As a result, consumption is often reduced in response to these types of shock, increasing poverty and producing long-term consequences on human capital attainment for children. In 2016, the drought resulted in a 23 percent reduction of consumption for rural households. For households with lower levels of consumption prior to the shock, reductions in consumption can lead to undernutrition, with poor health consequences in the short term and serious long-term consequences. These include a high risk of stunting, impaired cognitive development, lower school attendance rates, reduced human capital attainment, and higher risks of chronic disease and health problems in adulthood. Urban households and better-off households have more coping mechanisms available to them. Those who are educated, who have access to irrigation or who have a source of remittance income are less susceptible to such risks.

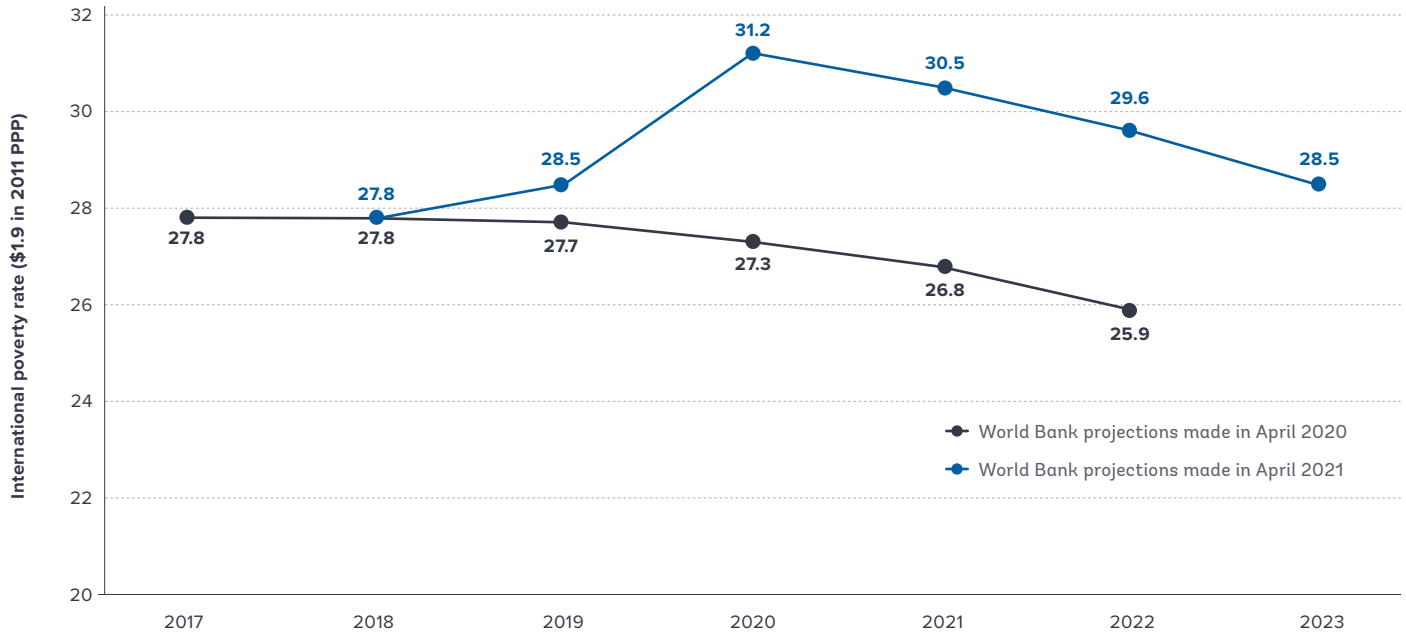
101. **The recurrent occurrence of shocks significantly slows poverty reduction.** Without the 2015/16 El Niño-induced drought, rural poverty would have been 6 percentage points lower, and the pace of national poverty reduction would have nearly doubled between 2002 and 2017. The disproportionate impacts of low rainfall on rural households led to an increase in the urban-rural divide, with urban poverty decreasing while rural poverty stagnated. However, even with normal rainfall, a large urban-rural divide would nonetheless remain in Lesotho. The 2015/16 El Niño-induced drought was not a one-off event. Climatic shocks will continue to impact Lesotho, likely with increasing frequency and severity going forward as a result of climate change. Preparing for these events is therefore essential.

The COVID-19 pandemic is projected to increase poverty and inequality

102. **The COVID-19 pandemic is projected to have a strong poverty impact.** Comparing the World Bank's Macro Poverty Outlook (MPO)[54] indicators for April 2020 and April 2021 highlights the adverse impact of the pandemic on poverty (Figure 21). In the April 2020 MPO, extreme poverty, measured at the US$1.90 per person per day (in 2011 PPP) poverty line, was projected to be at 27.3 percent in 2020. The revisions to better account for the pandemic resulted in an increase in the projection by 3.9 percentage points to 31.2 percent. Likewise, the projections for 2021 and 2022 were revised upwards. Economic recovery will be accompanied by declining poverty rates but will nonetheless remain higher than in 2019.

103. **To complement the MPO exercise, a micro-simulation model was used to understand the impact of the pandemic on poverty through labor market shocks.** While assumptions were made regarding the duration of the lockdown measures introduced by the GoL to curb the spread of the virus, the pattern of who is affected the most is clear. The impact is stronger for urban households, households with affected earners, those aged 25 to 54, and those with primary or secondary education, together with younger households with children. Existing social protection programs have the potential to reach the most badly affected. Specifically, top-ups of existing social protection grants can soften the poverty impact of the pandemic.

Figure 21. The pandemic is projected to increase poverty



Source: World Bank Macro-Poverty Outlook.

54. The Macro Poverty Outlook (MPO) analyzes macroeconomic and poverty developments in 146 developing countries. The report is released twice annually for the Spring and Annual Meetings of the World Bank Group and International Monetary Fund. Due to the extraordinary economic conditions caused by the COVID-19 crisis, the economic forecasts released in April in the MPO were updated on June 8, 2020.

Box 2. The impact of the COVID-19 pandemic on human capital

The negative economic impact of the pandemic had led to a decline in household incomes and consumption. This constrained financial situation for households is likely to reduce household investment on human capital. For instance, in a context where dropout rates are already high, especially for junior secondary education, the impact of the COVID-19 pandemic is expected to be worse at the junior secondary level as the economic impact of the lockdown is likely to make junior secondary education unaffordable for many students (junior secondary education is not free). In addition, with the prolonged school closures, some young people may not be able to return to school. Many families that rely on herding cattle and farming for their survival, income, or both, may compromise the participation of boys in education. Furthermore, adolescent pregnancy is likely to increase during the prolonged school closures. Thus, many of the factors that contribute to the high dropout rate at the junior secondary level are being exacerbated by the COVID-19 crisis. This underscores the importance of addressing the demand-side poverty related barriers to improve student retention.

Another illustrative example is in the household budget for cooking and lighting, as the 2020 shock engendered less purchase of paraffin and cooking fuels, inducing more time spent for wood fuels and dung collection, to the detriment of education and health.

Low usage of digital platforms for teaching and learning has exacerbated the disruption in learning and support for teachers. About 511,000 learners have been affected by the closure of all schools and ECD centers, and most of the learners are in the rural areas. There is a digital divide that exists across space (urban vs rural areas), as well as between rich and the poor households. At about one-third of the population, access to the internet is low and even lower among rural and poor households. As a result, only a few, largely private schools and tertiary institutions have continued learning using online platforms.

The pandemic is likely to increase inequalities in the education sector. This is because continuing learning through digital technology solutions may not be widely available and accessible to all learners, households and geographic areas. Children from marginalized and poor communities are at a greater risk of dropping out and falling behind as they have limited access to distance learning opportunities.

The pandemic presents an opportunity to overhaul delivery of education services, including in teacher training. Based on lessons learned, the Ministry of Education and Training (MoET) is strengthening the resilience of the education system by ensuring all students have access to digital devices with learning content, whether schools are open or closed. As a start, the GoL, in collaboration with UNICEF, has introduced television-based learning programs for selected subjects and classes. These platforms are, however, not interactive and this compromises their effectiveness. Nonetheless, they are an important step toward ensuring access to education, even in the context of shocks that make face-to-face interaction impossible.

On the health side, the pandemic is unfolding in a context of a fragile health system and poor health outcomes. The health system is already overburdened. It lacks the requisite resources and infrastructure and traditionally relies on South Africa to provide complementary secondary and tertiary health care. Even before the pandemic, access to health services had been difficult for many people, especially in rural areas.

The inequities in health-care service provision mean that the pandemic is affecting different population groups disproportionately. Vulnerable populations will be affected the most. For instance, the disruption in the supply chain could have an impact on the delivery of antiretrovirals in the country, thus affecting people living with HIV and subsequently increase HIV-related mortality rates in the country. The vulnerability of people with disabilities is heightened by the pandemic owing to stigma and discrimination, to lack of access to information, basic services, remote or distance-learning options, and pre-existing isolation and marginalization. This could result in increased fatalities. The lockdown will also make access to specialist health-care services in South Africa impossible, leading to mortalities. Anecdotal evidence suggests that access to sexual reproductive health services, including sanitary towels, was suspended due to the lockdown. Returning labor migrants coming through unofficial borders could also increase the risk of infection within rural communities. This risk is compounded by the limited capacity to effect quarantines and challenges in contact tracing. Gender-based violence has emerged as an area of concern during the pandemic. Furthermore, prolonged periods of closures and restrictions on movement may also lead to additional emotional unrest and anxieties among young people.

Social protection helps to reduce poverty and inequality, but its ability to help households mitigate the impact of shocks is limited

104. **The social protection system helps reduce poverty and inequality.** In 2017, social assistance transfers reduced the poverty headcount rate by an estimated 3.1 percentage points and the poverty gap by 5.3 percentage points. The poverty-reducing impact of Lesotho's social assistance system ranks ahead of the average for Sub-Saharan African countries. The inequality-reducing impact of social assistance is also significant: the Gini coefficient would be 3.8 percentage points higher without social transfers. This has a significant impact on inequality, greater than in many other countries contained in the Atlas of Social Protection Indicators of Resilience and Equity (ASPIRE) database. Cash transfers play the most significant role in reducing poverty and inequality.

105. **However, existing social protection programs play a role of income supplementing rather than risk insurance.** Social protection programs are limited in the degree to which they can help households mitigate the impact of shocks. Few households report receiving help from the GoL or NGOs in the face of shocks. Households that experienced drought, crop disease or chronic illnesses were more likely to report receiving help from the GoL or NGO resources. These are situations in which informal networks, labor markets and financial markets struggle to provide the required support to affected households. But too few households benefit from public support.

106. **The under-provision of public support persists despite the significant government and humanitarian response often put in place when large covariate shocks occur.** Analysis shows that pensions help households mitigate the impact of shocks, but existing social protection programs are limited as coping mechanisms. However, social protection policies are another means for governments to help households manage these risks. They provide a dependable source of household income that is not subject to risk (for example, pension support) and can be scaled up to provide more support in hard times. The GoL and the international community did increase support in response to the 2015/16 drought and this response did help to ameliorate the shock somewhat, but the impact was limited.

107. **Use of digital platforms in the rollout of social protection programs could strengthen resilience to shocks.** While some social payments data are stored in the National Information System for Social Assistance (NISSA) database, real time birth/death/income/location/contact data availability would facilitate targeting of social grants to help during shocks.

2.1.5. Remittances have been falling

108. **Remittances are strongly progressive, with significant impacts on poverty and inequality.** Rural poverty would have been nearly 10 percentage points lower in 2017 had remittances not declined since 2002. Poor households use the money to buy necessities and invest in human capital. Urban households are less reliant on remittances, and urban poverty would be only 2.7 percentage points lower if remittances had remained at their 2002 levels.

109. **Poor households, especially the less educated and rural residents, are particularly likely to be dependent upon remittances.** Among the 30 constituencies most reliant on remittances from South Africa, 25 are rural and all have poverty rates above 40 percent. Nonetheless, some of the very poorest constituencies in the mountainous areas rely relatively little on remittances. Their geographical isolation makes it harder to work in South Africa and this has important implications for the well-being of Basotho living in these areas.

Remittances serve as a buffer when shocks occur; without access to remittances, these regions are likely to be impacted more severely by shocks.

110. **Non-poor rural households are vulnerable to falling back into poverty because of high reliance on agricultural income and remittances, which makes their livelihoods volatile, and a shock increases the risk that rural households that have escaped poverty may fall back into poverty.** For one-quarter of Basotho, the predicted probability of being in poverty is sufficiently high to make them vulnerable to falling back into poverty. This means that these households share characteristics with others that are poor and, under different shock scenarios, may find themselves characterized as poor. This is particularly true of rural households, where three out of four non-poor households face high risks of falling into poverty. In contrast, only 30 percent of non-poor urban households are vulnerable to falling into poverty.

111. **Remittances are prominent channels for expanding financial inclusion and uptake of DFS, but costs remain high.** Lesotho is among the top 25 countries with the largest remittance inflows as a share of GDP, at 16 percent. While 27 percent of the population sent remittances in the past year, only 8 percent used financial institutions to do so. For households, the cost and time it takes to receive remittances is an important driver in the choice of provider.

2.2. Lesotho's Lagging Regions: The Case of Rural Mountainous Areas

112. **As highlighted in preceding sections, progress in reducing poverty has been slow, and even slower in rural areas where poverty remains highly concentrated.** While the 2017 national poverty map demonstrates heterogeneity in poverty across space, constituencies in rural mountainous areas tend to have the highest poverty rate and concentration (Figure 15). This section discusses some of the factors that are likely behind the slow progress in these areas.

113. **Access to basic services and infrastructure is low and this is associated with increased multidimensional poverty.** Rural areas, particularly in the mountainous regions (Figure 22 maps rural mountainous zones), are more likely to suffer deprivations (Figure 23) and subsequently poverty. As a result, the poor in these areas tend to suffer multiple deprivations that reinforce and perpetuate poverty. Constituencies with low access to basic infrastructure tend to have higher poverty rates. This underscores poverty as a barrier to access to basic services, and a contributor to and/or a result of resource inequality.

Figure 22. Mapping rural mountainous areas

	ID	NAME
Botha-Bothe	1	Mechachane
	2	Hololo
	3	Motete
	4	Qalo
	5	Botha-Bothe
Leribe	6	Malibamats'o
	7	Mphobong
	8	Thaba-Phats'oa
	9	Mahobong
	10	Pela-Ts'oeu
	11	Matlakeng
	12	Leribe
	13	Hlotse
	14	Tsikoane
	15	Maputsoe
	16	Likhetlane
	17	Peka
	18	Kolonyama
Berea	19	Mosalemane
	20	Makhoroana
	21	Bela-Bela
	22	Malimong
	23	Khafung
	24	Teya-Teyaneng
	25	Ts'oana-Makhulo
	26	Thupa-Kubu
	27	Berea
	28	Khubetsona
	29	Mabote
Maseru	30	Motimposo
	31	Stadium Area
	32	Maseru
	33	Thetsane
	34	Qoaling
	35	Lithoteng
	36	Lithabaneng
	37	Abia
	38	Thaba-Bosiu
	39	Machache
	40	Thaba-Putsoa
	41	Maama
	42	Koro-Koro
	43	Qeme
	44	Rothe
	45	Matsieng
	46	Machaleng
	47	Maletsunyane

	ID	NAME
Mafeteng	48	Thaba-Phechela
	49	Kolo
	50	Matelile
	51	Maliepetsane
	52	Thabana Morena
	53	Likhoele
	54	Qalabane
	55	Mafeteng
Mohale's Hoek	56	Taung
	57	Qhalasi
	58	Mohale's Hoek
	59	Mekaling
	60	Qaqatu
	61	Mpharane
	62	Ketane
	63	Hloahloeng
Quthing	64	Tele
	65	Moyeni
	66	Sebapala
	67	Mt. Moorosi
	68	Qhoali
Q. Nek	69	Qacha's Nek
	70	Lebakeng
	71	Tsoelike
Thaba-Tseka	72	Mants'onyane
	73	Thaba-Moea
	74	Thaba-Tseka
	75	Semena
	76	Mashai
Mokhotlong	77	Malingoaneng
	78	Senqu
	79	Mokhotlong
	80	Bobatsi

Share of population living in rural mountainous zones

- 0% - 20%
- 20% - 40%
- 40% - 60%
- 60% - 80%
- 80% - 100%

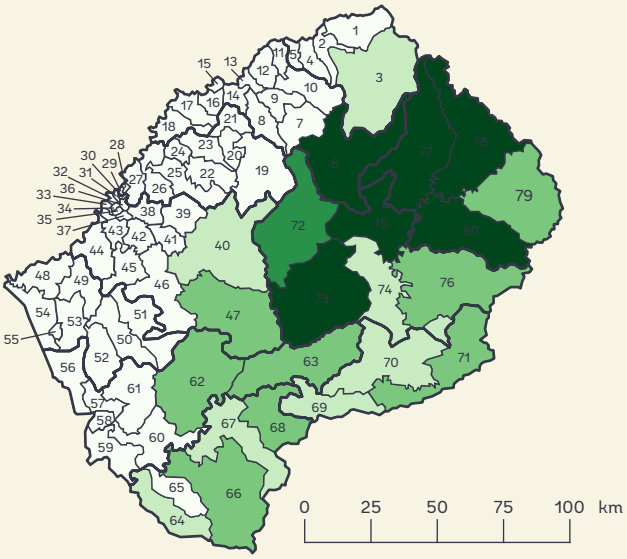
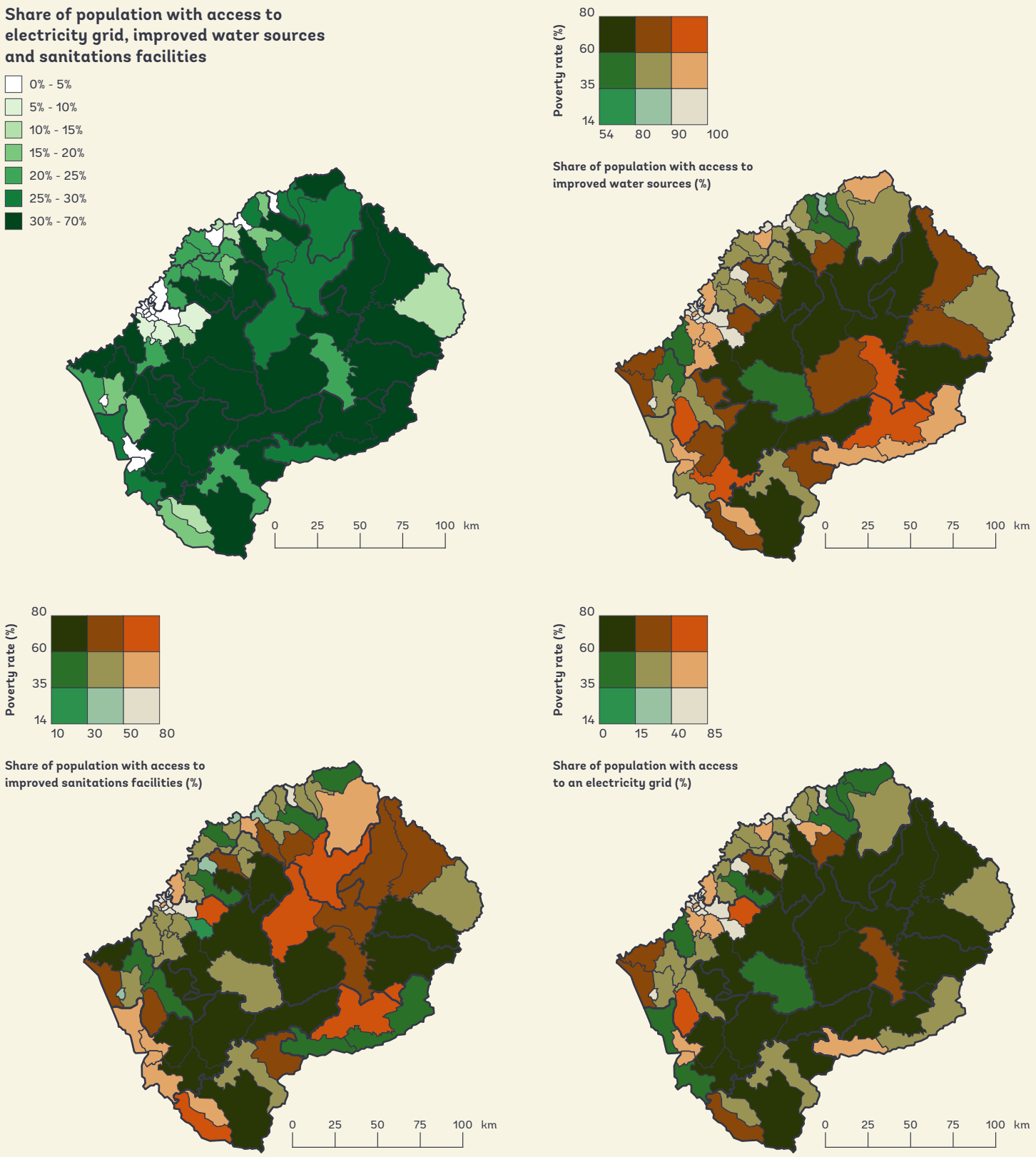


Figure 23. Lack of access to basic services and infrastructure is associated with increased poverty

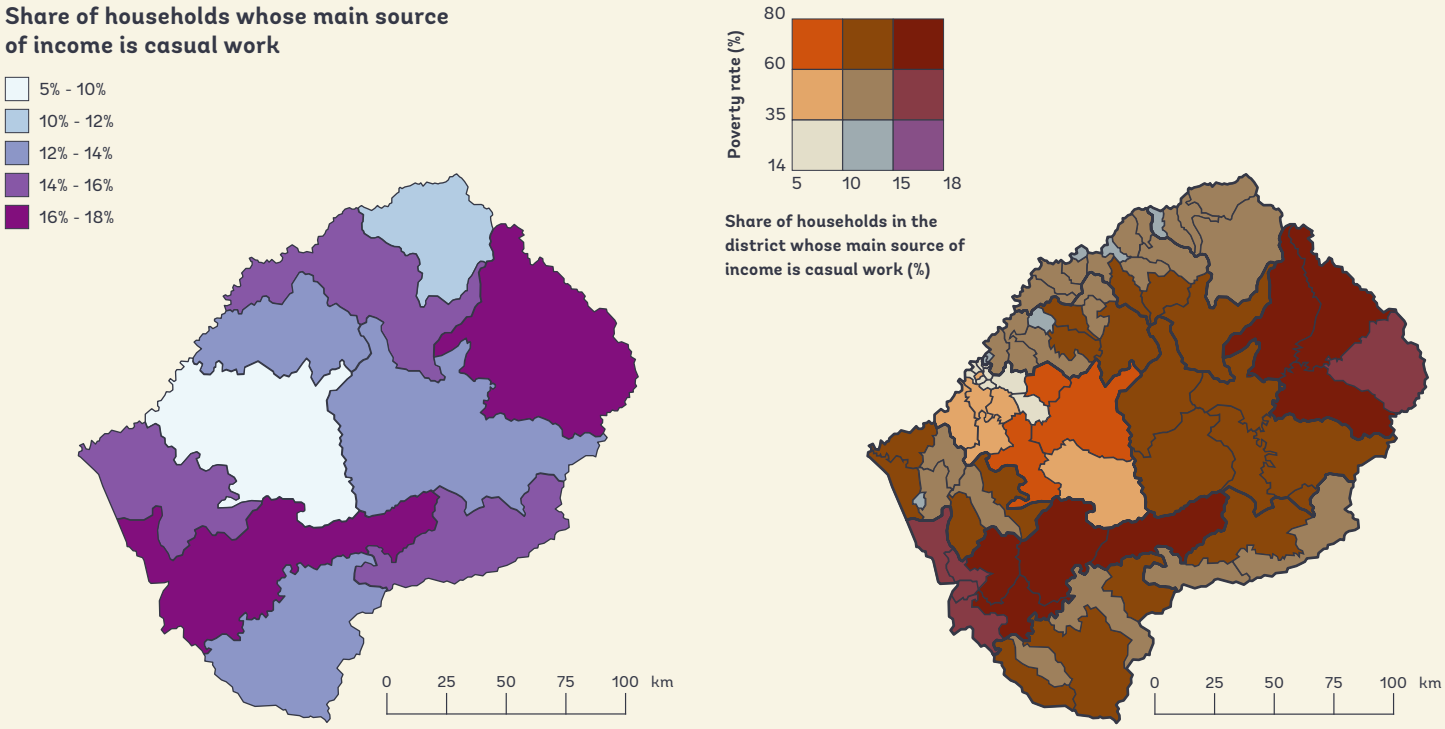


Note: The poverty rates were estimated using the national poverty line. See Figure 22 for an indication of which areas are broadly classified as rural and mountainous.

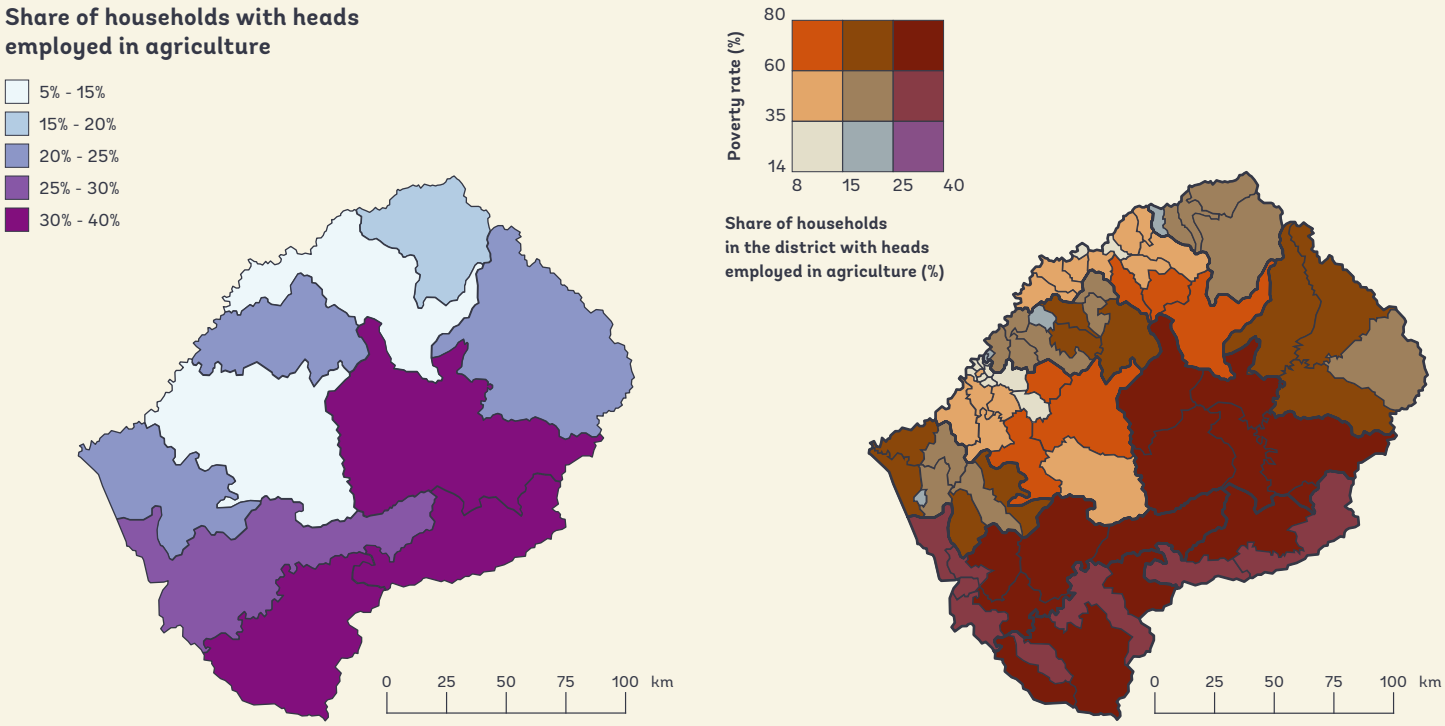
Source: BOS 2021: Mapping subnational poverty in Lesotho in 2017/2018: Methodology and key findings.

Figure 24. Limited economic opportunities are associated with increased poverty

a. Poverty and casual work as main income



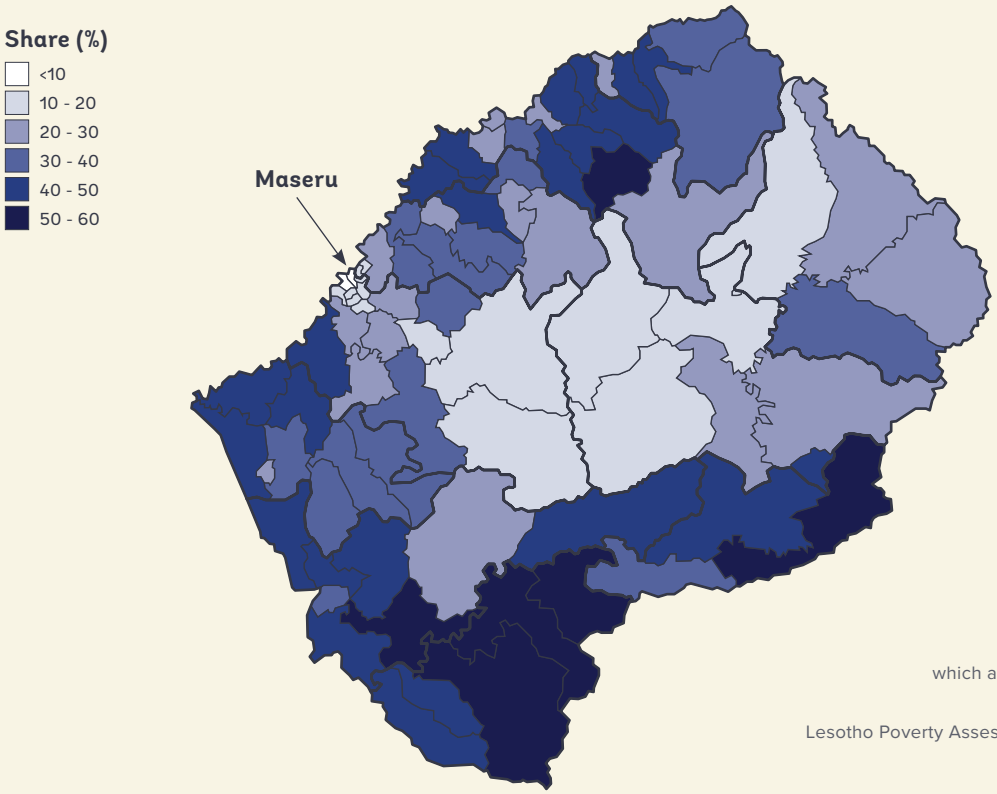
b. Poverty and employment in agriculture



Note: The poverty rates were estimated using the national poverty line. See Figure 22 for an indication of which areas are broadly classified as rural and mountainous.

Source: BOS 2021: Mapping subnational poverty in Lesotho in 2017/2018: Methodology and key findings.

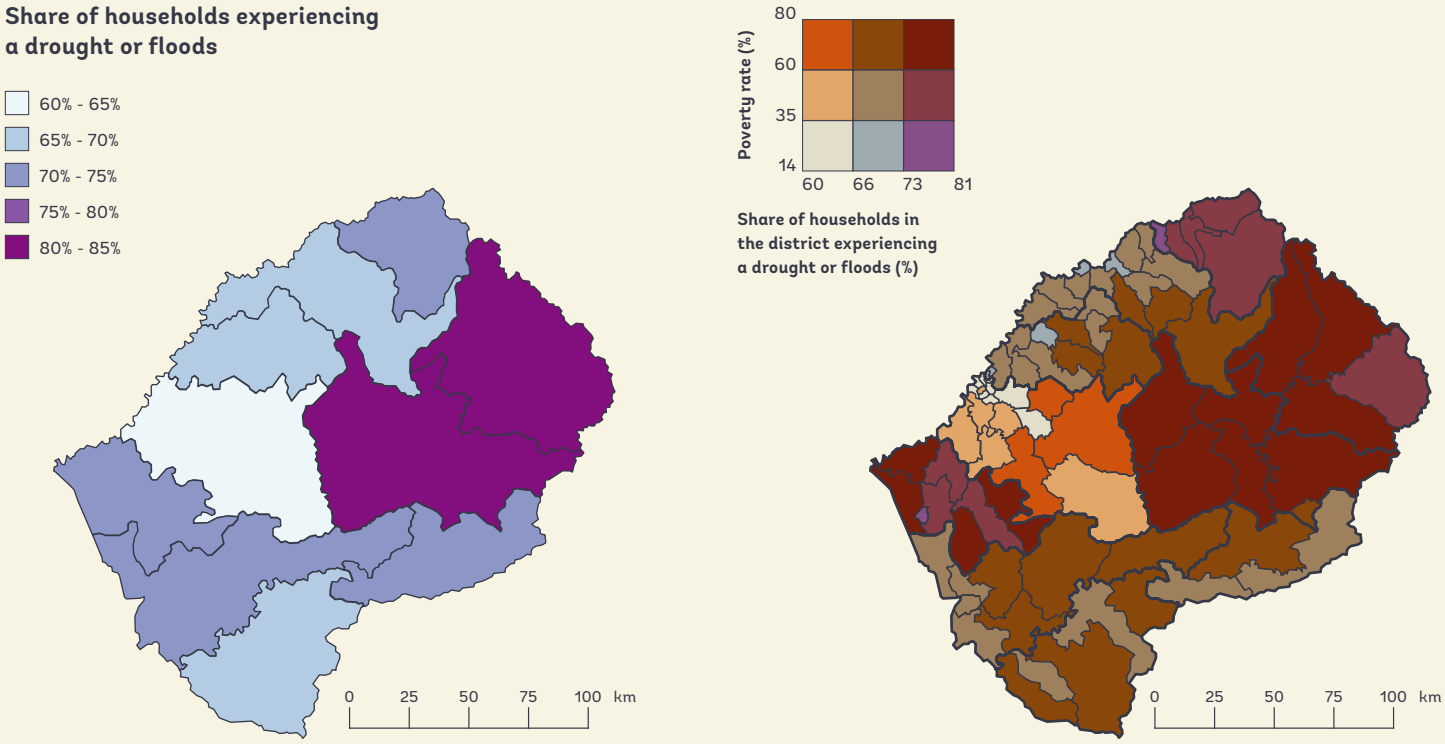
Figure 25. Share of individuals living in household with remittances from South Africa



Note: See Figure 22 for an indication of which areas are broadly classified as rural and mountainous.

Source: World Bank 2019b: Lesotho Poverty Assessment: Progress and challenges in reducing poverty.

Figure 26. Increased vulnerability to climatic shocks is associated with increased poverty



Note: The poverty rates were estimated using the national poverty line. See Figure 22 for an indication of which areas are broadly classified as rural and mountainous.

Source: BOS 2021: Mapping subnational poverty in Lesotho in 2017/2018: Methodology and key findings.

114. **Access to financial services for individuals has improved in recent years, driven by an increase in mobile money penetration, but gaps remain.** Rural residents, adults belonging to the poorest 40 percent of the population, and females are less likely to own an account. In addition, less than 40 percent of the adult population (aged over 15) use digital payments. Given the mountainous terrain and low population density in many rural areas, physical access points are mostly located in and around Maseru, underscoring the need to make digital payments more accessible. Outside Maseru and the urban center, areas with low population densities remain underserved by financial services. Due to the impact of the COVID-19 pandemic, expanding and facilitating the use of digital delivery channels will be key to maintaining access and potentially expanding access during recovery, though high associated fees pose a challenge.

115. **There are likely barriers to labor mobility in the face of limited economic opportunities.** Evidence shows that mountainous areas tend to have a high share of household heads employed in agriculture, as well as a high share of households with their main income coming from casual work (Figure 24). This suggests limited economic opportunities beyond agriculture, while reliance on casual work and/or agriculture is associated with increased poverty. Given this, migration, especially to South Africa where there are more economic opportunities, is a strategy many Basotho households use to diversify income sources. In general, poor households, especially the less educated and rural residents, are heavily reliant on remittances. However, some of the very poorest constituencies in the mountainous areas rely relatively little on remittances (Figure 25), suggesting barriers to labor mobility that could be linked to the cost of migration, as well as poorer human capital outcomes that might limit their ability to access jobs.

116. **Connectivity to global, national, and regional markets is weak and this holds back productivity gains in rural mountainous areas.** Both the hard and soft connective infrastructure are weak. First, these areas suffer poor road infrastructure. While improvements in transport infrastructure, the highlands, which cover three-quarters of the total land area, continue to suffer from low road densities and inadequate connectivity to rural communities. Access to the main roads and to basic services and markets is impeded by the mountainous terrain, and further limited by floods and landslides during heavy rainfall. Second, while digital technology can compensate for this, digital infrastructure and adoption is low in these areas.

117. **Being hard to reach, these lagging rural mountainous areas tend to bear the brunt of the costs of remoteness, particularly in the form of higher consumer prices.** Remoteness is typically associated with higher marginal costs and less competition, which result in higher markups. For example, Matchaya et al. (2020)[55] provide evidence that maize flour prices in the markets located in rural mountainous areas (particularly Mokhotlong and Thaba-Tseka districts) were generally higher than the prices in urban areas (Berea and Maseru districts) throughout 2019 and 2020. One explanation is that the highlands have limited arable land, which reduces agricultural productivity, resulting in households having to supplement their home-milled maize flour with purchased maize flour. The COVID-19 pandemic has exacerbated the challenge: being further away from the urban districts and not easily accessible, the shortage of maize flour was felt more acutely in Mokhotlong and Thaba-Tseka, hence the notable and significant price increases.

118. **Vulnerability to environmental and economic shocks is high, but households have few coping strategies at their disposal to manage shocks.** Rural mountainous areas are more likely to report drought risks (Figure 26). This is exacerbated by unsustainable land management practices, which lead to degradation of the natural resources base, adversely affecting the livelihoods of the rural poor. Because households have few coping strategies at their disposal to manage shocks, droughts tend to be associated with reduced consumption, with long-term consequences on human capital attainment for children.

55. Matchaya G; Fakudze, B; Nhlengethwa, S; and Ikhothatseng Greffiths. 2020. Maize Flour Price trends in rural districts and urban districts of Lesotho under COVID-19. Covid-19 Bulletin No. 15, December. Kigali. AKADEMIYA2063.

119. **In sum, Lesotho is facing challenges in achieving balanced regional development, with rural mountainous areas lagging behind.** Accelerating poverty reduction and shared prosperity therefore hinges disproportionately on addressing key constraints to ensuring that lagging regions are more productive and create economic opportunities for the poor. While the previous discussion describes the challenge of lagging regions in Lesotho, more analytical and policy work is needed in this area to inform a spatial development lens that allows for the identification of challenges, opportunities, and solutions at these subnational levels. At the same time, reducing persistent inequality between urban and rural areas will require an equity-based approach to investments in rural mountainous areas.

120. **Lessons can be drawn from countries that have had to adopt a spatially informed approach to development with the aim of overcoming the challenge of concentration of economic activity that has failed to improve living standards across the country.** Examples include Argentina (World Bank 2020a), Bhutan (Bhutan Urban Policy Notes: Regional Development and Economic Transformation), and Colombia. In the case of Colombia, the approach entails consolidation, coordination, and collaboration among territorial institutions to achieve increased regional impact, as well as working with institutions and policies for land market management in rural and urban areas to increase productivity and sustainable territorial development. The *World Development Report 2009 Reshaping Economic Geography* is a good resource for conceptualizing an appropriate framework for economic integration between leading and lagging areas.

3.

OPPORTUNITIES AND CONSTRAINTS FOR DEVELOPMENT: WHAT NEEDS TO CHANGE?

121. **Building on the 2015 SCD and based on evidence presented in the preceding chapters, this SCD Update argues that, in order to achieve higher, more sustainable, more inclusive growth, and faster poverty reduction and shared prosperity, interventions are needed in four areas.** These are: (i) rebalancing growth toward private investment and exports for job creation; (ii) strengthening human capital and improving service delivery, especially in rural areas and lagging regions; (iii) strengthening climate risk management and resilience; and (iv) across all of these focus areas, addressing public sector implementation gaps, which is important for improving the effectiveness and efficiency of public spending. The following subsections describe the recommendations in detail.

3.1. Rebalancing Growth: Shifting to Private Investment and Exports for Job Creation

A shift to a growth model that is driven by a larger, more vibrant, internationally competitive private sector that creates jobs has still to be realized. As a small, landlocked country, improving trade competitiveness and increasing integration into regional and global value chains are essential to growth and economic development. However, exports remain low, uncompetitive, undiversified, and with limited value addition. While agriculture, especially high-value horticulture, presents opportunities for export growth, the sector continues to be characterized by low growth and productivity. An uncompetitive investment climate and business environment discourage investment, both domestic and foreign. The level of financial intermediation and financial inclusion is low, especially for micro, small and medium enterprises (MSMEs), and the entrepreneurship ecosystem remains underdeveloped. The dominance of state-owned enterprises (SOEs) stifles private sector development. To rebalance growth toward private investment and exports, it would therefore be important to accelerate implementation of key business reforms, and close gaps in key infrastructure and increase agricultural productivity, while promoting integration between leading and lagging areas.

3.1.1. Opportunities to shift to private investment and exports for job creation

122. **There is an opportunity to build on past success to revitalize the manufacturing sector, ensuring the sector regains its competitiveness, by leveraging close economic ties with South Africa and the African Continental Free Trade Area (AfCFTA).** Lesotho has demonstrable comparative advantage in the textile and apparel sector. This is a priority sector to target for investment and job creation, focusing on improving manufacturing capabilities, strengthening business and trade facilitation for export promotion, promoting industrial clustering and integrated supply chains, and improving the overall regulatory framework to create a competitive business environment. The post-COVID-19 recovery in the export manufacturing sector presents opportunities to enhance the competitiveness of this sector and tap into its huge job creation potential. Relatively reliable and cheap electricity (over half of Lesotho's power is from bulk imports) and relatively low fuel prices (lower than in South Africa) provide advantages for manufacturers.

123. **Opportunities also exist in the non-textile and apparel sectors, with the potential to attract private investment and create new and better jobs in key value chains.** These include opportunities in leather, automotive parts, horticulture, tourism, and the digital economy. Tapping into opportunities in the leather manufacturing sector requires addressing the cost and time to ship leather by air from Ethiopia to Lesotho due to double clearances into and out of South Africa. It also requires

developing the value chain for production at scale, including targeted support for skills development. Tapping into opportunities in the automotive parts manufacturing sector requires strengthening vertical integration between South African and Lesotho firms, including through joint ventures. One specific opportunity is to tap into the Automotive Production Development Program (APDP), where material from Lesotho could be regarded as locally produced in South Africa, as part of a SACU regional effort. In terms of tourism, nature-based and adventure tourism can help to increase private investments and create new jobs in rural areas, tapping into regional markets. Furthermore, the digital transformation of the economy can be a source of growth and job creation, as it will lead to the creation of new digital jobs for young people, including tapping the benefits from private digital platforms for online wholesale, and retail trading and consumer services.

124. **Agribusiness also provides an effective pathway to crowd in private sector support for unleashing the potential of the agri-food sector for boosting exports and job creation.** There is evidence of an increase in value added from agro-based industries, and agricultural trade and distribution services, as well as a shift from traditional exports to higher-value agricultural products in international trade. In particular, high-value horticulture presents an important opportunity (World Bank 2018a), with potential to supply both domestic markets and export horticulture products.[56] Tapping into this potential will require investments to modernize and upgrade farmers' production processes, as well as in post-harvest infrastructure and management to support value addition. Together with horticulture, livestock farming offers opportunities for socioeconomic development, especially in the mountainous and remote areas of Lesotho, where it often serves as the primary source of food security and rural livelihoods. For instance, support for cattle development also provides opportunities for the production of organic red meat for exports to South Africa and other reginal/global markets. Overall, evidence suggests that the provision of training and investment support in productivity enhancing and climate-resilient technologies and farm practices in the horticulture and livestock subsectors, as well as capacity building activities to adopt a business approach, can improve agricultural productivity and marketable surplus among smallholder farmers.

125. **The biggest opportunities for trade lie in improved trade facilitation and trade policy integration with South Africa's trade system.** This benefits from Lesotho's efforts to actively reform its trade facilitation practices and procedures in line with the WTO's Trade Facilitation Agreement obligations and good practices. These include modernizing its procedures, automating, and increasing coordination at the border to reduce duplication and complexity. The Lesotho Revenue Authority (LRA) is also leading the implementation of a new integrated border management model that will reduce duplication and foster joint inspections to reduce the burden on the trade sector. Other opportunities include alignment of automated trade reporting to support integrated VAT refunds, as well as improved regional collaboration on both facilitation and on shared risk management and law enforcement. In 2019, Lesotho and South Africa agreed on the development of a One-Stop Border Post at the Maseru Bridge and Ficksburg border posts by 2025. This is expected to improve trade facilitation. In addition, to create a more favorable trade regime with South Africa, Lesotho could focus on opportunities at the bilateral level, initiating AGOA-like arrangements with multiple partners for multiple sectors.

126. **Shifting market trends due to the COVID-19 pandemic offer new opportunities.** Global value chains, including those in the textile and apparel sector, are being transformed due to the impacts of the COVID-19 pandemic, and this presents opportunities to increase investments and jobs in the sector. The pandemic had pushed most US buyers to look to a diverse sourcing base. Increasing digital presence is important for tapping into these opportunities, because online-focused operations are gaining more prevalence. Furthermore, a focus on fair wages and improved labor conditions is becoming increasingly important as global retailers, including those in South Africa, prioritize fair wages and uplifting workers due to customer preferences. Thus, supporting businesses to improve in these areas is expected to strengthen the attractiveness of goods and services to international buyers.

56. Source: Scaling investments in the horticulture value chain in Lesotho: summary note World Bank 2020 Internal Note.

3.1.2. Priority policy areas to shift to private investment and exports for job creation

127. **Accelerate implementation of business reforms, leveraging on the PMDU, which is already playing a key role in unblocking reforms and building consensus among the various government actors.** Several key reforms that had long been pending were recently adopted: the Business Licensing and Registration Law and Regulations, and the Secured Interest in Movable Property Law and Regulations, will make significant improvements to the ease of doing business in Lesotho. Adoption of the Insolvency Bill and Regulations and E-Commerce Bill and Regulations will further improve the conditions for MSMEs. The PMDU could perform the role of coordination, performance tracking, monitoring, and facilitating to ensure that pending legislation is adopted and effectively implemented as soon as possible.

128. **Establish a modern, competitive investment policy and legal regime.** This can be done by: (i) introducing an Investment Promotion Law (the draft Investment Promotion Bill is still in its draft stage), with legally-binding investment incentives; and (ii) adopting a new investment promotion policy and legislation that will enhance the competitiveness of Lesotho for private investments.

129. **Adopt a competition agenda for an effective role for SOEs.** Given the small size of the economy and domestic markets, there is a need to ensure a level playing field for the private sector and to facilitate the entry of new domestic firms, as well as foster efficient service delivery of SOEs. This will require clear and predictable regulations/guidelines and their effective implementation, as well as an effective PPP framework for increasing private investments in infrastructure.

130. **Accelerate the implementation of key legal and regulatory financial sector reforms, together with the rollout of digital financial services (DFS) to expand financial inclusion.** This would help in unlocking finance to underserved segments and expand financial inclusion. While the GoL and the CBL have implemented key reforms aimed at financial sector deepening and inclusion since 2015, several pieces of financial sector legislation remain pending. These include the Financial Cooperatives Bill, the Insolvency Bill, and the Financial Consumer Protection Bill, which are critical to pave the way for increased MSME access to finance and uptake of financial services. Key reforms to promote DFS include: (i) implementing a national switch; (ii) removing regulatory barriers to facilitate the entry of fintechs into the market; (iii) moving to accept and use digital payments in G2P and P2G payments; (iv) simplifying know-your-customer (KYC) requirements for low-income accounts to increase access to transaction accounts and usage; and (v) developing a financial consumer protection legal framework. Overall, interoperability across digital platforms would be beneficial for businesses.

131. **Improve land administration under the Lesotho Land Administration Authority.** This, together with expansion of systematic land registration, is important for creating an attractive investment regime for FDI and developing smallholder agriculture and rural transformation through land consolidation.[57] Improving land administration can be done through: (i) building awareness of the Lesotho Land Administration Authority and the Land Act; (ii) strengthening the capacity and funding of the Lesotho Land Administration Authority to expand systematic registration of agricultural land; and (iii) strengthening the legal framework for the long-term lease of land to investors.

132. **Close gaps in the supply and quality of electricity, road and water-related infrastructure.** This requires creating an enabling environment for road infrastructure development by reviewing and updating relevant legislation and institutions, improving M&E systems for infrastructure development, ensuring that transport infrastructure and connectivity are climate resilient, and improving efficiency and sustainability in road asset management, combining rehabilitation with maintenance in primary roads contracts. Given that population densities are higher in urban areas, it is imperative that an integrated land use planning

57. A recent assessment report (Land Administration Reform Project (LARP), Millennium Challenge Corporation 2008–13, Impact Evaluation Report June 2020) found that such measures can significantly empower women (7.8 percent more women operated land in the project area than in the control area), and stimulate the rental market (rental values were 5.5 percent higher and 10 percent more households rented land in the project area than in the control area), potentially contributing to land consolidation.

and public transport system is introduced. This will enhance efficiency of mobility throughout urban areas and contribute to growth and the efficient matching of jobs with industries. Improving air transport to support international trade and tourism is also important.

133. **Increase agricultural productivity, value addition and commercialization to promote agribusiness development, MSMEs and food security.** It is important that the GoL supports a shift toward the development of high potential value chains, i.e., horticulture and livestock, and puts in place the right mix of policies to harness the investment opportunities in the sector. Toward this goal, the GoL will, among others, need to: (i) provide incentives for diversification from maize production into high-value crops; (ii) build climate resilience through the promotion of CSA technologies; (iii) promote intensive and commercial livestock production, in particular; (iv) enhance the capacity of agriculture extension service providers for continuous and sustainable advisory services to farmers and agro-processors; (v) increase investments in irrigation; (vi) implement a targeted investment promotion program for private investments in commercial farms and post-harvest/marketing infrastructure; (vii) incentivize private sector participation in agribusiness by providing improved trade logistics, access to finance, market access, and agribusiness innovation centers and incubators; (viii) continue investments in establishing appropriate rural infrastructure; (ix) enhance measures to improve farmer/agri-enterprise access to financial services (e.g., by providing risk guarantees to commercial banks); and (x) promote agricultural risk management to provide insurance products to protect against extreme weather events. Overall, it will be imperative for the GoL to adjust the level and composition of public expenditures to agriculture to align with the development objectives and critical needs of the sector.

134. **Promote economic integration between leading and lagging areas to grow the economy, as well as improve the inclusivity of growth.** Many Basotho continue to live far away from job opportunities, and this contributes to widening and persistent differences in living standards between areas of the country. The *World Development Report 2009 Reshaping Economic Geography* outlines how countries can speed up their own development by "reshaping economic geography" and thus provides the conceptual underpinnings for such policy actions. It argues that economic growth has been, and will continue to be, unbalanced (at the local, national, and international levels). Efforts to redress the spatial imbalance, it argues, will only discourage further economic development and poverty reduction. The key to inclusive, but spatially uneven, development is economic integration between leading and lagging areas. It posits that economic integration requires a greater density of population, as seen in the growth of cities; shorter distances (through transport infrastructure, for example), to encourage businesses and workers to migrate toward dense areas; and fewer divisions, through thinner economic borders and access to global markets.

3.2. Strengthening Human Capital and Improving Service Delivery, Especially in Rural Areas and Lagging Regions

As shown in Chapter 2, high levels of poverty and inequality are critical drivers of low human capital outcomes in Lesotho and vice versa: the low human capital is one of the key determinants of high poverty and inequality. Health and child survival outcomes are the worst for the poorest who tend to be concentrated in rural regions, and the high prevalence of HIV/AIDS exacerbates the human development challenge in the country. Compounding this challenge is the inability of children from poor households to stay in and complete basic education. Children do not learn enough by the time they leave school. In addition, there tends to be a gap between skills that the education system currently delivers and skills that are in demand in the job market, contributing to poor labor market outcomes, which are more prevalent among the poor and those located in rural areas.

To improve human capital outcomes, the focus should, therefore, be on ensuring that children access education and stay in school, but also that they are learning while in school and that they are equipped with skills that are in demand in the job market. In addition, it is important to address vulnerabilities, largely a result of poverty, such as gender-based violence, sexual and reproductive health, and substance abuse, among others. There also needs to be a deliberate focus on interventions that support poor communities in rural areas and lagging regions. To ensure effective implementation of programs and initiatives to improve human capital outcomes, better coordination between the health, education, and social protection systems, including building system-level capacity and improving accountability, is critical.

135. **Lesotho is making progress in improving human development outcomes, but outcomes in education and health remain well below what is expected of the country's level of development.** The Human Capital Index (HCI) estimates for 2020 showed that a child born in Lesotho today will be only 40 percent as productive when s/he grows up as s/he could have been if s/he had enjoyed complete education and full health by the age of 18. This shows an encouraging improvement from the 2010 estimate of 34 percent. However, the deficiencies in human capital are still considerable and human capital outcomes remain low compared with other LMICs. Significant changes are needed to improve the quality, efficacy, efficiency, and equity in delivery of health, education, and social protection services in Lesotho.[58]

3.2.1. Opportunities to strengthen human capital and service delivery

136. **Lesotho has an opportunity to build on achievements made in the health, education, and social protection sectors since 2015.** In the health sector, major investments have been undertaken by the MoH in partnership with DPs, including the opening of the Queen Mamohato Hospital in 2015. Equity in health outcomes is on the right track, with a decline in fertility, maternal,[59] neonatal, infant and under-5 mortality along with their inequity levels. Access to maternal health services for women has been improving, with improvements in the number of births attended by a health professional and the proportion of women delivering in a health facility. Improvements are recorded on the 90-90-90 UNAIDS HIV-related targets. Lesotho has also advanced in preventing mother-to-child HIV transmission and increasing the proportion of HIV+ women accessing treatment. Lesotho is on track to achieve the 2020 tuberculosis eradication milestones (WHO 2020). Progress in these areas is important for inclusion and enhancing the quality of life for women overall, as well as for their contributions to household wealth and overall economic growth. An effective and extensive network of Village Health Motivators (VHM) and social workers presents an opportunity for community-based nutrition and health service delivery.[60]

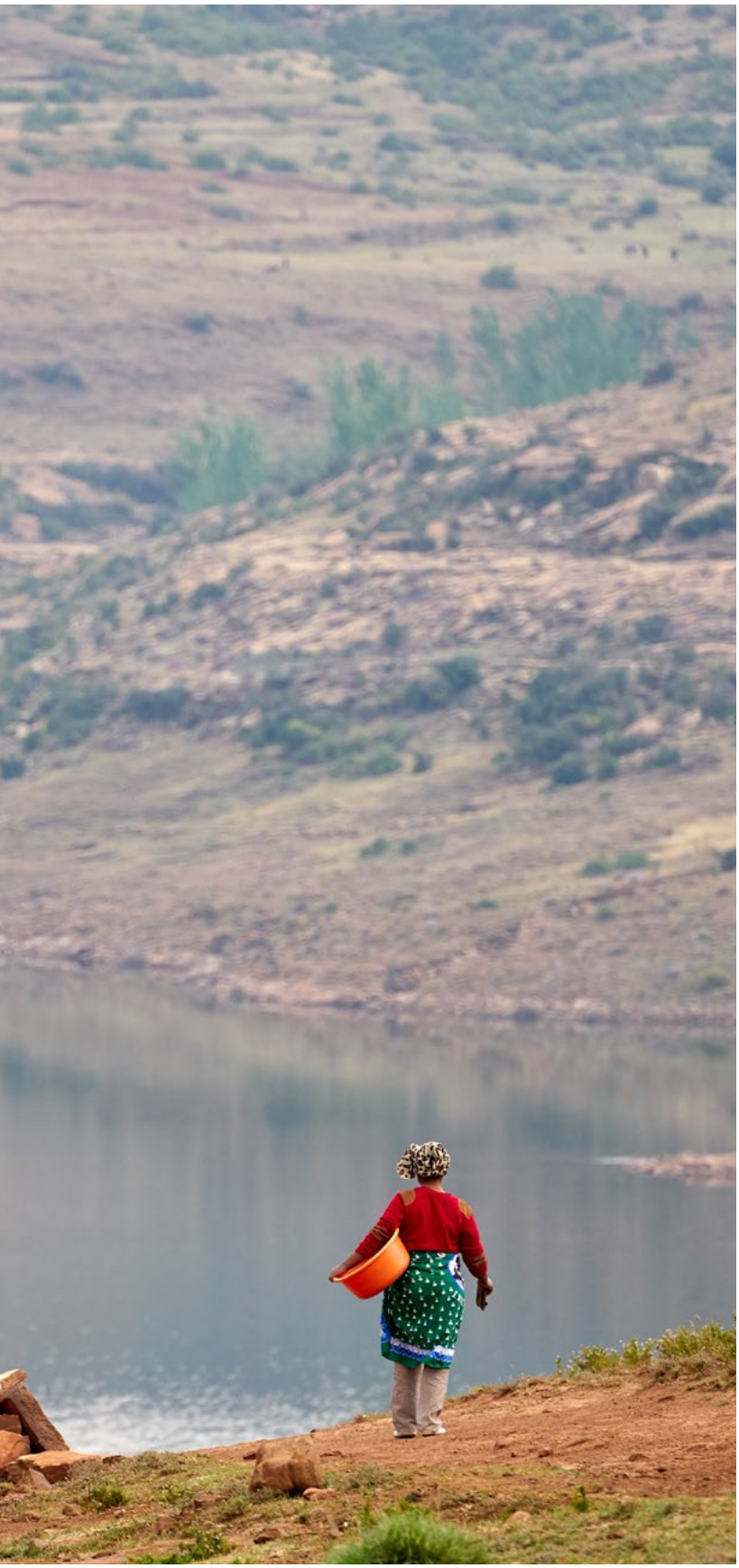
137. **Notable achievements have also been made in the education sector.** The Government is starting to prioritize ECDE services as reflected in the 2013 National Policy on Integrated Early Childhood Care and Development, which prioritizes the development, health, education, nutrition, hygiene, and protection of young children from preconception to age 5.[61] The MoET is currently in the process of revising the 1998 Early Childhood Care and Development curriculum to reflect national and global policies pertaining to play-based learning and child development. There are signs of improvements in mathematics and science education as a result of an innovative technology-based pilot that has been implemented in targeted junior secondary schools. The MoET has successfully piloted the Progressive Mathematics Initiative-Progressive Science Initiative (PSI-PMI) model, which has a strong online teacher training component. Furthermore, progress is being made in strengthening communities' involvement in the management of schools by establishing and institutionalizing School-Based Management Committees (SBMCs), which consist of key actors in the community and at the school level. In this regard, the MoET is collaborating with the MoSD to enhance the role of SBMCs in liaising between

58. This section was prepared by the Lesotho Human Development team: Victoria Monchuk (SPJ), Elizabeth Ninan and Jesal Kika (HNP) and Omer Ramses Zang Sidjou and Kajali Goswami (HNP), under the guidance of Aleksandra Posarac, Program Leader for Human Development. The analysis in this chapter is largely drawn from the forthcoming World Bank note "Investing in Human Capital in Lesotho: A Framework for A Coordinated Multi-Sectoral Approach" prepared in 2020/21 by the World Bank's Human Development team working on the Lesotho Human Development Program.

59. Maternal mortality remains unacceptably high.

60. There are about 10,000 VHWs who offer health services at the community level.

61. An associated five-year Strategic Plan developed to guide the full implementation of the plan has, however, not been updated in recent years.



communities and schools to support children from poor households who are beneficiaries of social protection programs, such as the Orphans and Vulnerable Children Bursary (OVC-B) program, to enroll and stay in school. There are also several existing initiatives and extracurricular programs to support boys and girls to stay in school that can be strengthened and scaled up. These programs and initiatives complement the regular Life Skills Education Program, which is implemented in all secondary schools, by providing a safe space to empower adolescent girls and boys and enable them to make informed decision as they transition into adulthood by giving them relevant information and life-skills.

138. Lesotho can build on the advances made in reforming social protection since the 2015 SCD. First, the NISSA social registry and targeting system has been expanded to cover all 64 rural community councils across the country, and is currently in the process of being rolled out in the urban councils.[62] Second, payment systems are in the process of being harmonized by using the same payment cycle and pay points. However, moving to digital payments, which is estimated to be much cheaper and a faster way of reaching households, is needed, especially in urban areas where connectivity and access to mobile phones and payment agents are relatively high. Third, over the past two years, the old age pension (OAP) program has undergone several reforms to improve its transparency, equity, and administrative efficiency. A new Management Information System (MIS) has been built and is almost ready to be launched.[63] Fourth, technical work is underway to introduce a way of proxy-means-testing mechanisms for the Tertiary Education Loan Bursary program, to improve the equity of the distribution of bursaries to young people.

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62. To date, the Child Grant Program (CGP) exclusively uses NISSA for targeting and the OVC program is in the process of doing so. NISSA was also effectively used as a targeting tool during the 2019/20 drought response when programs used it to identify new households that would benefit from additional temporary support.

63. The system includes automatic and regular cross-check of pensioners data with the civil-servant pensions database and the Ministry of Home Affairs (MoHA) national ID system to ensure that only eligible people receive the pensions.

3.2.2. Priority policy areas to strengthen human capital and service delivery

139. **Once young people leave school, only a small fraction moves into higher levels of education, despite the strong correlation between education attainment and labor market outcomes.** Investing in human capital through multiple interventions is critical throughout the lifecycle to maximize the life-time potential of individuals and improve positive intergenerational effects, and at the aggregate level boost economic productivity and growth opportunities. At the population level, sound investments in reproductive health, health systems, education, social protection, and water and sanitation can trigger a demographic dividend that can contribute to a longer period of growth (Bruni, Rigolini and Troiano 2016). To maximize the efficacy of resources invested in these programs, a strong harmonization and coordination of interventions across sectors is a must. Co-location of human development initiatives at the local level and building on existing initiatives that support greater linkages and coordination between multiple implementing entities are key in strengthening human capital. This SCD Update argues for an individual-centered and holistic service delivery approach focusing on three stages of an individual's lifecycle: (i) early childhood; (ii) school age; and (iii) youth to adulthood. While it focuses on three main sectors—health and nutrition, education, and social protection—access to other basic infrastructure services, such as water and sanitation, electricity, housing, and roads, is important.

140. **Interventions in early childhood, with an emphasis on expanding access to good quality ECCD services, especially for children in rural, poor communities, are important for laying a foundation for improved human capital outcomes.** This requires well-targeted investments to improve the nutrition status of all Basotho, particularly young children in their first 1,000 days to break the intergenerational cycle of malnutrition and poor health and contribute to Lesotho's human capital.[64] In addition, strengthening the institutional framework to improve coordination and collaboration between multiple ministries involved in the delivery of different services for children and pregnant mothers is key. A single coordinating agency would ensure there are more programmatic approaches to address ECDE across human development sectors. It is important that interventions are inclusive of children in rural, poor communities.[65]

141. **Interventions for school age children would need to support children from poor households to stay in school and to ensure that children are learning in school.** This would entail, implementing interventions to ensure better targeting and coverage of the OVC-Bursary program; providing as part of the CGP a bonus payment for children from poor households who transition from primary school to junior secondary school; and supporting young Basotho who face multiple deprivations. In addition to keeping children in school, it is important to ensure that children are learning in school. As a priority, interventions to strengthen Early Grade Reading (EGR) and Early Grade Mathematics (EGM) programs are key to support the mastery of foundational skills of literacy and numeracy in early grades (Grades 1-4) of primary school. This requires a structured pedagogy approach to teaching and learning, including: (i) teaching in mother-tongue in early grades before transitioning to English around Grade 4; (ii) teaching curricula that are relevant for today's society including digital literacy skills; (iii) training and supporting teachers inside and outside the classroom, to teach children with the most appropriate pedagogy; (iv) ensuring that all

64. Some of these investments include: (i) mobilizing the VHWs program's platform to scale up community-based health and nutrition services provision to adolescents, mothers, and children; (ii) further addressing the adolescent health gap by implementing counseling and health service delivery programs in formal and non-formal education centers; (iii) extending the Health Management Information System to include community-based health and nutrition information; (iv) conducting Social Behavior Change Communication campaigns on malnutrition and NCD risk factors; (v) ensuring that mothers/caregivers of children from birth to age 3 in poor households receive adequate social assistance support; and (vi) advocating for an extra levy on soft drinks and tobacco.

65. This entails: (i) additional allocation of financing to this subsector, which could mean additional financing to the education sector, or more realistically, intra-sectoral reallocation of financing from tertiary education—which mainly benefits the non-poor—to ECCD; (ii) rolling out the new integrated ECCD curriculum; (iii) collecting information on child development and learning outcomes on a regular basis to monitor progress; (iv) adequately regulating ECCD service provision by public and private providers; and (v) developing a financing and expansion strategy for ECCD service provision that includes expansion in the most cost-effective manner including through PPPs.

children have access to age-appropriate learning materials; and (v) assessing student performance periodically, and adjusting teacher training and lesson plans to address areas where there are gaps in learning. In addition, it requires improving performance, management, and accountability of teachers through a better MIS for teachers to track their training, deployment, and utilization in school (absenteeism rates and time they teach in class), as well as their content knowledge and pedagogical skills.

142. **Interventions from youth to adulthood are important for strengthening the skills and employability of the youth, preparing them for productive adult life.** This means the education and training system needs to provide for different routes into productive adult life, including tertiary education, and technical and vocational education and training (TVET), as well as a variety of non-formal immediately employment-oriented education and training formats. Interventions to increase access to these education and training programs, especially for the poor, are a priority, as is improving the quality and relevance of training programs. It includes addressing the skills mismatches between training programs, and the needs of the labor market by forging stronger partnerships with the private sector and ensuring more on-the-job training through apprenticeships and internships. Aside from developing the right technical skills required by the labor market, education and training programs also need to build digital skills, entrepreneurship or business skills and other non-cognitive skills. As with the ECCD subsector, it is also important to develop a comprehensive data system for TVET and tertiary education providers in order to quality assure and regulate training programs. Improving access to these programs by applying the poverty targeting system for Tertiary Bursaries to make the system more pro-poor is also critical. Furthermore, Active Labor Market Programs need to be more coordinated and holistic, targeting at vulnerable youth and addressing both the demand and supply side of the labor market.

143. **Social protection services cut across the three lifecycle stages. Social program harmonization and system integration need to continue to improve to support human capital outcomes.** This would entail: (i) introducing "Cash Plus" measures to link social assistance beneficiaries to productive activities, economic inclusion, and link the CGP to better invest in human capital; (ii) finalizing ongoing harmonization of targeting, payment, management information systems of the Public Assistance (PA) program, the OVC-Bursary, and the CGP; (iii) reforming the management information system, especially to incorporate the PA and build a unified system that can support all social assistance programs, including the OAP; (iv) investing in integrated registration platforms, and building on national IDs as identifiers to help further integrate social assistance programs; (v) harmonizing benefit levels between social assistance programs to increase the poverty-reducing impact of poverty-targeted programs; and (vi) shifting payments from cash to digital payment (including mobile money).

144. **The negative impact of the COVID-19 pandemic on human capital outcomes, which were already low before the pandemic, means recovery efforts need to restore and protect human capital advancements, particularly among the poor and the vulnerable.** In parallel, it will be important to bolster service delivery systems that can build, protect, and utilize human capital in ways that position human capital for economic recovery, and promote resilient and inclusive development. Given the adverse fiscal impacts of the pandemic, recovery requires strengthening the adequacy, efficiency, and sustainability of public spending toward human capital outcomes. Immediate priorities include restoring health, ensuring all students return to schools after they were closed due to the COVID-19 pandemic, recovering learning losses, and supporting labor income opportunities. Going forward, service delivery systems would have to be reimagined through digitization and strengthening institutions for preparedness, coordination, financing, and service delivery.

145. **It is important that the policy responses to improve human capital and service delivery address widening and persistent differences in living standards between areas of Lesotho.** Many Basotho continue to have poor access to basic services and infrastructure, partly due to poor spatial planning and development. Access to basic services and resources remains much weaker in remote and rural areas. This results in disparities in access to economic opportunities. Interventions to strengthen human capital through a lifecycle

approach, therefore, need to be complemented with the provision of basic services to poor households in rural areas of Lesotho, including the provision of universal access to safe water, sanitation and hygiene (WASH), and access to basic housing, energy and transportation. This will help to equalize opportunities.

146. **Thus, improving human capital and service delivery needs to be embedded in a broader approach to territorial development that seeks to improve living standards in lagging rural and mountainous areas where the poor tend to be concentrated.** As argued in the *World Development Report 2009 Reshaping Economic Geography* leaving no area behind is not equal to "doing the same everywhere." Rather, such an approach might call for heterogeneity of policy instruments given heterogeneity across areas. That is, policies should seek unity, NOT uniformity. In the case of Lesotho and consistent with WDR 2009, this means: (i) there is no need to fight density, rather agglomeration of economic production in leading areas can be harnessed to benefit both firms and households through job creation and economic growth; and (ii) de-linking the geographies of production and living standards is key to promoting equity; (iii) integrating leading and lagging places through institutions that promote mobility, augmented by spatially connective infrastructure, is important. Overall, an effective approach to territorial development is to delink the lumpy geography of production from the geography of welfare or living standards. That is, economic activity and growth can remain substantially concentrated in urban areas. However, effort is needed to ensure all Basotho have access to opportunities and a decent standard of living.

147. **Examples from other countries could inform such an approach.** For example, the Republic of Korea had quite substantial economic concentration in Seoul, while investing in world-class human capital and basic services across the country. This meant that everyone enjoyed good living standards and, with strong human capital, could also more easily migrate domestically to access opportunities. In Argentina, firms are tightly concentrated in the capital and capital region, but provinces have converged over time in key human outcomes and service delivery, such as primary completion rates. In France, from 1982 to 2002, production concentrated in certain regions with stronger agglomeration economies, but strong progressive tax and transfer policies, captured these gains and redistributed them to less advantaged people, with the effect of equalizing disposable incomes across regions even while production remained concentrated. Bhutan has begun to introduce more spatially differentiated national planning to achieve convergence in living standards across regions. This is being done through initiatives such as the National Human Settlements Strategy 2017, which breaks down key measures of service delivery and outcomes across space.

3.3. Strengthening Climate Risk Management and Resilience

Lesotho, being highly vulnerable to frequent and severe weather events, particularly flooding and drought, is exposed to a myriad of uninsured climatic risks that threaten livelihoods and the economy, and have real impacts on poverty and inequality. The COVID-19 pandemic is set to compound these impacts as it is unfolding in a context in which the country is still addressing the recurring challenges posed by frequent droughts and floods. The prevalence of shocks with large impacts on welfare is higher in rural areas, resulting in poorer households being exposed to greater risk.

Strengthening climate risk management and resilience is therefore important for inclusive growth and poverty reduction. This will require a comprehensive approach that promotes: physical resilience to reduce risk and prevent disasters; financial resilience to minimize the financial impact of shocks on the fiscal balance, subnational governments, households, and businesses; and social resilience to help households and society cope with shocks. In addition, building institutional capacity to enhance resilience to climate change, including strengthening the capacity of relevant ministries in risk and vulnerability assessment and supporting the Disaster Management Agency, and other relevant ministries in disaster preparedness and response, is important.

3.3.1. Opportunities to strengthen climate risk management and resilience

148. **Progress has been made in developing various bills, polices, strategies and plans to strengthen disaster risk management.** Through the support of DPs, Lesotho has been updating several strategic documents, such as the Disaster Risk Management Bill and an Early Warning Strategy, that are critical for improving overall national level disaster risk management (DRM). A National Resilience Strategic Framework (NRSF) has been developed. The Disaster Management Agency (DMA) continues to develop multi-hazard contingency plans targeting a variety of hazards threatening the country to improve planning and coordination.

149. **Progress has been made in advancing disaster risk financing.** The World Bank supported and helped conduct a disaster risk financing diagnostic with the aim of identifying options to strengthen the country's financial resilience to disasters (World Bank 2019a). It identifies some of the next important interventions to include the development of a disaster rick financing (DRF) strategy to improve the timeliness of resource mobilization and the strengthening of the budget execution system. It also argues that Lesotho could explore the feasibility of agricultural insurance, given its frequent exposure to droughts. Moreover, the ability of households to withstand shocks is limited, and direct payments (social transfers) may be needed.[66]

66. According to Findex 2017, only 17 percent of the population in Lesotho report savings as a potential source of emergency funds. This proportion is much lower for those in the bottom 40 percent of the income distribution, of whom only 9 percent can mobilize savings for emergencies.

150. **The CBL has achieved significant progress in maintaining the resilience of the financial sector.** Notable achievements have been made by the CBL in adopting the Basel Core Principles. Amendment of the Financial Institutions Act is currently still pending. In addition, the CBL is also in the process of implementation of the FSB Key Attributes of Effective Resolution Regimes, including the development of guidelines for recovery and resolution, as well as the Deposit Protection Policy and Bill. Cross-border arrangements between the CBL and the South African Reserve Bank (SARB) are important, since most of the banks in Lesotho are subsidiaries of South African banks.

151. **Several initiatives have worked to strengthen hydro-metrological services in Lesotho.** The Lesotho Metrological Services (LMS) has, in partnership with DPs, developed a long-term capital investment and operational improvement roadmap by prioritizing expansion of selected observational networks and fostering partnership with regional and international organizations. The Southern Africa Severe Weather Forecast Demonstration Project (SWFDP) and the Southern Africa Region Flash Flood Guidance (SARFFG) systems implemented by the World Meteorological Organization (WMO) and USAID have resulted in the support of regional-based systems designed to provide the LMS with the necessary data and information needed for timely and effective warnings of severe events.[67] LMS is also developing a five-year climate change adaptation early warning project with partial support from the Global Environment Facility (GEF). Strengthening the metrological and hydrological services, and the general technical capacity of the Government to generate, analyze and use climate-risk datasets is important.

152. **Given that drought has been one of the main natural disasters in the past few years, progress in sectors such as agriculture, social protection and water has been critical in managing climate-related natural disasters.** The Lesotho Climate Smart Investment Plan was developed in 2019, prioritizing key policy actions and investments toward building a productive, climate-resilient, and low-emissions agriculture sector in Lesotho.[68] Large agriculture projects have also been implemented. An institutional framework for integrated catchment management (ICM) has been adopted to protect and sustainably manage the country's water-producing landscapes and reduce the impact of droughts. In social protection, existing programs were expanded in response to the 2015 drought emergency, during which about 447,000 people were classified as being food insecure. Similar programs were also utilized to respond to the 2019 drought. Overall, progress made in these three sectors was critical for improving DRM in Lesotho. There is an opportunity to better understand the specific vulnerabilities of rural and urban areas, and develop a comprehensive land management policy that can support sustainable urbanization and agricultural productivity.

153. **Development of renewable energy resources can simultaneously contribute to mitigation and adaptation to climate change, while also increasing energy security.** Due to the highly sensitive aspect of current electricity supply to climate change, for both local and imported electricity, the use of abundant solar and wind resources would alleviate the negative impact of droughts on the energy system in the future, as these renewable resources are independent from water resources, in addition to being economically viable. The decentralized characteristic of solar photovoltaic technology—and its dispatchability thanks to battery storage—makes this solution even more attractive for both industrial and rural development. Development of hydropower generation could also contribute to the mitigation of climate risks by allowing the use of cleaner energy and increasing the amount of water reservoirs in country for more climate-resilient irrigation.

154. **The COVID-19 pandemic provides an opportunity to improve coordination for disaster risk management and climate resilience.** The pandemic also presents an opportunity to accelerate certain DRM actions, including coordination of emergency operations. There is now a greater need for the DMA and the MoH to work closely together in responding to the pandemic. Strengthening coordination between the DRM agencies in the region will also be critical.

67. https://www.mdpi.com/2073-4441/8/6/258

68. http://documents.worldbank.org/curated/en/847551575647928833/Full-Report

3.3.2. Priority policy areas to strengthen climate risk management and resilience

155. **Disasters have a disproportionate effect on small states such as Lesotho, making a comprehensive approach to resilience imperative.** Such an approach would have three broad pillars: (i) physical resilience that focuses on reducing risk and preventing disasters; (ii) financial resilience that involves pre-arranged predictable funding when disasters strike to protect the fiscal balance, subnational governments, households, and businesses; and (iii) social resilience that entails helping households and society cope with shocks. In addition, across these three broad pillars, building institutional capacity to enhance resilience to climate change is important.

Physical resilience: ***Strengthen investments for comprehensive disaster risk management, including sustainable urban development***

156. **Strengthen the management of water systems and landscapes.** Improving national water resources infrastructure and increasing water security will be pivotal to enhancing resilience to extreme weather events. In the short term, this entails: (i) enacting a National Irrigation Policy based on the findings and recommendations of the National Irrigation Master Plan (NIMP); (ii) strengthening institutional coordination and capacity for natural resources management (NRM); (iii) improving the quality of ecosystem services data through natural capital accounting to better understand health of water services and to inform decision-making; (iv) implementing public works programs and community-driven development (CDD) opportunities to promote job-intensive growth to support livelihoods, prevent or mitigate future crises, and build back better, greener and with more resilience; (v) using the country's National Determined Contributions (NDC) implementation plan to identify implementation-ready projects and programs for public works and CDD programs; and (vi) mainstreaming ICM and climate resilience considerations across sectors impacting water systems. In the medium to long term, key reform priorities include: (i) developing an integrated NRM approach to promote more inclusive, resilient, and sustainable development; (ii) mitigating climate change effects by strengthening the national hydro-meteorological system, village-level data collection, disaster risk monitoring procedures weather forecasting systems, flood and drought management, and monitoring natural resources; (iii) piloting the mainstreaming sustainable landscape management across catchments; and (iv) adapting to the impacts of climate change and variability by mainstreaming the Climate Change Policy 2017–2027.

157. **Promote climate-smart agriculture.** Promoting climate-smart agriculture is important because agriculture, especially subsistence agriculture, which is a source of livelihoods for poor rural households, is highly susceptible to climate change impacts. The Lesotho Climate-Smart Agriculture Investment Plan (CSAIP) (World Bank 2019c) offers two complementary pathways for scaling up climate-smart agriculture (CSA). The first is the commercialization pathway that entails: focusing on commodities for which the country has a clear comparative advantage, such as: horticulture, potatoes, poultry, and aquaculture; developing the country's irrigation to its full potential; and developing linkages that connect smallholders with both export and domestic markets. The second pathway is the resilient landscape pathway that combines modern scientific practices such as improved crop varieties with the traditional Machobane farming system—a farming system that combines the use of crop rotation, relay cropping, and intercropping practices with the application of manure and plant ash to conserve soil moisture and replenish soil fertility.

158. **Build climate-resilient infrastructure.** Emphasis on building climate-resilient infrastructure is important to maintain all-year access to the road network and other infrastructure services, and reduce the cost of frequent maintenance. Extreme flooding continues to undermine infrastructure development gains, resulting in extensive damage and impeding access to socioeconomic services to a large segment of the rural population. Flooding and other weather events have led to significant maintenance backlogs, with 42 percent of paved roads and 85 percent of gravel roads in 'poor' or 'very poor' condition. The water supply and sanitation sector has also been widely affected by frequent flooding, causing frequent uptick of water-borne diseases due to water contamination.

Financial resilience: Improve financial resilience to disasters[69]

159. **Develop and adopt a national Disaster Risk Financing (DRF) strategy.** This would formalize the policy priorities for financing disaster response, allowing Lesotho to define its priorities regarding financial planning for disaster response and options to strengthen the Government's financial resilience. By allowing the Government to identify and plan where resources for responding to future disasters will come from, a national DRF strategy would help to reduce financial distress, and ultimately reduce the human and economic cost of disasters. It would set a legal framework to strengthen the financial management of disaster risks by outlining an optimal combination of risk financing instruments, including both risk retention and risk transfer instruments, making response to different types of disasters more cost-effective. There is a wide array of financial protection policies and instruments to consider in developing a national DRF strategy, including sovereign risk finance, social protection programs, as well as agriculture and risk insurance programs. In particular, and in the context of limited fiscal space, developing risk transfer mechanisms and insurance products would be important. Exploring the feasibility of agricultural insurance as part of a broader agriculture risk management and finance agenda would protect farmers and herders against disasters through a public-private partnership with domestic insurance companies.

160. **Increase the amount and improve the timeliness of resources mobilized for disasters,** through (i) a dedicated contingency fund with clear rules for replenishment and disbursement targeted at recurrent natural disasters, building on the existing contingency funds; (ii) access to a contingent line of credit; and (iii) purchase of sovereign catastrophe risk insurance to cover severe disasters. The GoL has begun exploratory discussions with the African Risk Capacity on sovereign insurance solutions.

161. **Strengthen budget execution systems for targeted support to affected households, including through strong operational rules for the disbursement of disaster risk finance instruments.** Together with the DMA, the MoF could lead the development of the operational rules for disaster risk finance instruments, such as a disaster-dedicated contingency funds and Catastrophe Deferred Draw Down Option (CAT-DDO).

162. **Strengthen the crisis preparedness and deposit insurance system for the financial sector.** To do this, the CBL should: (i) further implement Basel 3 requirements for the banking sector and further strengthen cross border cooperation with the SARB; (ii) implement the FSB Key Attributes of Effective Resolution Regimes; and (iii) establish a deposit insurance fund to make the financial sector more resilient and protect deposit-takers.

Social resilience: *Improve shock-responsiveness of social protection to deliver targeted early assistance to poor and vulnerable households after disasters*

163. **Improve the shock-responsiveness of social protection.** While current fiscal pressures pose a challenge to expanding social protection in response to shocks, this remains a critical tool to assist poor and vulnerable households to manage risks. Thus, it is recommended that Lesotho leverages the existing social protection program systems to build a framework for how social protection programs scale up and down to respond to shocks including developing a flexible financing mechanism. This can be achieved through: (i) developing a shock-responsiveness framework for the overall social protection system, including a scalable/contingency financing mechanism to more quickly mobilize resources in times of shocks; (ii) supporting public assistance and public works programs that can be used to address short-term shock-response programs; and (iii) a more responsive system that builds contingency funding mechanisms to more quickly

69. The discussion in this subsection is drawn from the 2019 Lesotho Disaster Risk Financing Diagnostic, which can be accessed via the following link: *https://openknowledge.worldbank.org/handle/10986/33141*

mobilize resources in times of shocks. Lesotho's National Social Protection Strategy recognizes the need to strengthen shock responsive social protection and, in the past, existing programs have been scaled up in response to disasters.[70]

164. Digitize government-to-person (G2P) payments as a big part of strengthening the social system's shock-responsiveness. This requires: (i) further development of the National Payment Infrastructure that addresses the lack of interoperability between different financial service providers; (ii) enhancing the National Payment System Act and implementing regulation (e.g., an oversight regulation) to allow new payment service providers, and new payment products and services (fintech); (iii) optimizing the distribution network of financial institutions, for example, bank agents and payment agents, by harmonizing its regulatory requirements, and expanding the usage of merchant payments; (iv) leveraging the implementation of the National Identity Card and simplifying customer due diligence requirements; (v) adopting a Financial Consumer Protection Legal Framework and strengthening its supervisory framework to address high and opaque fee structures by financial institutions that are stifling digitization; and (vi) developing and implementing financial and digital education programs.

70. For example, the Child Grant Program has been used to provide additional assistance to existing beneficiaries (vertical scale-up) during the El Niño induced drought in 2015/16.

Strengthen institutional capacity for enhancing climate risk management and resilience

165. **Develop and adapt a national Disaster Risk Management Policy and Strategy.** Such a policy and strategy would need to be comprehensive and harmonize institutional and regulatory framework, as well as other sectoral policies, strategies, and plans. Disaster Risk Management Act, policy and draft strategy exist, but need to be updated and harmonized. Greater focus on harmonization of all polices related to resilience and urbanization will be critical to ensure effectiveness, including alignment of DRM strategic documents with sector polices such as agriculture, water resources and hydro-meteorological services. It will be critical to finalize, approve and implement these documents, including the draft Disaster Risk Management Bill (drafted in 2020), the draft Disaster Risk Management Strategy, the draft Early Warning System Strategy, and the National Disaster Risk Financing Strategy. The second set of documents that are critical to finalize, approve, and implement are the construction industry policy, construction standards, urban development plans, housing action plans, and a sectional titles bill. These set of policies and plans will ensure appropriate management of the built environment. To ensure well-managed urbanization and resilience, additional policies need to be drafted in the medium to long term, including: (i) a National Hydro-Meteorological Policy; (ii) a National Urban Policy (NUP); (iii) a National Spatial Strategy (NSS); and (iv) land, infrastructure and urban development framework. Well-aligned and timely updated polices will provide more opportunities for effective implementation. Finally, considering the COVID-19 pandemic, policies that will enable expansion of strategic basic services and programs, including WASH facilities, targeted social services and labor-intensive infrastructure development in cities, as well as in remote districts, will be critical to easing the immediate shock from the pandemic.

166. **Strengthen meteorological services.** Establishing a functional early warning (and advisory) system that is community-based but informed by data and products flowing from especially the hydromet value chain will be critical for building resilience in Lesotho. Consistent with meteorological services in the Southern Africa region and around the world, adapting to the rapidly evolving way in which national agencies operate, collaborate, and use technologies is important. The sector is highly complex, with high capital and running costs required to run the state-of-the-art models and satellite systems that are needed to produce weather and climate projections. Hence, there is a need to have a robust strategy that prioritizes a focus on developing products and services that are at the local level and are complemented by strong collaboration with the global community for the generation of information. The four strategic areas that should be prioritized for strengthening of meteorological services are: (i) providing user-orientated weather, climate and related environmental services to support the development of fit-for-purpose services and products, guided by a national framework for climate services; (ii) infrastructure and information systems to streamline and modernize the service; (iii) partnership and cooperation with the relevant agencies within the country as a basis for developing fit-for-purpose products. In addition, strong partnerships with international and regional organizations, the private sector and academia would help to leverage the vast amounts of data and information being generated by the various organizations involved; and (iv) introducing a quality management system will provide confidence to end-users on the information generated. Developing and implementing a sustainable financial and human resources model to enable the LMS to fulfil its mandate will be central to Lesotho's ability to manage climate shocks.

3.4. Overarching Constraint: Bridging Public Sector Implementation Gaps

Lesotho's slow progress toward its development goals is partly due to public sector implementation gaps, which reduce the efficiency and effectiveness of public policies. These gaps are mainly the result of foundational constraints related to the fragile political environment, deteriorating quality of governance and economic reliance on external resources, which contribute to high levels of public spending and weak policy ownership. Overcoming implementation gaps is key to addressing fundamental structural challenges and thus accelerating progress. To do this, it is recommended that Lesotho: (i) enhances the capacity and performance of the public sector; (ii) improves commitment, coordination, and cooperation as core functions of institutions that are needed to accelerate development; (iii) strengthens monitoring and evaluation of implementation; and (iv) strengthens public financial accountability.

167. **The preceding chapters have shown that progress in addressing the constraints that were identified in the 2015 SCD has been limited, resulting in slow progress on development outcomes.** The poor outcomes are not primarily from a lack of spending: investment levels are high, with most of this investment led by government. Public sector investment levels rank among the highest in the world. This raises the following questions: Why do Lesotho's development outcomes remain relatively poor despite high public spending, and the significant financial and technical support that the country receives from the DP community? What must be done differently to accelerate progress?

3.4.1. Lesotho's implementation challenge: a case of isomorphic mimicry?

168. **This SCD Update argues that isomorphic mimicry partly explains the slow progress toward building real capability and improving development outcomes, despite high levels of public spending and significant support from development partners.** Isomorphic mimicry is the tendency of governments to mimic other governments' successes, replicating processes, systems, and even products of 'best practice' examples (Andrews, Pritchett and Woolcock 2017). This mimicry often conflates form and function, leading to a situation where 'looks like' substitutes for 'does', i.e., governments may appear more capable after the mimicry but are in fact not more capable.

169. **Lesotho has elements that render it susceptible to isomorphic mimicry.** For instance, heavy reliance on DP funding makes Lesotho susceptible to (external) agenda conformity, resulting in weak ownership of the reforms needed for economic development, as well as heavy reliance on DPs for basic service delivery. Furthermore, Lesotho exhibits characteristics of a state, with laws, policies, and institutions (*form*), but these do not always efficiently and effectively deliver socioeconomic outcomes (*function*). The laws, policies and regulations are either not implemented, or distorted.

170. **Several illustrations of isomorphic mimicry exist in Lesotho.** For example, there is a public investment management (PIM) system, but the budget includes capital investments and PPP projects that are not assessed by the system. In the FY2020/21 budget, only 77 percent of new capital investment projects were appraised by the Public Sector Investment Committee (PSIC) and selected from the Public Sector Investment Plan (PSIP) aligned with NSDP II.[71] A recently upgraded IFMIS now supports improvements in PFM, but key processes take place outside of the system and the number of unreconciled transactions continues to grow.

171. **Implementation failures are evident in the legislative processes.** An example is the lack of well-functioning legislative processes that impedes the private sector development agenda and handicaps the GoL's reform initiatives. Parliament, and the Ministry of Law and Constitutional Development (MoLCD) are understaffed and decapacitated, impeding both horizontal and sectoral reforms in the private and financial sectors, as well as all other sectors. Another example of implementation failure in the legislative processes and legal framework is regarding laws to promote gender equality. Despite having made strides in creating an enabling legal framework for gender equality, inconsistent implementation of gender-progressive laws and policies is a major barrier. The process of harmonizing common and customary laws is particularly lengthy, and it is unclear when it will be completed. In addition, the Ministry of Gender, Youth, Sports and Recreation (MoGYSR), which is responsible for coordinating across ministries, faces capacity and financial limitations to implementing and monitoring of actions related to gender equality.

172. **The way the GoL has handled the COVID-19 pandemic is another illustration of implementation gaps in the public sector.** The response plan was formulated late, few actions have been implemented, and M&E of progress has been lacking. In fact, the pandemic has magnified the urgency of strengthening the social compact to support an integrated collaborative response in terms of both containment of the pandemic and recovery efforts. The pandemic has underscored the importance of addressing coordination failures, and promoting open government principles to bolster the trust between all levels of government, business, and citizens, and subsequently support better implementation.

71. Ministry of Finance PFMR Secretariat reporting on Public Sector Modernization Project results framework.

3.4.2. Foundational factors contributing to the implementation challenge

Distorted incentives in the public sector

173. **Lesotho's political settlement—the formal and informal systems for managing political and economic competition—is associated with short-termism in government, thereby undermining effective policy design and implementation, resulting in implementation gaps.** Lesotho's political system notionally accepts that elections are the only legitimate way to gain political power, largely due to external pressure from other countries in the region and the international community, rather than through a long-standing and demonstrated internal commitment to democracy. The governance system is unpredictable because governing coalitions can collapse when alternative viable ones emerge. The settlement has led to high levels of political volatility, a concentration of economic opportunity and political power in the hands of a very small elite. Political volatility has been a consistent feature of Lesotho's political system since 2012. The country's Mixed Member Proportional (MMP)[72] system has low thresholds for parties to gain representation in parliament and dissolving governments, creating strong incentives for political entrepreneurs to form new parties and push for votes of no confidence. The result, since 2012, has been a succession of unstable coalition governments. Political fragmentation exacerbates existing challenges in achieving more inclusive development, as it creates strong incentives to seek short-term political gains and encourages opposition parties to exploit fissures within the governing coalition.

174. **The damaging impact of political fragmentation is evident in the increase in the number of political appointees and their rapid replacement, exacerbating implementation gaps.** Three changes are particularly clear: (i) *The number of ministers and deputy ministers (DMs) has risen* from 23 prior to the first coalition government to 35 under the current administration. (ii) *Constant changes in the composition of the cabinet*, including reshuffles and replacements of individual ministers and DMs. Many ministers serve for less than one year. (iii) *Rising politicization of the civil service* is leading to the replacement of skilled senior civil servants with politicians and officials of varying degrees of competency and interest in policy. This is most apparent through the replacement of permanent secretaries, hitherto senior civil servants, with politically appointed principal secretaries since the first coalition government in 2012. Principal secretaries often have political ambitions and are subject to the same high level of turnover as ministers. These challenges are acknowledged in NSDP II, which states that "the review of NSDP I revealed that one of the key factors that led to the sub-optimal implementation of NSDP I was the chronic political uncertainty and the politicization of civil service management."

175. **The poor and deteriorating quality of governance and political instability contribute to a challenging business enabling environment.** Nearly half of all respondents on the World Economic Forum's 2017 Executive Opinion Survey claimed that issues such as corruption, political instability, and government inefficiency were the most problematic issues they faced. With the GoL being the largest purchaser of goods and services from Lesotho's private sector, cash shortages, late payments and arrears undermine business performance and discourage investment.

The strong influence of external actors in the political and economic system results in a lack of accountability and weak policy ownership

176. **Lesotho is heavily dependent on external actors, especially South Africa, a much larger and wealthier country that surrounds Lesotho.** This dependence is reflected in heavy reliance on SACU revenues, migration of many Basotho to find employment, access to good transport infrastructure by textile exporters, and access to essential health care and other critical services not available in Lesotho. However, heavy reliance

72. Borrowed from New Zealand (Tsikoane et al. 2007), the MMP system is a hybrid of proportional representation that creates multi-member and single-member districts.

on South Africa also creates a disincentive for the efficient delivery of public services within Lesotho. The elite and many political leaders can access better quality services (e.g., education and health) in South Africa, with the result that those with the most control over policy-making do not face the consequences of their decisions due to external support systems.

177. **Funding from DPs is critical in filling some of the gaps in service delivery and providing significant technical assistance to the public sector; however, reliance on external resource flows has resulted in high levels of public spending, beyond what would be possible if Lesotho relied on the domestic mobilization of resources.** Lack of discipline in the management of Lesotho's public finances—ranging from leakage, manual accounting, extrabudgetary expenditure, arrears, and underperforming government investments—has impeded the country's ability to deliver on its policy commitments without significant intervention by external actors. Furthermore, influence by external actors encourages the proliferation of best-practice models that may not be fit-for-purpose because they make Lesotho susceptible to (external) agenda conformity. This explains, at least in part, why progress toward building real capability and improving development outcomes has been slow, despite high public spending. In hindsight, the focus of many of these interventions has been on the form, while overlooking the function, ultimately resulting in public sector implementation gaps and a lack of sustainability of the investments.[73] Also, it is associated with weak policy ownership and allows external actors wide latitude in the process, with civil servants encountering limited pressure to implement formal policies due to lack of accountability, rapid turnover of politically appointed officials, and limited capacities and resources. In addition, external dependence is likely to have resulted in citizens of Lesotho being less likely to participate in their political system.[74] While protests occur, these focus on specific issues, such as wages in the textile sector, not on broader issues regarding governance and development.

3.4.3. Opportunities to bridge public sector implementation gaps

178. **In bridging public sector implementation gaps, Lesotho has an opportunity to build on progress made in the recent past.** There are positive recent developments in Lesotho that can serve as a basis for learning about what works well and might be used to secure further gains. To demonstrate, this section highlights three such pockets of effectiveness: (i) the Ministry of Home Affairs (MoHA) Department of National Identity and Civil Registry (NICR); (ii) the Lesotho Highlands Development Authority (LHDA); and (iii) the U.S. Government's African Growth and Opportunity Act (AGOA). Initial observations suggest a common feature across these pockets of effectiveness is that they contain individuals with a combination of technical skills, dedication, and an ability to manage the political authorizing environment.

179. **The National ID (NID) and Civil Registry system has the potential to promote more efficient, transparent, and citizen-centered service delivery.** Lesotho has made significant progress implementing its NID system and extending coverage to the country's population (85 percent of the eligible population), providing significant opportunities to promote more efficient, transparent, and citizen-centered service delivery in both the public and private sectors. There is significant demand for automated identity verification and authentication from both the private and public sectors. The MoHA is looking to strengthen the legal and regulatory framework for data-sharing and privacy. The Data Protection Act 2011 is the prevailing law related to data

73. An example is the dichotomy that exists in Lesotho's health sector between DP-funded areas, mainly related to HIV and TB, and areas lacking DP support. Performance in the former is generally competent because the interventions are driven by external actors, while outcomes for government-owned interventions are not commensurate with investment.

74. For example, the number of votes cast as a share of the eligible population has fallen steadily by about 20 percent from 1998 to 2017 (Independent Electoral Commission of Lesotho).

privacy, while the draft National Identity Cards (Amendment) Bill 2019 is still under development. As demand for linkages to the NIR that facilitate identity verification and authentication grows, strengthening safeguards for data protection and privacy will also be critical in maintaining trust in the NID system and its use in service delivery. There is scope to further leverage the NICR database to facilitate verification of the identity of beneficiaries that open an account at a financial institution, and the burden of proof of low-income/low-risk customers could be reduced. While significant progress has been made on the NICR form, in order to cover the entire population additional steps are required to address coverage gaps among those living in the most remote rural areas, and among members of marginalized and vulnerable groups who may have mobility constraints, are socially excluded, or lack the supporting documentation needed to obtain an ID.

180. **The Lesotho Highlands Development Authority (LHDA) is one key pocket of effectiveness with demonstrated development impact.** Despite an initial lack of familiarity with building complex dams and water delivery systems, and initial governance challenges, the LHDA—an independent body, with its own Board appointed by the Lesotho Highlands Water Commission (LHWC)—effectively oversees the construction of high-quality dams and water delivery systems to South Africa. It implements the Lesotho Highlands Water Project (LHWP)—one of Africa's largest and most complex civil engineering projects—on behalf of the GoL through the 1986 Treaty on the Lesotho Highlands Water Project between South Africa and Lesotho. The LHDA is also the main generator of electricity for the country. It is arguably now one of the best governed public sector agencies in Lesotho and a major public investment management success. High-level corruption occurred during the initial phase of the LHWP, but the corruption was exposed and successfully addressed through the courts. Following the exposure of the corruption, the Governments of Lesotho and South Africa made several fundamental changes that led to significant improvements in the autonomy and management of the agency. Though this combination of government interest in reform and clear evidence of corruption may be difficult to replicate, it demonstrates that the GoL has the capacity to fight corruption and manage complex projects effectively.

181. **AGOA has not only facilitated the development of the textile industry in Lesotho but has also been a catalyst in improving governance more broadly.** While the garment industry existed prior to AGOA, primarily due to Taiwanese firms relocating to Lesotho from South Africa to avoid apartheid sanctions in the 1980s, the sector expanded rapidly after becoming eligible for the trade agreement. By July 2001, employment in the sector had expanded from around 10,000 in 2000 to 23,500, and currently employs around 40,000 people. AGOA also provides thousands of additional indirect jobs from goods and services surrounding textile exports. Between 2007 and 2018, exports to the United States under AGOA accounted for between 30 and 50 percent of the country's total exports. Furthermore, AGOA has contributed to improving governance because one of the requirements for continued AGOA eligibility is that countries must make progress on a range of governance criteria, such as creating an enabling business environment, adherence to the rule of law, and the protection of human rights. There is evidence that the threat of losing AGOA eligibility resulted in the GoL making significant commitments to political reform, such as agreeing to continue to engage in the dialogue led by SADC designed to improve political stability, limit the role of the military in politics, and better adhere to the rule of law. The pressure from employers, employees, civil society,[75] foreign investors, and DPs played a central role in ensuring that the GoL met AGOA eligibility requirements during this time period.

182. **There is an opportunity to advance citizen engagement to enhance accountability through M&E in public sector implementation.** The NSDP II acknowledges that demand for accountability from the general public has been weak due to several factors such as political polarization, lack of access to information, poor coordination of

75. In December 2016, about 20,000 people took part in public demonstrations to pressure the GoL to meet AGOA eligibility criteria.

institutions involved in oversight function as well as weak Civil Society Organizations (CSOs) and private sector. As part of strengthening governance and accountability systems (the fourth key priority area), promoting civic education to stimulate demand for accountability is indicated as an intervention that would help strengthen oversight bodies and subsequently improve effectiveness of oversight institutions. Further, to support improved service delivery, raising awareness of citizens' and non-state actors on local governance and service delivery to stimulate demand for accountability is included as an intervention that would support decentralization of public sector services. Devoting more focus to promote civic engagement is therefore important, as it signals government's commitment to building strong partnerships with non-state actors to promote accountability.

3.4.4. Recommendations for bridging public sector implementation gaps

183. **The structure and depth of the disincentives for the GoL to bridge technical implementation gaps imply that developing recommendations to address the symptoms of these disincentives is likely to have only limited impact.** However, if designed carefully and with a results-based rather than input-based orientation, technical interventions could create incremental shifts toward a more efficient, transparent and citizen-centered public sector. This SCD Update emphasizes that, while it is important to prioritize addressing the foundational factors (root causes) of implementation gaps, putting in place technical interventions to close the gaps is also important. This is especially pertinent given that political fragmentation and dependence on strong influence of external actors in the political and economic system are likely to remain for the foreseeable future. Considering this, the question is then: how can public sector implementation gaps be bridged in such a context?

184. ***The World Development Report 2017 Governance and the Law* provides the conceptual underpinnings for this priority policy.** It puts forth the following main messages: First, successful reforms are not just about 'best practice.' To be effective, policies must guarantee credible commitment, support coordination, and promote cooperation. Second, power asymmetries can undermine policy effectiveness as they can lead to exclusion, capture, and clientelism. Exclusion occurs when individuals or groups are systematically sidelined from policy decisions that affect their interests. In Lesotho, exclusion manifests itself in the lack of access of the many Basotho in rural and lagging regions to assets, markets, and services. Capture happens when powerful groups can influence policies and make them serve their narrow interests. One form in which capture manifests itself in Lesotho is through the political elite influencing policies and making them self-serving. Third, change is possible through shifting incentives, reshaping preferences and beliefs, and enhancing the contestability of the decision-making process. Fourth, three guiding principles can help rethink governance for development: (i) thinking not only about the form of institutions, but also about their functions; (ii) thinking not only about capacity building, but also about power asymmetries; and (iii) thinking not only about the rule of law, but also about the role of law.

185. **Specific recommendations, based on lessons learned from implementing policies and programs in Lesotho, include the following:**

Enhancing capacity and improving performance

186. **Creating greater accountability, autonomy, and performance incentives within the technical cadre of the public service may support program implementation and results.** A review of 'pockets of effectiveness' in Lesotho indicates that the following are critical for driving results and enhancing service delivery: prioritizing professional merit over political and personal considerations in civil service management decisions; ensuring that performance management systems genuinely promote performance-oriented civil service management decisions; and paying enough to retain more motivated civil servants and prevent large-scale turnover of high performers. The Ministry of Public Service is working toward the implementation of a performance management system for civil servants to link performance to results. If paired with a reward and/or award system, this could incentivize improved implementation across the technical cadre.

187. **Building the capacity of technical staff and non-state actors for program implementation may also drive results.** Once-off training and study tours have not been effective in building capacity over time—likely because of high turnover at multiple levels of government. However, focusing on on-the-job training and linking the learned skill back to performance monitoring and management may prove more effective. Furthermore, engaging and building the capacity of non-state actors, such as the private sector and civil society organizations, can help crowd in the technical and contextual expertise needed to move complex reforms toward completion.

Improving commitment, coordination, and cooperation

188. **To be effective, policies need to have devices that guarantee a credible commitment over time. In the context of Lesotho, political fragmentation and instability create an environment of policy uncertainty.** It is associated with high staff turnover in the public sector, resulting in short-termism and a lack of commitment, in particular to tackling long-term structural issues. Other factors that compromise credible commitment to public policies include, among others: lack of integrated planning for sectors in need of coordination (e.g., infrastructure planning for industrial development); weak policy implementation; lack of prioritization in the allocation of resources; uncertain regulatory environment; lack of political will and political commitment to reform; top-down policy-making with limited citizen engagement; and incidences of corruption and fiscal challenges amid declining SACU revenues. In particular, strengthening the link between the budget and policy priorities by linking them to specific activities and budget allocations, will signal credible commitment.

189. **Resolving coordination problems is about eliciting socially desirable actions based on rules, standards, and regulations that help coordinate actors' actions based on shared expectations.** New approaches to improving coordination within government and with other stakeholders could be piloted by the GoL. One example of such a pilot is the Prime Minister's Delivery Unit (PMDU), which has been set up to address some of the challenges of reaching political consensus and coordination failures across government, as well as strengthen public-private dialogue. Given that coordination challenges are largely a consequence of the politically volatile nature of Lesotho, ensuring policy certainty and keeping implementation consistent will remain a challenge. Thus, exploring context-specific opportunities to incentivize coordination, based on lessons learned from pockets of effectiveness and leveraging structures with high-level political backing will be needed. Introducing incentives to coordinate through program-based budgeting, creation, and tracking of ministry, department, and agency (MDA)-level key performance indicators (KPIs), together with the introduction of accountability and reward systems for organization performance, would support these efforts. Furthermore, the GoL can build on progress made in establishing mechanisms for aid coordination with DPs. Overall, improving coordination requires the GoL to integrate the different elements of Lesotho's development agenda, currently reflected in NSDP II. Given the strong influence of DPs and other external partners, integration of different elements of the development agenda would reduce duplication and, where necessary, support consolidation of effort.

190. **Using principles of collaborative leadership could promote cooperation by ensuring that all actors, including public service providers, uphold their end of the deal.** Collaborative leadership puts leadership and coalitions at the center of the development agenda, seeking to strengthen the capacity of government counterparts to work as effective teams and by helping to build coalitions for change among different actors in society. Some initiatives that could be components of a collaborative leadership and open government approach include: (i) regular training and sensitization on collaborative leadership and open government, starting at the Cabinet level; (ii) working with implementing teams in government, civil society and business to strengthen their roles; (iii) engagements and hands-on application of building reform coalitions; and (iv) peer-learning and knowledge-sharing between Lesotho and other regional and global countries that have successfully implemented collaborative leadership.

Strengthen monitoring and evaluation (M&E) of implementation

191. **A stronger national M&E system that is an integral part of the program and/or project cycle, being evident throughout the lifecycle of a program and/or project, as well as after completion, would support the identification of implementation gaps, and the prioritization of actions and resources to closing them.** NSDP II articulates the GoL's plan to develop a national M&E policy that would define the scope of, and assign responsibilities for, M&E activities across ministries and government entities. This would build on existing sectoral or thematic M&E plans, for example on HIV/AIDS.

192. **Improving national statistics is at the core of improving and leveraging the national M&E system.** To do this, Lesotho can build on recent achievements by the Bureau of Statistics (BOS)—the government department charged with data collection, analysis, and the dissemination of official statistics. The recent achievements by BOS include, among others, rebasing national accounts and the development of quarterly GDP, improvements in the breadth of the surveys, and increasing use of digital technology in data collection. Another highlight is the approval by the Cabinet, in December 2020, of the Data Dissemination Policy, allowing anonymized micro-data to become available in the public domain—a move that is envisaged to promote evidence-based policymaking. Despite improvements, Lesotho will need to continue to direct resources toward improving capacity in M&E to ensure that all key indicators can be tracked regularly. Some of the challenges affecting BOS that need to be addressed to strengthen the department's capacity to support an effective M&E system include: persistent delays in implementation of surveys due to a lack of resources; structural challenges such as poor infrastructure, access to roads, electricity connectivity, limited network coverage, unfavorable topography that impede effective data collection, field visits and supervision; and some of the surveys are DP-driven and only undertaken when requested by DPs and, when they do, BOS takes the opportunity to include its own module. Most shortcomings can be better addressed with autonomy of BOS, especially operational autonomy. Now, the BOS budget is controlled by the Ministry of Development Planning and budget cuts for surveys are frequent. Operational autonomy should be accompanied by stable funding, human resources, and technical capacity available across the National Statistical System (NSS).

193. **Improving the efficiency and use of digital systems has the potential to reduce the transaction costs of coordination, increase accountability and transparency of government systems, and enhance citizen-centered service delivery.** E-Government systems are burgeoning in Lesotho and leveraging them has the potential to generate significant savings for government. But to do so efforts around e-Government need to be well-coordinated through a single well-capacitated entity to ensure critical data can be smoothly exchanged across systems (interoperability), and key international and local systems standards are adhered to. The use of procurement and financial management technologies, such as e-Government Procurement (e-GP) and Integrated Financial Management Information Systems (IFMIS), promotes transparency and limits the opportunity of corruption. Fast-tracking the digitization of key public records and datasets would support M&E. To ensure digitization is pursued safely, the GoL needs to prioritize the updating of its legal framework and infrastructure for data privacy and cybersecurity.

Strengthening public financial accountability

194. **Improving the quality of PFM through fiscal discipline and accountability is important for enhanced implementation and efficiency of public spending.** A renewed commitment by the GoL to complete the implementation and customization of the IFMIS, and enforce its use for all government transactions (revenue and expenses) would be important. Similarly, it is also important to insist on the use of project appraisal guidelines for new capital investments and implement commensurate actions regarding public procurement and PPPs. Full implementation of the Human Resources Management Information System (HRMIS) would shore up gains made with the biometric census of civil servants, which removed thousands of deceased and unemployed persons from the government payroll, thereby reducing the wage bill. Enacting and implementing the Procurement Bill and the Public Financial Management and Accountability Act will also address some of the procurement shortcomings by establishing the legal, regulatory, and institutional framework. In laying the foundation for transparent and accountable systems there is a need for a paradigm shift from the traditional view of seeing procurement as the floating of bids, evaluation, and award of contracts, to a more strategic view encompassing the development of strategic options and the management of outcomes.

195. **While fiscal decentralization—a clear priority for the GoL as stated in the 2014 National Decentralization Policy—can improve service delivery, it imposes coordination complexities because it brings in different levels of government.** For successful fiscal decentralization, simultaneously strengthening local governance systems and local administration at the district level is crucial. At the central government level, the GoL has a strong and transparent budget framework with a modern budget management system implemented to facilitate national planning and budget formulation. In contrast, district councils, the Maseru Municipal Council, as well as community councils, typically manage their finances using manual books of accounts without the benefit of an integrated financial management system. The GoL will need to demonstrate a firm commitment to addressing these capacity constraints among central ministries and between central and local departments to reduce the vulnerability of decentralized funds being misused and prevent leakage.

196. **An open government approach is key to demonstrating a commitment to strengthening public financial accountability.** An open government is one with high levels of transparency and mechanisms for public scrutiny and oversight in place, with an emphasis on government accountability. In particular, fiscal openness, defined broadly to mean increased budgetary disclosure and participation, is associated with improvements in the quality of the budget, as well as governance and development outcomes.

197. **In sum, this section has emphasized bridging implementation gaps as an overarching priority policy area that will accelerate progress in addressing the challenges and binding constraints to development.** Implementing better will accelerate progress in the other three broad policy areas that have been identified in the preceding chapters to include: (i) rebalancing growth by shifting to private investment and exports for job creation; (ii) strengthening human capital and improving service delivery, especially in rural areas and lagging regions; and (iii) strengthening climate risk management and resilience.

4.

PRIORITIZATION FOR ACCELERATED, INCLUSIVE AND SUSTAINABLE PROGRESS

198. **This SCD Update revisits the constraints identified in the 2015 SCD and provides a renewed perspective on policy priorities based on the developments since 2015,** together with analysis of the constraints and opportunities discussed in the preceding chapters.

199. **Lesotho's development outcomes have not changed substantially since 2015.** However, the macroeconomic position has deteriorated markedly, with the economy in recession since 2017. While the long-term poverty trend shows a decline between 2002 and 2017, almost half of the population lives below the national poverty line and almost one-third lives below an international US$1.90/day (in 2011 PPP terms), not commensurate with Lesotho's income levels. While Lesotho managed to reduce inequality between 2002 and 2017, the country nonetheless remains one of the 20 percent most unequal countries in the world.

200. **The policy priority areas for Lesotho remain largely the same as those identified in 2015.** Many of the same constraints are still hindering faster progress toward the WBG's twin goals of eliminating extreme poverty and boosting shared prosperity. Thus, the factors that were considered critical to the development agenda of Lesotho in 2015 remain critical today. Furthermore, climate change risks and the COVID-19 pandemic have only served to exacerbate the existing development challenge.

201. **The evolution of the key priorities identified in the 2015 SCD are summarized in Table 2.** The summary is organized into five broadly defined priorities for implementation. These are: (i) reducing the size of the state, rebuilding buffers, and improving service delivery by achieving fiscal consolidation and modernizing the public sector; (ii) facilitating a competitive export-oriented private sector by aligning incentives and developing key infrastructure; (iii) increasing the returns to self-employment by raising smallholders' and small business' productivity; (iv) improving health and education outcomes by reducing the disease burden and raising and aligning skills; and (v) reforming social protection to reduce fragmentation and improve targeting, efficiency, and effectiveness.

202. **This SCD Update argues for a two-pronged agenda: (i) continuing the necessary reforms in priority areas that were identified in the 2015 SCD and that remain valid today; and (ii) placing emphasis in other areas that have grown in importance since the first SCD.** The SCD Update identifies four priority areas, as shown in Table 3. The first group of priorities implies that Lesotho needs to continue efforts in redefining the role of the state by rebalancing growth from that driven by government to one driven by private investment and exports for job creation. Reducing the size of the state and facilitating a competitive, export-oriented private sector were treated as two different priority areas under the first SCD, but a competitive, export-oriented private sector is key to rebalancing growth. As such, this SCD Update has grouped both elements under the same priority area, arguing that growing the private sector is at the center of rebalancing growth. In addition, Lesotho needs to build on recent achievements on the human capital front to further strengthen human capital and improve service delivery, and on this, the SCD Update elevates the focus on rural and lagging areas. The second group of priorities places increasing prominence on strengthening climate risk management and resilience. Also, the need to bridge public sector implementation gaps, which are wide and reduce the efficiency and effectiveness of public policies, has increased in prominence. As the earlier discussions show, in most cases the laws, policies and institutions that are meant to support the efficient and effective delivery of development outcomes already exist. However, they often are either not implemented, or distorted. Although these challenges were discussed in one form or another in the first SCD, they received less attention in 2015 because the overwhelming urgency at that time was to redefine the role of the state, and promote private sector-led job-intensive growth, as well as strengthen individual and group assets.

Table 2. Highlights in the evolution of key priority interventions identified in the 2015 SCD

2015 SCD: Priority interventions	Evolution since 2015
1. Reducing the size of the state, rebuilding buffers and improving service delivery by achieving fiscal consolidation and modernizing the public sector	**The size of the public sector remains large and characterized by inefficiency of spending:** ☑ Public spending has averaged over 50 percent of GDP over the past five years, driven by one of the highest wage bills to GDP in the world: the public sector accounted for 36 percent of total employment in 2015, and 35 percent in 2019; the public sector wage was at 22.7 percent of GDP in 2014/15 and 17.4 percent in 2019/20, although this may be an underestimate given the number for 2018/19 was 20.2 percent. ☑ General government final consumption expenditure was at 37 percent of GDP in 2015, and 38 percent in 2019. **Fiscal consolidation has yet to take hold:** ☑ Consequently, large deficits have persisted since 2015/16, which cumulatively sum to 19 percent of GDP in 2019/20. ☑ Debt-to-GDP ratio has increased: 41 percent at end 2014/15 to 57 percent. ☑ Domestic payment arrears emerged after attempts to raise financing were hampered by the limited domestic market. ☑ Gross international reserves have come under pressure: Over the 2015–19 period, international reserves have been on average 20 percent lower than during the 2010–14 period. **Fiscal buffers:** ☑ Several years of low transfers from the Southern African Customs Union (SACU) have eroded Lesotho's buffers. SACU transfers are projected to decline further in the near to medium term due to the COVID-19 pandemic. **Progress toward modernizing the public sector has been slow:** ☑ Lesotho is one of the few countries in Africa with a fully biometric National ID that has been rolled out to 85 percent of the eligible population, forming a basis for digital authentication services. ☑ Several government-to-business (G2B) services have been developed and adopted with success. ☑ However, progress on digitalizing government services has been slow: Lesotho ranks among Africa's lowest performers in the United Nations' global e-Government Development Index (EDGI), falling below the continental average and other Southern African Development Community (SADC) countries. ***SCD Update proposal:*** The need to reduce the size of the state remains important and closely linked to growing the private sector. The Update emphasizes the need to improve the efficiency and effectiveness of public spending in order to strengthen service delivery in a spatially blind manner. There is need to rebalance public investments to increase complementarity with private sector development (particularly digital technology and energy).

2015 SCD: Priority interventions	Evolution since 2015
2. Facilitating a competitive, export-oriented private sector by aligning incentives and developing key infrastructure	**The overall doing business environment has deteriorated:** ☑ Global Competitiveness Index ranking dropped from 107/144 to 131/141. ☑ Gaps in key productive and connective infrastructure remain wide, especially in rural areas: the Logistics Performance Index dropped from 133/160 in 2014 to 139/160 in 2018. ☑ Political instability/weak political consensus weakens the business environment: fragile coalition governments, frequent elections (2015, 2017) and high turnover of ministers and principal secretaries between elections. ☑ Foreign direct investment (FDI) has fallen since 2015. ☑ Exports lack diversification, still concentrated on very few products, mainly the textiles and apparel, and diamonds sectors. ☑ Lesotho is no longer the leading apparel exporter to the United States under the African Growth and Opportunity Act (AGOA) trade preferences arrangement. ***SCD Update proposal:*** The need to facilitate a competitive, export-oriented private sector that creates jobs has increased in prominence, together with the need to reduce the size of the state.
3. Increasing the returns to self-employment by raising productivity of smallholders and microenterprises	☑ As of June 2020, there are 12 main active entrepreneurship support programs that could be considered as providing support to grow entrepreneurs. However, these are concentrated in Maseru and around 53 percent of businesses are excluded from the financial system. ☑ Labor productivity in industry and services (a sector in which microenterprises are concentrated) has declined over time. ☑ Productivity is particularly low in subsistence agriculture (smallholders): ▪ Yields remain low and highly variable due to drought vulnerability. ▪ Slow progress in crop diversification from staples to high value/ job creating value chains. ▪ Progress: slight improvement in labor productivity; significant export diversification after 2012 (mainly from greasy wool to non-greasy wool, mohair, cotton, but also into processed fruit and vegetable oil). ☑ Limited job creation: Unemployment rate of 22.5 percent in 2020, with youth unemployment at 29.1 percent. ***SCD Update proposal:*** Increased vulnerability to climate change impacts has raised the prominence of the need to raise productivity of smallholders and small business.

2015 SCD: Priority interventions	Evolution since 2015
4. Improving health and education outcomes by reducing the disease burden and raising and aligning skills	Education, learning, health and nutrition outcomes remain poor and not commensurate with the high levels of public spending on education and health. ☑ Lesotho has managed to improve human capital levels since 2010 but with an HCI of 0.40 the score is low for the country's income level. Learning performance remains among the lowest in Southern Africa. ☑ Health outcomes are poor especially among the poor and rural population: over one-third of children under 5 are stunted; 23.6 percent of adults lived with HIV in 2018; only 52 percent of 15-year-olds survive to age 60; HIV/AIDS prevalence (25.6 percent), TB incidence (611/100,000) are among the highest globally. There is a growing burden of non-communicable diseases (NCDs), estimated to account for about one-third of all deaths. ☑ Lack of skills is a major concern for the private sector, particularly in skilled occupations such as managers, chefs, engineers, and technicians. In general, there are signs of a potential mismatch between the skills pursued by the youth and those demanded by the private sector. For instance, two-thirds of tertiary students complete study fields of education and the social sciences, while most of private and public investment is oriented toward creating jobs in the fields of agriculture, manufacturing, tourism, and technology. ***SCD Update proposal:*** Progress has been made in selected areas, but significant gaps remain, especially on learning and nutrition outcomes, and the skills shortage. This remains a priority because outcomes remain poor despite progress and are an important driver of poverty and inequality reduction. Further the SCD Update emphasizes the need to pay particular attention to improving outcomes in rural areas and lagging regions.
5. Reforming social protection to reduce fragmentation, and improve targeting, efficiency and linkages	There has been progress in reforming social protection, but more progress is needed. ☑ The National Information System for Social Assistance (NISSA) is available in all rural areas and in the process of being rolled out in all urban areas end 2020. NISSA is a national social registry and targeting system now serves as a unified targeting tool. ☑ Payment systems are in the process of being harmonized: programs are moving toward delivering payments using electronic methods and relying on National IDs for identification, but uptake of e-payments is still low. ☑ Reforms to reduce leakages and administrative efficiencies in the old age pensions are progressing. ☑ Opening for means-testing tertiary bursary program. ☑ Expansion of coverage but coverage of the poor is still low. ***SCD Update proposal:*** Notable areas of progress have been made (and some are ongoing) to reform the social protection system. The gaps are in coverage of the poor, as well as shock responsiveness. Furthermore, the link between social protection and other social outcomes, specifically education and health, can be further strengthened.

203. The prioritization is informed by new knowledge from recent analytical work,[76] as well as additional internal and external consultations. These included discussions with the WBG's Lesotho country team and five workshops with representatives of government, the private sector, civil society and the youth, development partners, and academia. During these discussions, analysis from the preceding chapters was presented, together with the logic leading to the identification of challenges and priorities. This was followed by discussions of the analysis and the identification of priorities. Overall, the consultations underlined broad support for the analysis and priorities identified. There was broad consensus on the slow progress toward addressing challenges and constraints identified in the 2015 SCD, and its negative impact on progress toward the twin goals.

204. The priorities identified are necessary to overcome the main development constraints by rebalancing growth, strengthening human capital and basic services, and strengthening climate risk management and resilience, and bridging public sector implementation gaps. Figure 27 provides details on interventions that are recommended for prioritization under each of the broad priority policy areas. Bridging implementation gaps is seen as a guiding framework for how to act rather than stand-alone actions to be prioritized, and is envisaged to improve efficiency and effectiveness of the public sector.

Table 3. Summary of broad priority areas

Priority areas where continued efforts are needed	Priority areas with increasing prominence
1. Rebalancing growth: shifting to private investments and exports for job creation (previously: facilitating a competitive, export-oriented private sector). **2.** Strengthening human capital and improving service delivery, especially in rural areas and lagging regions (previously: improving health and education outcomes by reducing the disease burden and raising and aligning skills). This SCD Update emphasizes closing gaps in rural areas and lagging regions.	**3.** Strengthening climate risk management and resilience. **4.** Overarching constraint: Bridging public sector implementation gaps.

76. See Annex 1 for new knowledge and an update of key data and knowledge gaps.

205. **To rebalance growth by shifting to private investment and exports for job creation, this Update identifies three interrelated priority interventions.** First, **accelerating the adoption and implementation of outstanding legislation and business environment reforms** to enhance the role of the private sector in fostering a more export-oriented economy. This could leverage on the PMDU, which is already playing a key role in unblocking reforms and building consensus among the various government actors, providing a good avenue for accelerating progress. Given the dominance of Micro, Small and Medium Enterprises (MSMEs) in the private sector, it is important that these reforms strengthen the ecosystem for MSMEs including improving access to finance. Second, **strengthening skills and employability of youth, ensuring a gender-nuanced approach** is important. This should be anchored on providing relevant skills training to, and better coordination between the existing youth employment programs (by both public and private actors) to improve their reach, impact, and efficiency. In addition, there is a need to support gainful self-employment among the most disadvantaged youth, comprising mainly low-skilled youth, particularly in rural areas, who are most severely affected by unemployment, inactivity and, when employed, low earnings. Third, **closing gaps in key infrastructure,** specifically in electricity, sustainable and safe road connectivity, and ICT infrastructure, as highlighted in the 2015 SCD, remains critical to competitiveness.

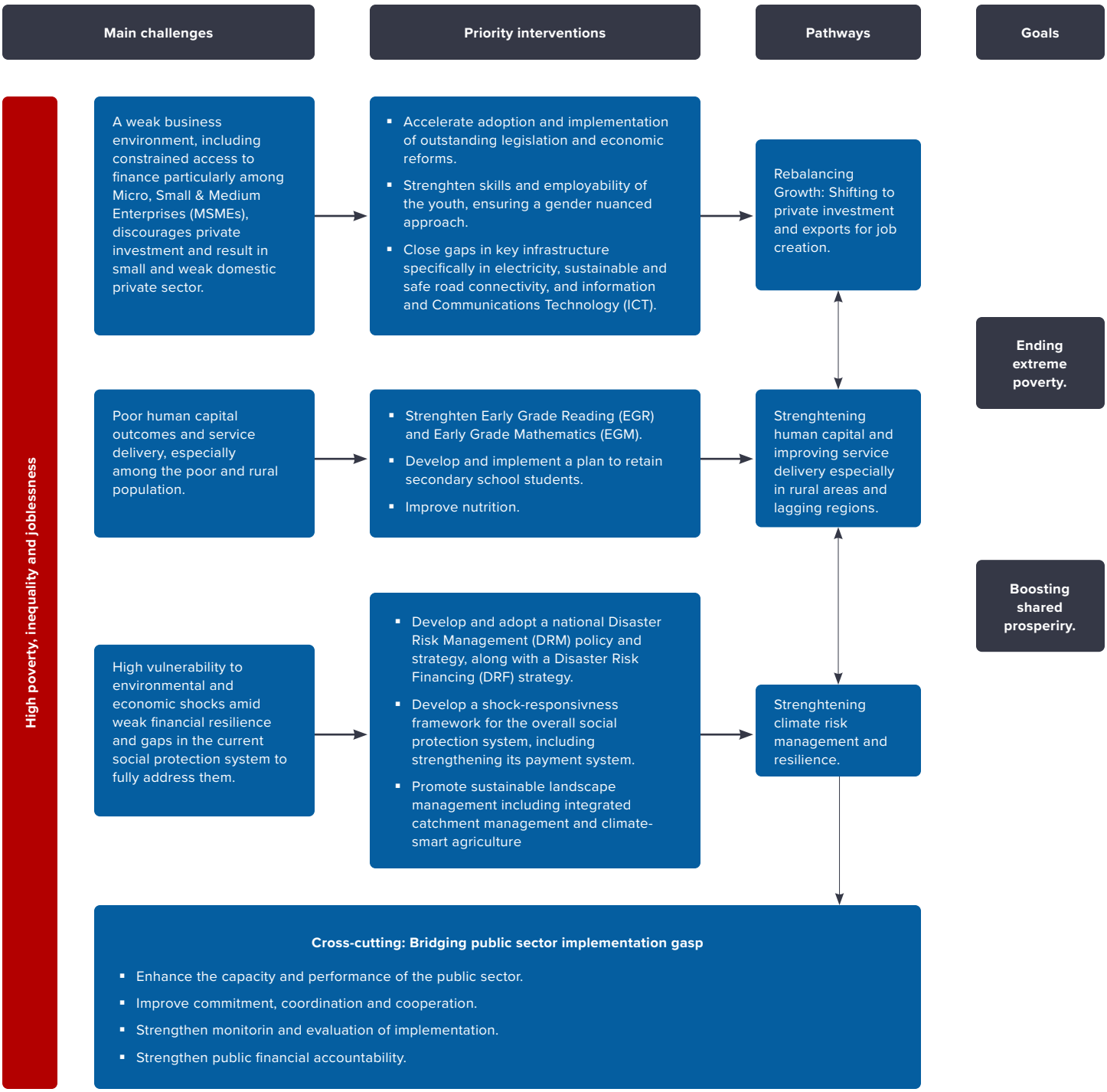
206. **Priority interventions to strengthen human capital and improve service delivery, especially in rural areas and lagging regions include:** first, **strengthening Early Grade Reading (EGR) and Early Grade Mathematics (EGM)** to ensure that children are learning in school by supporting the mastery of foundational skills of literacy and numeracy in early grades (Grades 1-4) of primary school. Second, **developing and implementing a plan to retain secondary school students** taking into account gender, income and location-level differences, and considering the reasons behind dropping out, which include the high cost of education, lack of interest in education, pregnancy or marriage, poor performance, and insufficient supply of quality secondary schools, among others. Third, **investing in nutrition** through well-targeted investments, particularly young children in their first 1,000 days, will help break the intergenerational cycle of malnutrition and poor health, and contribute to Lesotho's human capital. Strengthened complementarity between social protection programs and education, nutrition and health investments would maximize impact, especially among youth. Overall, priorities to strengthen human capital and improve service delivery need to be embedded in a territorial development approach that delinks the lumpy geography of production from the geography of welfare or living standards.

207. **In terms of strengthening climate risk management and resilience, the three priority interventions include:** first, **develop and adopt a national Disaster Risk Management (DRM) policy and strategy, along with the development and adoption of a national Disaster Risk Financing (DRF) strategy.** The DRM policy and strategy would be anchored on updating and harmonizing institutional and regulatory frameworks, as well as sectoral policies and plans thereby strengthening institutional capacity for enhancing climate risk management and resilience. The DRF strategy would formalize policy priorities based on a risk-layering approach, and address both budget mobilization and budget execution. Such a strategy would strengthen the financial management of disaster risks and, by diversifying risk financing instruments, create a fiscal buffer and reduce budget volatility. Second, **developing a shock-responsiveness framework for the overall social protection system,** building on ongoing efforts in this direction by the Ministry of Social Development, in coordination with the DMA and with the support of DPs. Progress made to update, extend, and strengthen the NISSA database are crucial to scaling up social protection system in response to disasters, together with digitizing government-to-person (G2P) payments in a manner that does not lead to the exclusion of vulnerable populations and accompanied by strong institutional, legal and technical safeguards for data protection and privacy. Third, **promoting sustainable landscape management, including integrated catchment management and climate-smart agriculture (CSA),** can be a cost-effective way to shore up

resilience. Linked to this, promoting CSA guided by Lesotho Climate-Smart Agriculture Investment Plan (CSAIP) is important for protecting livelihoods of poor rural households that depend on rain-fed subsistence agriculture.

208. **Overall, this SCD Update has shown that Lesotho needs new and integrated approaches to tackle longstanding and emerging development constraints.** This would entail an integrated approach to rebalancing the economy towards inclusive private sector led development and growth; deeper international and regional economic integration; an integrated approach to tackling multiple dimensions of inequality, including strengthening human capital and service delivery especially among the poor and in rural and lagging areas; promoting a modernized and resilient economy; and a public sector with the capacity and orientation to effectively implement development policies and programs.

Figure 27. Updated priority policy areas



Source: Authors' own representation

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ANNEXES

Annex 1. New Knowledge Generated by the WBG since 2015 and Remaining Knowledge Gaps

2015 SCD knowledge gaps	Priority areas with increasing prominence	
☑ Remittances, migration and brain drain ☑ Growth-poverty link ☑ Skills premium/ new labor force survey ☑ Addressing energy needs ☑ Constraints to agricultural productivity ☑ Addressing childhood malnutrition ☑ Climate change impacts on rural communities, migration and urbanization ☑ Private sector analysis ☑ Gender constraints to agricultural productivity	**2017** ☑ Public Health Sector Expenditure Review ☑ Youth Employment Programs in Lesotho: The Policy Gaps (and Overlaps) ☑ Renewable Energy Investment Plan (link) **2018** ☑ Public expenditure review: Improving expenditure efficiency for inclusive development and growth ☑ Jobs analysis ☑ Unlocking the potential of Lesotho's Private Sector: A Focus on Apparel, horticulture, and ICT ☑ Forever Young? Social Policies For A Changing Population In Southern Africa. **2019** ☑ Agriculture Public Expenditure Review ☑ Disaster Risk Financing Diagnostic ☑ Education Public Expenditure Review ☑ Poverty Assessment ☑ Electrification Master Plan (EU-funded) **2020** ☑ Digital Economy Diagnostic ☑ Gender Assessment ☑ Social Protection Assessment ☑ Strengthening efficiency in health care delivery in Lesotho	☑ Better understanding of deeper business environment issues—e.g., considering in detail key remaining business environment constraints, especially sector-specific constraints. ☑ A Country Economic Memorandum (CEM) to provide a comprehensive analysis of a country's economic developments, prospects, and policy agenda, and it identifies policy reforms for key economic sectors. ☑ What is it that the other sectors such as mining and manufacturing have done to attract foreign investment? How can this be replicated in other sectors? ☑ Scope for diversification of exports, including understanding the impact of the African Continental Free Trade Area (AfCFTA) on exports and growth. ☑ Scope for diversification of domestic revenue sources. ☑ Labor Force Survey analysis. ☑ Value-chain analyses of growth sectors that generate jobs for youth. ☑ Understanding of within-country migration trends, and implications on aggregate productivity and service delivery. ☑ Gender assessment. ☑ Strategies to increase student retention particularly in secondary education. ☑ How and to what extent can fiscal decentralization strengthen service delivery? ☑ Analyses of challenges and opportunities in lagging rural and mountainous regions to inform an appropriate territorial development framework for Lesotho.

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