PD-AAU1-520
ISN 52079

LESOTHO ECONOMIC POLICY REFORM PROGRAM

PAIP SUBMISSION

SEPTEMBER 1987

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Lesotho Economic Policy Reform Program

PAIP Submission

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EXECUTIVE SUMMARY

Lesotho's continued heavy dependence on the Republic of South Africa (RSA) which completely surrounds it, has produced serious social and economic distortions in the country.

High levels of employment in RSA mines, resulting in a reduced agricultural labor force, combined with recurrent drought which reduced crop yields and retarded pasture recovery has led to overall decline in agricultural productivity from that obtained in the late 1970's. The lack of effective policies designed to curtail the importation of cattle has led to serious rangeland degradation. Existing cropping policies were unable to bring about improved crop production during the period. Repatriated earnings from the export of labor has resulted in a large difference between GDP and GNP accounts. As a result, GDP is less than half of GNP making the country heavily dependent on the continued flow of repatriated mine earnings to maintain current income and spending patterns. Although a predominately rural nation with only 15 percent of its population living in urban centers, agriculture provides less than 20 percent to the country's GNP.

Even minor shifts in South African policies toward Lesotho, such as trade restrictions, miner repatriation or modifications of the customs union agreement can have critical repercussions for the country as long as domestic production policy fails to address alternatives. Inappropriate government policies and programs, including unneeded subsidies on agricultural input supplies, inefficient and costly, loss-producing parastatal agencies, and unchecked growth in livestock numbers over the past two decades have been major contributors to the country's decline in agricultural production and to the serious degradation of its land and range resources.

In 1986/87, Lesotho's budget deficit as a result of its fiscal situation may reach 9 percent of GNP. Even with reforms proposed by the IMF under new Structural Adjustment Facility (SAF) arrangements proposed by the IMF/World Bank, Lesotho's deficit is projected to remain above 5 percent in 1989 and above 4 percent into 1991. If projected customs union receipts fail to materialize, the deficit could be proportionally higher.

A variety of factors is responsible for these unfavorable projections. Among these is the high cost of public enterprises including Coop Lesotho, a parastatal created to deliver agricultural inputs to farmers and the Technical Operations Unit (TOU). The GOL presently subsidizes 30 percent of the cost of fertilizer sold through Coop Lesotho. The TOU provides custom farm machinery services at a subsidized cost of 40 percent. While direct subsidy to the livestock sector is not as significant, the unrestricted use of public land has resulted in overstocking estimated to be in excess of 200 percent with a consequent decline in range quality. Live animal exports fell between 1981 and 1985 from 4.7 percent to 2.4 percent with a corresponding decline in the quality of animal product exports. The overall index of crop production fell by 5 percent a year between 1973 and 1984.

This EPRP, which complements the IMF/World Bank SAF, will assist the GOL in implementing policy reforms which, within four crop years, will restructure Coop Lesotho and the TOU, transfer their essential service functions to the private sector and stem the present drain on the national budget. Further, these policy actions are aimed at increasing the efficiency and delivery of agricultural inputs in order to increase overall agricultural productivity. New policies and the enforcement of existing policy in the livestock sector

will check unrestrained range degradation and improve livestock quality, yields and farmer incomes. These actions will also complement existing USAID agriculture projects focusing on improving farming and livestock production techniques.

A total of $15,000,000 is proposed for this EPRP initiative based on anticipated direct implementation costs, implications of the GOL's projected fiscal deficit, calculated maintenance of per capita import levels and the minimal financial assistance required to enable the GOL to take the politico-economic steps specified in the conditions.

LESOTHO ECONOMIC POLICY REFORM PROGRAM

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I. Problems to be Addressed

A. The Macroeconomic Situation Facing Lesotho

Lesotho's economy is extraordinary. First, it is highly dependent on the economic policies of the Republic of South Africa (RSA). This dependency has four aspects:

-- In 1986, as in other recent years, 40 percent of Lesotho's male labor force (60 percent of men aged 20-44) were employed in the RSA at wages much above alternative employment opportunities within Lesotho.

-- All of Lesotho's merchandise imports and exports, including those moving by air, must pass through, or originate, or terminate in the RSA. In recent years, 95 percent of both exports and imports have gone to or come from the South African Customs Union (SACU), in which the RSA, Botswana, Lesotho and Swaziland (the BLS countries) are members. All of Lesotho's petroleum and all of its electricity come from the RSA.

-- Seventy percent of the annual receipts of the Government of Lesotho (GOL) come from SACU. Customs and domestic excise taxes collected by each of the four members go into the RSA's State Revenue Fund. As sole custodian, the RSA distributes SACU revenue to the BLS members according to three formulas that leave the residual to the RSA.

-- As a member of SACU, Lesotho has no independent tariff program. As a member of the Common Monetary Area (CMA), consisting of the RSA, Lesotho and Swaziland, Lesotho has a currency, the loti (plural, maloti), pegged to equal the South African Rand. Thus, Lesotho has no control over the value of its foreign exchange and has no discretion in monetary matters.

The second extraordinary characteristic of Lesotho's economy, following from the first, is that half of its citizens' employment output is produced in the RSA, mainly in mining. The value of all production within Lesotho, its Gross Domestic Product (GDP), is matched, more or less, by the wages and salaries of Lesotho citizens working in the Republic. Lesotho's Gross National Product (GNP) is the sum of production within the country, its GDP, less contributions to that production by foreign capital and labor (negligible for Lesotho), plus the contribution of Lesotho's capital and labor to production elsewhere. For 1985/1986, Lesotho's output measures were:

GDP	M	557,000,000
Net investment income	M	3,000,000
Net workers' remittances	M	550,000,000
GNP	M	1,110,000,000

Because Lesotho's GNP is double its GDP, the following analysis repeatedly distinguishes between GDP, over whose components GOL economic policies have direct influence, and the other half of GNP, over which the GOL has no effective control.

1. Hazards Associated with Dependency on the RSA

Each of the four aspects of dependency cited above delivers substantial benefits to Lesotho's citizens. Each also subjects Lesotho to potential and serious hazards this Economic Policy Reform Program (EPRP) will help to moderate. The hazards are:

a) Repatriation of the Miners. The number of Lesotho miners employed within the RSA fell about one percent a year between 1977 and 1985 before a sharp increase in 1986 that recovered half of the previous 8 year's losses. While the numerical decline is expected to resume this year or next, rising wages are expected to hold the real value of miners' total earnings nearly constant over the next 3 to 4 years. However, projected high labor force growth and slow economic growth in South Africa over the next decade will force Lesotho's miners into increased competition with South African labor. Such improvements are expected to increase incentives for miners to invest their repatriated earnings in the agricultural sector.

In the current decade, meanwhile, Lesotho faces the risk that the RSA may send home early some portion of these men. This EPRP will add to employment opportunities within Lesotho by increasing agricultural productivity and demand for labor in agriculture and in agricultural marketing and processing. Such improvements will increase incentives for miners to repatriate their earnings and to invest in the agricultural sector.

b) Restrictions on Trade. Because of its geographic location, Lesotho will remain vulnerable to border closings or slowdowns affecting merchandise trade. The proposed EPRP will minimize this vulnerability by raising agricultural production which will, to a certain degree, marginally reduce the injuries trade restrictions could produce.

c) Reductions in SACU Revenue. Expected slow economic growth in the region may reduce available revenue to Lesotho. Cuts in customs union revenue would reduce both GOL budget receipts and Lesotho's capacity to import. The three distribution formulas give predictable results so long as the RSA adheres to them and to the existing schedule of payments.

The first formula gives each BLS nation a portion of SACU receipts equal to that nation's share of dutiable goods imported into or produced in the SACU region. During 1983-84, Lesotho produced or imported 11.1 percent of the region's dutiable goods and therefore became eligible for 11.1 percent of SACU receipts. The second formula gives each BLS nation an additional 42 percent of the first formula's result, "to counteract the disadvantages of being members in a customs union with a much more developed economy, such as diminished fiscal discretion and a diminished potential for development" (for 1983-84, this raised Lesotho's share to 11.1% + 42% of 11.1% = 11.1% + 4.7% = 15.8% of the SACU pool). The third formula stabilizes year-to-year BLS receipts by algebraically adding to the first two formulas' result half the difference between their result and 20 percent (for 1983-84, since 15.8% was 4.2 points below 20%, 2.1 points were added to give Lesotho 19.9% of the SACU pool; for 1977-78, the first two formulas yielded 23.4%; so -1.7 was added algegraically to give Lesotho 21.7% of that year's pool). Since 1974, the three formulas have kept Lesotho's share between 17 and 22 percent.

The 42 percent "to counteract the disadvantages..." is arbitrary; so is the stabilization calculation. But the 1983-84 difference between 11.1 percent based on SACU revenue, attributable to Lesotho's import or production of dutiable goods, and the 17.9 percent eventually received (doled out over 3 years) is an incentive for Lesotho to sustain SACU membership.

Recently, the RSA reduced the SACU pool by cutting excise tax rates while raising sales taxes. For several years, the RSA has discussed with the BLS countries revision of the SACU agreement. Revisions, when they come, are likely to reduce Lesotho's receipts from the SACU. This EPRP will help strengthen Lesotho's balance-of-payments and its fiscal flows. Over the medium term it will strengthen Lesotho's capacity to absorb reductions in receipts from the SACU.

d) Restrictions on Lesotho's Foreign Assets. Lesotho's Common Monetary Area (CMA) membership subjects its monetary system to regulations imposed by the Reserve Bank of South Africa (the RBSA). For example, the RBSA requires a 100 percent rand reserve against the issue of malotis and that at least 65 percent of Lesotho's foreign exchange reserves be subject to management by the RBSA. Lesotho is therefore vulnerable to decisions by the RBSA to freeze or limit access to assets owned by the GOL but controlled by the RBSA. The Lesotho - RSA bilateral agreement guarantees Lesotho's access to foreign exchange, from its resources with the RBSA, on the best terms available to the most favored individuals or institution in the RSA. The treaty can be abrogated only on six months notice. Nevertheless, Lesotho and the RSA are not equal in the CMA. This EPRP is unlikely to reduce this aspect of dependency; but by helping expand Lesotho's productive capacity, it will strengthen the domestic financial system supported by that productive capacity.

2. Total and Per Capita Real GDP and GNP

Even with extensive policy reform and additional foreign assistance, Lesotho's real per capita GNP is likely to fall in the medium term. All of the GDP and GNP references in this section are to "real" changes with the effects of price changes removed.

Per capita GDP and per capita GNP both averaged 4.5 to 5.0 percent growth during the 1970s. During the 1980s, however, per capita GDP has fallen over 1 percent per year, while per capita GNP has risen just under 1 percent per year. The fall in growth rates has been due to persistent drought conditions in the 1980s, to the closing in 1982 of Lesotho's diamond mine, and to economic policies that have proven to be inadequate or counterproductive, especially in agriculture.

Over the next 5 years, the real value of wages and salaries earned in the RSA is expected to remain constant or rise slightly. Without major economic policy reforms, Lesotho's GDP is projected to grow just 2 percent per year. Because population growth in the 1980s is 2.6 percent per year (up from 2.3 percent during the 1970s), 2 percent growth in GDP translates into a 0.5 percent a year fall in per capita GDP and a 1.5 percent a year fall in per capita GNP.

In consultations with the International Monetary Fund (IMF) and the World Bank, the GOL is undertaking a number of structural reforms. If successful, these reforms are expected to raise GDP growth to 3.5 percent per year and GNP growth to 1.7 percent per year over the period 1987 to 1992. However this increase will be too small to keep per capita GNP and per capita real private consumption from falling more than 0.5 percent per year. The proposed EPRP is intended to mesh with the GOL's other economic reform programs and to moderate the projected decline in per capita GNP and private consumption.

3. Labor Force and Employment

Lesotho faces an immediate prospect of a growing labor force, contracting employment opportunities in the RSA, and downward pressure on domestic wages. Lesotho's economically active population numbered 670,000 in 1986. The prospective net growth rate of new job entrants is 20,000 a year, 1986-1990. Of the 670,000, 121,000 men are employed in mines and some 20-30,000 men and women were employed elsewhere in the RSA, 65,000 worked in Lesotho's modern sector, and 450,000 plus worked in agriculture and the informal sector.

Basotho employment in RSA mines peaked at 129,000 in 1977 and averaged a fall of 1,500 a year through 1985 (coal mine employment halved, gold mine employment rose 5,000 during this period). Employment recovered to 121,000 in 1986 as new mines opened in the Orange Free State, but the downward trend is expected to resume this year or next. During this next decade, Lesotho's labor force will grow 2.8 percent a year while the portion of the 40 percent of men now employed in RSA mines declines.

4. The Government of Lesotho Budget

Even with the reforms the GOL may implement with IMF and World Bank assistance, the budget deficit is projected to remain above 5 percent of GNP into 1989 and above 4 percent of GNP into 1991.

The budget deficit peaked at 9 percent of GNP in the 1981/82 fiscal year before being brought under control and reduced below 2 percent of GNP in 1984/85. However, the deficit may again reach 9 percent of GNP during 1986/87; and, without extensive policy reforms, it is expected to remain in the range of 8 to 9 percent of GNP during the period 1987 to 1992. If nominal receipts from the SACU do not grow as projected, the deficit would be proportionally larger.

A variety of causes explain these unfavorable projections. One major cause is the cost of subsidies to public enterprises. Two enterprises receiving subsidies are Coop Lesotho, a parastatal created to deliver agricultural inputs to farmers, and the Technical Operations Unit (TOU) of the Ministry of Agriculture. Presently, the government subsidizes 30 percent of the cost of fertilizers sold directly to farmers by Coop Lesotho. The TOU provides custom farm machinery services - i.e., plowing, harrowing and crop planting - for farmers, along with a complete package of crop inputs - i.e., seed, fertilizers and agricultural chemicals. The TOU charges farmers approximately 60 percent of the cost of the inputs and services supplied, with the government subsidizing the remaining 40 percent.

During the fiscal year ending 31 March 1986, Coop Lesotho had a net loss of M754,000. The cost of the fertilizer subsidy was M1.041 million and the cost of subsidies to the TOU was M3.5 million. The total drain on the budget was therefore M4.541, about $2.012 million at the exchange rate of $1 = 2.257 then prevailing. That was 2.03 percent of 1985-86 recurrent expenditure of M224 million.

The proposed EPRP will assist the GOL in implementing economic policy reforms which, within four crop years, will disband both enterprises, transfer their essential service functions to private sector agents, to a lesser extent to other Ministry of Agriculture divisions, and stem the present drain on the budget.

5. The Balance of Payments and Foreign Trade

In World Bank - IMF projections, Lesotho does not have a balance-of-payments problem in the sense of a projected unfilled financial gap. The staffs of the Bank and the IMF have projected financing gaps of 3.0, 1.7, and 2.0 million SDRs for 1987/88, 1988/89, and 1989/90 respectively. These would be exactly filled if Lesotho were to receive, as expected, three tranches from the IMF Structural Adjustment Facility (Lesotho's IMF quota is 15.1 million SDRs). But the Bank-IMF projections assume import projections that would accept continuation of the decline in imports per capita begun in 1983 and that would see both GNP and private consumption per capita falling over at least the next 5 years. This EPRP would provide resources that would slow those reductions.

Lesotho's principal foreign trade problem is its dependency on imports financed principally by worker remittances, its consequent vulnerability to reductions in those remittances, and the prospect of 5 more years of decline in imports per capita. Merchandise imports exceed GDP by 30 to 40 percent, while the value of merchandise exports is only 7 percent of imports. These large import levels have been sustained by the remittances. Since the real value of remittances is expected to hold barely constant in the medium term, this source of import growth appears to have ended.

In 1980, diamonds constituted 50 percent of the value of Lesotho's merchandise exports. The diamond mine, however, closed in 1982, and the value of diamond exports is now under $1,000,000 per year. At the start of the 1980s, non-diamond merchandise exports were stagnant. Since 1982, their volume has grown almost 8 percent per year. Such growth is essential to diversification of Lesotho's means of financing imports. Nevertheless, a cautionary note is in order. An 8 percent increase in non-diamond merchandise export revenue in 1987 would be offset by a mere 0.6 percent decline in workers' remittances.

The agricultural sector can produce both export growth and substitutes for food currently imported. Livestock offers a potential for increased exports. Livestock products - i.e., wool, mohair, hides and skins - made up 32 percent of non-diamond merchandise exports in 1981 and 50 percent in 1985. Live animal exports, however, fell between 1981 and 1985 from 4.7 to 2.4 percent of non-diamond merchandise exports. The latter decline may have been due to the uneven effects of the drought over those years, to continuous range degradation, and to inappropriate or inadequate livestock policies. If the GOL begins to implement its Integrated Livestock Management Program, the second of the two proposed EPRP initiatives, the size of the national herd will be drawn down, with that drawdown contributing to increased exports of live animals and meat. Subsequently, the proposed livestock program would contribute to reversing the decline in range quality and would gradually increase the exports of high quality animal and animal products.

Grain and legume production have the potential of substituting for current food imports. Throughout the 1980s, foodstuffs have accounted for 25 percent of merchandise imports. The increase in food imports was caused by the growth of population and per capita GNP but also because domestic production fell. The overall index of crop production - aggregating maize, sorghum, wheat, beans and peas - fell by 5 percent per year between 1973 and 1984. Although 1984/85 was a good year for Lesotho's principal crop, maize, domestic production supplied less than half of national consumption.

The fall in domestic agricultural output has been due to drought, land degradation causing yields to fall by 4 percent per year, and to the effects of inappropriate government policies. In particular, Coop Lesotho and the TOU have drained Government of Lesotho resources from more productive uses and have interfered with private suppliers' capacity to assist farmers to increase their productive efficiency. This EPRP would remove those barriers to efficient resource use.

6. The Real and the Foreign Exchange Value of the Loti

The Loti has depreciated in the 1980s in dollar and in SDR terms to an extent much beyond the implications of purchasing power parity. Therefore, the dollar and SDR statistical series of the World Bank and the IMF suggest trends quite different than have really occurred. They should be interpreted with caution.

For example, the World Bank's 1987 Country Economic Memorandum, in current dollars, and the IMF's 1986 Recent Economic Developments, in current SDRs, show Lesotho's merchandise imports falling 36 percent and workers' remittances falling 35-38 percent between 1983 and 1985. If those reductions are adjusted for price inflation in the United States and in the other currencies defining the SDR, the real reductions in merchandise imports and in remittances appear to have approached 45 percent.

But in current maloti, merchandise imports rose 24 percent and workers' remittances rose 20 percent between 1983 and 1985. Adjusting for inflation of just above 31 percent, the real values of merchandise imports and of remittances fell 5 percent and 8 percent over those 2 years, much less than indicated by the SDR and dollar series. The contrast results because the SDR and dollar series are calculated as though the maloti were earned and spent in Europe or the United States. The maloti series recognizes the reality that nearly all Lesotho foreign transactions are with the RSA and that what counts for Lesotho are price changes in the RSA.

Under these circumstances, a CIP program would be impractical. With only a few million dollars worth of merchandise imports bought outside the CMA each year, CIP implementation for eligible commodities from eligible sources would take many years. The funds could not be quick disbursing. Further, identification and certification of eligible commodities, each involving relatively few dollars, would impose an unacceptable administrative burden on the Mission. Finally, and most important, importers would be unwilling to make any use of CIP funding involving any slight paperwork barriers when foreign exchange is freely available from any bank. For these reasons, a CIP is not proposed.

A direct cash transfer is proposed which would entail a one-step, simultaneous authorization of GOL use of the dollar assistance and of the local currency equivalent. This is recommended because the GOL views maloti as freely interchangeable for rand and for non-rand foreign exchange; and because, except for servicing foreign debt. the GOL conducts nearly all its affairs in maloti and in rand.

If a segregated account is established for the dollars provided to the GOL, their release might be authorized for three categories of use:

1. Paying for GOL imports billed in foreign exchange;
2. Paying a portion of the $10-11 million a year required to service GOL foreign debt; or,
3. Buying maloti from the Central Bank for uses cited in Section III-C.

If the first category is used, the release of dollars would be very slow. Even if category "1" uses were restricted only by a negative list, GOL imports from outside the CMA are too small to permit expeditious release of the dollars.

A.I.D. has, in a few cases, permitted FAA resources to be used to pay host government debt service to multilateral and to some other creditors. Of GOL foreign debt, 84 percent is concessional; 91 percent of the concessional, and 77 percent of the nonconcessional, debt is to multilateral institutions. But if this second criterion is proposed, issues would have to be resolved regarding which creditors could be paid and whether, in this case, any FAA resources should be used for debt service. Because of the sensitivity of these issues, the PAIP team recommends against such use of the cash transfer.

This PAIP recommends that only Category 3 be used to authorize the release of dollars. Disbursements from the dollar account would then go directly to fund a local currency account that would be almost exclusively for payments denominated in maloti or rands.

B. Perceived Problems in the Agricultural Sector and Their Relationship to the Macroeconomic Situation

1. Agricultural Input Distribution System Inefficiencies and Market Distortions

The most recent published data and interviews indicate that on-farm use of agricultural inputs such as fertilizer, improved seed, and pesticides is quite low in Lesotho. For a total arable area of approximately 390,000 hectares, only 11,596 tons of fertilizer was used in 1983/84 (Planning Division, MOA, 1985). While effective fertilizer use per hectare increased more than eight-fold from 1975 to 1984, this achieved a level of only 12.6 kilograms of nutrients per hectare in 1983/84. This represents only 10.6 percent of Ministry of Agriculture fertilizer recommendations (Research Division/MOA). Unfortunately, national statistics on pesticide and improved seed use do not exist, but usage levels appear quite low, except in high value horticultural crops grown for urban markets, agricultural development projects, and to a lesser extent, in maize.

Since a major priority of government is to increase agricultural production, agricultural input use will undoubtedly increase in Lesotho in the future, but only at a slow pace under current production conditions which are characterized by:

a) Subsistence production systems based on low cash inputs, low labor inputs due to a male worker shortage, and risk averting extensive cultivation strategies due to highly variable rainfall;

b) Inadequate delivery of technical advice via extension service or private technicians and insufficient on-farm demonstrations of viable and profitable technical packages compatible with the subsistence orientation described in point one above;

c) Input market problems such as late delivery or scarcity of inputs, lack of technical support by input suppliers, poor coordination with the extension service, and inappropriate or poor quality input supplies;

d) Output market problems such as lack of information on prices and potential markets, low seasonal prices, and high transportation costs.

Due to Lesotho's proximity to the vast markets of the Republic of South Africa and its membership in the Southern Africa Customs Union, virtually all of Lesotho's agricultural inputs are produced and supplied by South Africa. Historically, input trade patterns linked Basotho farmers to regional South African markets surrounding the periphery of Lesotho's borders. Until the mid-1970s, input trade was handled by a variety of small general merchandise traders, large South African owned companies (such as Frasers and other trading companies), local agents, and direct purchases from cooperatives and sales agents in South Africa. During the late 1970s, Lesotho's policy was to reduce the role of traders in both agricultural input and output marketing due to perceived exploitation of farmers by some traders and disenchantment with free market principles.

The parastatal, Produce Marketing Corporation, was formed in 1973 and granted monopoly powers for agricultural input and output marketing. Its monopolistic role eventually took most private traders out of the agricultural marketing business. However, due to its poor performance and substantial losses, it was merged with Coop Lesotho under an IFAD-financed project in 1980. Coop Lesotho had been established to serve as an apex organization for farmer cooperatives even before the Produce Marketing Corporation was formed. A major objective of Coop Lesotho was to facilitate the distribution of agricultural inputs in the increasingly distorted agricultural marketing system.

Although Coop Lesotho has grown since 1981, its relative impact in the Lesotho agricultural input market has declined. Sales have tripled from M5,2000,000 in 1982/83 to over M15,000,000 in 1986/87, but much of this increase is due to inflation and to the addition of product lines unrelated to agricultural inputs such as coal, wood, foodstuffs, building materials, and groceries. Increases in fertilizer sales by Coop Lesotho over this period are primarily due to governmental subsidy programs administered by the Technical Operations Unit of the Food Self-Sufficiency Program.

Because of management and financial problems at Coop Lesotho, private input traders are currently increasing their share of the market. While detailed agricultural input usage and marketing data do not exist for Lesotho, interviews with local traders and South African suppliers suggest that Coop Lesotho's share of the market may only be 50-70 percent for fertilizer and probably 30-50 percent for seed, pesticide, and possibly livestock feed. This contracts sharply with the 95 percent market share which is assumed by Coop Lesotho officials.

Even these figures vastly overstate Coop Lesotho's potential market share if government subsidy programs were either abandoned or were more open to private traders. Technically, Coop Lesotho appears to have no legal monopoly on the agricultural input trade (although Coop Lesotho officials view this differently than some government officials). Coop Lesotho does have exclusive rights to receive the government's 30 percent subsidies on fertilizer and 40 percent subsidies on Food Self-Sufficiency Program input and service package. Thus, private traders sell insignificant amounts of inputs during the fertilizer subsidy periods (summer and winter cropping seasons) and never sell subsidized Food Self-Sufficiency Program input packages. In fact, private traders actually purchase subsidized fertilizer from Coop Lesotho during the subsidy periods and hold them for resale during non-subsidy periods. Although precise data are unavailable, such sales of subsidized fertilizer to private traders appear to be sizeable. Approximately 45-50 percent of Coop Lesotho input sales occur under these two subsidy programs, according to Coop Lesotho officials.

The Government of Lesotho is currently evaluating its input subsidy programs, particularly the Food Self-Sufficiency Program administered by the Technical Operations Unit, due to the high costs in the face of the growing government deficit and the low apparent benefit of subsidies. The phased elimination of input subsidies is recommended as part of the EPRP program because it not only subverts the major reason for Coop Lesotho's existence, but also will help reduce the government deficit.

The Government of Lesotho had the best intentions in forming Coop Lesotho in the late 1950's. The primary objectives were:

a) Cooperative ownership and management.

b) Low cost distribution of agricultural inputs due to economies of size and low cost bulk purchasing.

c) National scale system permitting subsidization of input distribution to remote sites out of profits from distribution in more accessible lowland sites.

d) Elimination of purportedly exploitative traders.

Unfortunately, most of these original objectives have not been met. Coop Lesotho has evolved into a parastatal organization which is not only unprofitable to the government, but which is extremely costly to Basotho farmers due to the distortions it creates in the agricultural marketing system.

Coop Lesotho has not functioned as an apex organization as planned. Cooperative ownership is nominal (only three percent versus 97 percent government ownership) and includes no farmer cooperatives which purchase substantial amounts of agricultural inputs. There are few active farmer cooperatives in Lesotho, so the potential for Coop Lesotho to become cooperatively owned and managed appears remote. Out of over 600 cooperatives registered in Lesotho, only 168 are still functioning and of these few are very active. As a result, Coop Lesotho remains essentially a government owned parastatal with little structural incentive to provide efficient service.

Secondly, Coop Lesotho has been unable to achieve the objective of realizing economies of size and pass along lower input prices to farmers. Serious inefficiencies and management problems have eliminated any benefits of size. Personnel problems and poor management at Coop Lesotho have led to problems of poor accounting, stocking problems, late delivery, pilferage, inappropriate types and quality of goods, and lack of agronomic expertise among sales agents.

Other inefficiencies result from basic design flaws. Coop Lesotho was originally funded to operate 16 regional depots. Due to the inheritance of facilities from the Produce Marketing Corporation and the Basic Agricultural Services Program, Coop Lesotho ran 59 depots in 1981, the vast majority of which were unprofitable due to remoteness, low sales, and high transport costs. Today, only 37 depots are operated and the majority of these are considered unprofitable by Coop Lesotho officials.

Furthermore, Coop Lesotho management has decided to diversify into other product lines besides agricultural inputs in order to amortize fixed costs and spread sales throughout the off-season. While some products have been profitable in this regard, such as coal and firewood, others have been quite unprofitable, such as food stuffs and building materials. Furthermore, branching into areas traditionally marketed by private traders has opened Coop Lesotho to substantial criticism because such sales do not fall within its original mandate to supply agricultural inputs. Even more importantly, it also suggests an important hypothesis: if an agricultural input supply system requires complementary trading in general merchandise in order to be profitable, then perhaps the original 1970s system based on general merchandise traders made economic sense.

Benefits from economies of scale due to bulk buying have also been illusory to Coop Lesotho due to financial problems and possibly poor negotiating. Coop Lesotho is clearly undercapitalized despite the original endowment of 59 depots and several vehicles. In terms of liquidity, only the $956,000, provided from the 1981 IFAD loan, represents any Government of Lesotho capital funding for Coop Lesotho to date. This is clearly insufficient to capitalize an organization with M15,000,000 in projected sales for 1986-87, particularly in light of the M1,115,000 net loss sustained from 1982-86.

Because of delays in the system for reimbursing Coop Lesotho for government subsidies (amounting to M2,500,000 for the current year) which typically last six to nine months, Coop Lesotho is often in a cash flow crisis and thus consistently late in paying suppliers. Coop Lesotho currently requires 120 day credit from its suppliers, but historically it has paid invoices after 150-180 days while ignoring the two percent per month interest penalty.

As a result, suppliers are becoming increasingly annoyed with Coop Lesotho's payment delays and are building in a 10-12 percent additional cost into their bids. This situation is rapidly worsening since several current suppliers have not yet been paid fully ten months into the current season and several June payment checks have bounced.

Furthermore, it appears that Coop Lesotho has not negotiated purchase contracts as successfully as it could, given the size of its bulk purchases. There are examples of Coop Lesotho purchasing directly from South African suppliers rather than from the local sales representatives which have resulted in a higher purchasing cost.

As a direct result of inefficient bulk buying and hidden costs of late payments to suppliers, the net effect of the government subsidy programs is to subsidize Coop Lesotho inefficiencies rather than subsidize food production among small farmers. For example, the 1986 subsidized price at Coop Lesotho for 50 kilograms of 2:3:2 (22%)-Zn fertilizer is M17.17 CIF Maseru. The 1987 prices will not be announced until July, but are expected to rise by at least 10 percent to M18.89. The 1987 retail price for the same sack of fertilizer F.O.B. Maseru purchased from the Ladybrand Cooperative in South Africa is M20.82, or only 10 percent higher. This means that despite a 30 percent subsidy, Lesotho farmers will purchase fertilizer in 1987 only 10 percent cheaper from Coop Lesotho than from a private retailer. Even more startling is the fact that the Ladybrand Cooperative normally provides a 20 percent discount for bulk orders of 8,000 tons or more, which is the magnitude of a Coop Lesotho bulk order. Even after Coop Lesotho's 12-18 percent margin to cover handling, distribution, and retailing costs, it appears that proper bulk ordering accompanied by timely payment should allow Coop Lesotho to pass along the entire 30 percent fertilizer subsidy to farmers, plus an additional discount for bulk buying. Therefore, at least two-thirds of the government fertilizer subsidy does not reach farmers but is used to cover Coop Lesotho's hidden inefficiencies.

The third objective of Coop Lesotho, subsidization of distribution to remote sites, may have achieved some success. Remote sites undoubtedly would never receive agricultural inputs at so low a price without Coop Lesotho. However, interviews at several remote depots suggest that actual agricultural input sales are quite low at these sites. Remote depots in the highland areas tend to sell higher proportions of food stuffs and coal because these heavier items benefit from subsidized transportation. Fertilizer is not as important in remote highland areas because of the small cultivated area and relatively richer soil. Pesticides and vegetable seeds are high value, low weight items which do not require a transport subsidy. Grain seed does benefit from remote site transport subsidies, but only wheat seed is of major importance to highland areas, whereas hybrid maize is less commonly used. While the intent of assuring the agricultural input supplies to remote regions sounds appealing, the Lesotho government should reassess the actual benefits and costs of such programs based on better data on input use in remote regions. Subsidization of coal and food stuff delivery to remote regions was not the original objective of Coop Lesotho.

The fourth objective of Coop Lesotho, elimination of purportedly exploitative traders, may have been achieved, but at enormous cost: the elimination of an efficient, multi-channel agricultural marketing system. At the outset of the Produce Marketing Corporation in the mid-1970s, there appear to have been cases of exploitive practices by some traders who charged usurious real interest rates on credit sales or barter crop purchase arrangements. At the same time, the political climate was changing in Lesotho towards a more critical view of traders. Short-sighted greed on the part of some traders was not only a cause for Lesotho's private trade restrictions, but probably also was a fatalistic reaction by traders to an increasingly constrained trading environment. Unfortunately for the non-exploitive traders, interventions by the Lesotho government took the form of exclusionary actions, such as eliminating private trading in selected spheres like agricultural output marketing, rather than regulating it.

The result was that historically important agricultural input marketing systems were destroyed and have been very slow to recover. Small trader agricultural input retail outlets are no longer visible in the interior of Lesotho, although entrepreneurs appear to be transporting agricultural inputs from South African cooperatives and suppliers to some Lesotho farms. Large traders such as Fraser's and Spar show little inclination to reestablish retail trade in agricultural inputs given the somewhat unpredictable distribution system of Coop Lesotho. They probably would consider reentering this market if Coop Lesotho's future activities were clearly defined, limited to profitable activities, and predictable.

Agricultural input sales agents from South African suppliers who used to service Lesotho would also be interested in returning if the market was stable and more predictable. South African suppliers originally saw benefits from selling to Coop Lesotho rather than selling directly to farmers via agents because of greater assurance of eventual payment, despite expected delays. Because payment delays are increasing and represent a substantial hidden business cost, suppliers are becoming leary of dealing with Coop Lesotho.

One of the major criticisms of Coop Lesotho is the lack of technical training of sales staff which means that farmers are left on their own to select technical packages and learn how to use them. Given the vast capacity of the South African input marketing system, a regional sales agent system in Lesotho could provide important benefits by providing supplementary technical advice to farmers. Currently, the Lesotho extension service has inadequate resources to fully disseminate technical information to farmers throughout the country. Furthermore, in most of the productive agricultural regions of the world, the most comprehensive system for supplying technical agricultural advice to farmers is provided by agricultural input sales agents. They not only have the incentive to instruct and convince farmers in the beneficial use of latest technologies, but they also must respond to market pressures when their technical advice and instruction proves to be deficient.

As an additional benefit, these technical support services would be funded by South African suppliers. While it is true that such technical services will be paid for out of sales receipts from South African suppliers and hence be hidden in margins charged to Basotho farmers, the current Coop Lesotho system is already based entirely on South African suppliers who charge their standard margin in addition to Coop Lesotho's margin.

The difference from the current system is that a sales agent representing an input supplier has incentive to provide technical assistance on a continuing basis and to increase agricultural production. Basotho farmers now use only 10 percent of recommended fertilizer levels because they either:

a) Perceive no benefit from such use and/or;
b) Do not understand how to implement the technical package and/or;
c) Receive inputs too late, and/or;
d) Lack credit.

A supplier sales representative has incentive to overcome all four of these constraints. Coop Lesotho has little, if any incentive to overcome any of these constraints.

The idea of local agents for South African suppliers, at first reading, sounds like domination of the Lesotho agricultural input market by the South African economic giant. This domination already exists, except that Coop Lesotho is the middleman, but an inefficient one without incentives to provide generally expected services. Furthermore, there is no reason why a South African supplier agent system would exclude Basotho participation.

Such a system, with substantial Basotho participation, is already evolving in Lesotho. Two of the largest competitors to Coop Lesotho are Garden Center and Agrivet, both Basotho owned companies which serve as agents for South African suppliers. The former specializes in seed, chemicals, gardening supplies, and other horticultural inputs. The latter specializes in veterinary supplies and livestock feed. Both have substantially increased their operations over the past three years and are perceived by their clients as distinctly superior to Coop Lesotho in the level of technical support they provide. In contrast to Coop Lesotho, it is interesting to note that both these private firms have national marketing networks largely without any depots outside of Maseru based on a rapid throughput system with minimum warehousing. Unlike most African countries, Lesotho has an advantage in that small traders can operate with very small inventories because they have access to the large warehousing capacity of South African suppliers.

In summary, there are many benefits to privatization of agricultural input marketing in Lesotho, some of them uniquely related to proximity to the South African market. First, there is an unusually large opportunity for competition and efficiency in a privatized agricultural input supply system. There are multiple input suppliers in South Africa: four major fertilizer companies, eleven chemical companies, and many major seed companies. The road system is generally good, except in the remote regions, and road projects related to the Highlands Water Scheme will improve roads in the center of Lesotho. Relative to Lesotho's small geographic size and population, there already exists a surprisingly large trading network for consumer goods and general merchandise. This network includes everything from large trading companies, such as Frasers, with over 60 regional stores, to innumerable small cafes and itinerant traders. This trading network will be available to participate in a privatized agricultural input distribution system because of the obvious complementarity with trade in agricultural outputs and even general merchandise.

The only major constraint to broad participation is the credit limitation of undercapitalized small traders. Currently, Lesotho's banks have excess liquidity but they seldom make agricultural loans. Government officials and some donors contend that banks are unwilling to take reasonable risks. However, current banking regulations have kept banking margins too low to justify loans on any investments which are not absolutely solid and fully backed by collateral. Unless banking regulations are relaxed to permit higher interest rates or a government fund is created to guarantee loans to small traders, Lesotho risks allowing agricultural input distribution to become centralized in the hands of only the well-financed firms, such as Frasers.

The benefits of privatization of Coop Lesotho to Basotho farmers are several. Competition forces private traders to provide services and technical support in order to attract and maintain clients. Minimal services to be expected, but now now provided by Coop Lesotho include:

a) Timely delivery of inputs;
b) Appropriate input types and quality;
c) Technical support;
d) Low costs due to more efficient purchasing, transport, and warehousing;
e) Buyer credit; and,
f) Complementary marketing services for farm products.

Private traders who do not provide these services will not maintain customers for more than one season.

There are some potential costs to privatization of agricultural input marketing in Lesotho, particularly if the elimination of subsidies is included as part of the program. First, it can be argued that food production in Lesotho might decrease during the 2 to 3 year transition period until a privatized agricultural input distribution system becomes fully established. Subsidies do increase the on-farm use of fertilizer by decreasing its cost to farmers. However, only one third of the fertilizer subsidy reaches Basotho farmers and the rest is used to subsidize Coop Lesotho's inefficiencies. Because the current system sometimes delivers fertilizer late, provides no technical support, and provides fertilizers inappropriate for certain regions (such as low analysis fertilizers for highland regions where transport costs are prohibitive), a privatized sales system will very likely increase fertilizer use and food production.

As to possible negative income distribution effects, interviews with government officials suggest that the beneficiaries of the Food Self-Sufficiency Program input subsidies include a much smaller proportion of small farmers than originally intended. Negative effects may be experienced by poor farmers in remote sites who now benefit from implicit transport subsidies, although these benefits derive mainly from reduced prices and increased supply of coal and food stuffs. While rural food supplies must be assured to poor farmers in rural areas, further study is necessary to evaluate the costs of the current system in comparison of more direct subsidy programs having smaller overhead costs and fewer detrimental effects due to distortions in rural marketing system. In addition, research is necessary to develop production technologies more appropriate to remote areas, such as dairy, staff feeding, or poultry projects which are less dependent on transport subsidies for livestock feed.

2. Lack of an Integrated Livestock Management Program and a Prioritized Agenda for its Implementation

The livestock owners and herdboys of Lesotho make their contribution to the national accounts principally through exploitation of the extensive grazing opportunities in the country's foothills and mountains. The national livestock composite herd consists of approximately 1,000,000 animal units divided in the main between cattle, Merino sheep, and Angora goats. Considerable numbers of donkeys and horses also complicate the grazing situation while making modest economic contributions as transport animals.

Lesotho's cattle herd is maintained for subsistence dairy production, as a source of oxen for draft power in cropping operations and rural transport, and for various traditional obligations, such as contributions to the bride price - i.e., "lobola" - and intergroup cattle loans. The benefits of cattle ownership from the Basotho family's viewpoint are not necessarily ennumerated simply on the basis of net cash returns from commercial product sales. In fact, most of the products or services provided by a traditional Basotho cattle herd are either auto-consumed by the family or used in family production processes - i.e., manure for field and garden crops, animal power.

The annual offtake of the herd in slaughter animals is low as a percentage of the total herd and is comprised principally of aged cows, other sterile females, and wornout oxen and produces lean, grassfed beef of manufacturing grade for which there is only a limited domestic market. There is a high effective demand for such meat, however, among certain consumer groups in the Republic of South Africa.

In addition to livestock contributions from the cattle herd, Basotho livestock owners derive considerable revenues from production of wool and mohair from their Merino sheep and Angora goats, respectively. At the national level, these two fibers together constitute the largest single merchandise export from the economy at present.

Moreover, local consumption of milk and meat - particularly mutton - from the national composite herd plays a vital role in supplying a high proportion of the limited protein intake in Basotho diets. With growing population and relatively high per capita income levels, domestic demand for dairy products, poultry, eggs, and certain types and qualities of meat has been rising and outstripping local production. This situation has contributed to the increasing import bill for foodstuffs, while declining per animal productivities and inefficiencies in existing livestock marketing arrangements have combined to diminish Lesotho's potential livestock product export earnings.

Finally, because all classes of livestock in Lesotho - i.e., cattle, goats, and sheep - are maintained for primary production objectives other than meat production-i.e., milk, traction, power, wool or mohair - most meat production is a function of offtakes of animals which for one reason or another are no longer capable of meeting their primary production role. This

means not only that most cattle are aged when slaughtered but also that sheep and goats may not be marketed for meat at times of the year when they are still unsheared or, in the case of females, carrying fetuses. These facts greatly complicate effective marketing strategies for livestock in Lesotho since they obviously cannot be based upon the simple assumption that Basotho livestock owners are raising their animals primarily to sell as red meat.

The essential problem facing the livestock economy in Lesotho at present is the persistent imbalance between the number of animal units maintained by Basotho stockowners and the inherent productivity of the country's grazing resource. This buildup of excessive animal numbers has been driven by several related factors: the relatively high total returns to livestock investments - reported by Swallow et al. (1987) to average between 8 and 10 percent per annum; availability of miners' earnings repatriated as live animals or used to buy stock in-country; the absence of attractive alternative investment opportunities in rural areas.

Given that Lesotho's resource base on extensive grazing lands is a fragile one even under excellent land management practices due to the prevalence of steep slopes, shallow soils, and modest vegetation cover even under optimal conditions, any mismanagement or overtaxing of the resource by excessive grazing, continuous animal traffic, and associated human activities quickly leads to accelerating resource degradation. Gully and sheet erosion, disappearance of the soil from the underlying rock mantle, range encroachment by brush and unpalatable plant species, and in the declining productivities of herds and flocks maintained in such conditions are certain indicators of a deteriorating environmental situation and the concommitant loss of opportunities for Lesotho's economy.

The lack of well-defined government policies in land and livestock management has allowed Basotho livestock owners to reap substantial financial benefits from exploitation of the national range without paying the social costs of their destruction of that resource. Alternatively stated, livestock ownership in Lesotho in most cases is attractive to many people because the government has allowed a divergence to occur between the financial costs and returns incurred in individual livestock ownership and the economic costs and returns incurred by the nation in use of the national range. Because individual livestock owners are not held responsible by the nation for their abusive management of the range resource through government programs that either place absolute limits on animal numbers or tax away owners excess profits - i.e., "rents" in economic parlance - to compensate the nation for the resource damage, the livestock owner's rational economic response to the opportunity is to stock as many animals as he or she can get away with at the expense of his or her neighbors - and, ultimately, the entire Basotho nation.

As a result of an inability to effectively come to grips with the key socio-political problems of land management and livestock controls in the foothills and mountains, the present policy landscape is littered with detailed technical proposals to "solve" a situation which at the core is <u>not</u> inherently technical in nature. Some of the existing proposals are technically sound. They could be highly beneficial

to the Lesotho livestock economy if implemented in the context of a comprehensive and integrated livestock program which was annunciated and supported at the highest levels of the government. However, in the absence of such an overarching statement of policy, with accompanying well-defined and prioritized livestock programs, the isolated and discrete technical actions being undertaken at present are destined to have only very limited effects on rationalizing overall resource utilization to permit production of quality livestock on a sustainable basis.

The initiative to develop an Integrated Livestock Management Program, with USAID assistance, as proposed in Section III.B below, is designed precisely to put in place such an overarching policy statement with an accompanying implementation strategy and to assist in implementing key elements of that strategy. With respect to development of the policy and implementation strategy, the Government of Lesotho at the highest levels must formulate programs and discrete policy actions itself to solve, over time and at a minimum, the following major problems:

a) The Current Divergence Between the Financial and Economic Rates of Return to Extensive Livestock Enterprises

Basotho livestock owners at all levels of society must be required, on behalf of the entire Nation, to pay the economic costs of maintaining their livestock enterprises. The most effective and equitable way of accomplishing this end is through government tax programs which effectively raise the financial costs to livestock owners of maintaining their animals to levels commensurate to the extent possible with the costs of the damage they are causing to the national range resource - i.e., the real costs of the induced "externality" in economic terms. In this case, the specific tax would be a grazing fee administered on a per head of stock owned basis to all livestock owners in the country. For reasons of administrative simplicity, such a tax would almost certainly have to be structured so as to be tax neutral with respect to owner's herd/flock sizes.

b) Appropriate Land Allocation and Management Policies Which Take Into Account National Needs for Alternative Land Uses

One of the striking problems with current government agricultural policy statements, as presented for the draft Fourth Five Year Development Plan and in connection with the IMF/IBRD Economic Reform Program is that all land-using activities - i.e., cropping, livestock production, forestry, recreation uses - are presented as if they can all be expanded rapidly and simultaneously. There is currently no evident prioritization set down to govern land use patterns. These simultaneous expansions in land use obviously cannot take place in the real world and any Integrated Livestock Management Program must take strict account of the twin realities that the Basotho population is growing at a rapid rate and the existing resource base is both limited and deteriorating due to human misuse of the land.

c) Promotion of More Intensive and Productive Livestock Enterprises

It seems clear from review of existing material on livestock enterprise potentials in Lesotho that the economy, with rising population, increasing urbanization, and rising income levels, will continue to have a relatively high effective domestic demand for quality livestock

products - e.g., milk, quality meats, eggs and broilers. In addition, Lesotho's unique position with respect to the Republic of South Africa gives it a considerable potential for export of live animals, meat and animal fibers to a sizeable additional market with very considerable purchasing power and rising shortages in its own domestic livestock product supply system.

Any integrated livestock management program, therefore, must conceptualize and implement incentive programs to draw Basotho livestock owners out of their traditional and extensive livestock enterprises and into more intensive enterprises based on genetically more productive animals maintained on higher planes of nutrition. Such programs could introduce incentives - positive and negative - to replace low quality animals with more productive breeds of dairy and beef cattle, sheep, goats, and other stock. They should also promote progressive regeneration of range resources under controlled grazing schemes and supplementary production of other animal feeds through cropping enterprises.

d. Removal of Current Distortions in Live Animal and Livestock Product Marketing

The past 15 years have witnessed a progressive deterioration in the efficiency of live animal and livestock product marketing systems in Lesotho. Such deterioration has been caused in large part by government efforts to restrict all marketing activities to certain privileged i.e., parastatal-marketing channels. As a result, private traders have been progressively restricted by legislative - and/or more informal means - from participating fully and openly in live animal and livestock product marketing. The result is that the economy is deprived of many opportunities for export earnings and domestic market demand for quality livestock products is met in large measure by imports, rather than domestic production.

To remedy this situation, any effective integrated livestock management program must be predicated on eliminating the present market distortions by encouraging full and competitive participation of private agents in livestock marketing, creating domestic incentives for greater local marketing of high quality livestock products, carefully regulating import flows to initially protect intensive livestock enterprises in their development phase, and finally, on promoting maximum sales into the existing export markets.

The integrated livestock management program initiative, as outlined below, both recognizes the differential time horizons needed to effect the fundamental changes in Lesotho's existing livestock economy and proposes to attack those key deficiencies which are amenable to change in the short-term. The three elements, therefore, which have been selected for policy assistance efforts are:

a) Development and dissemination of a national Integrated Livestock Management Program.

b) Institution of a national grazing fee system to tax away the current financial benefits garnered by livestock owners while abusing the national resource base.

c) Eliminating present distortions in livestock marketing systems to promote greater market efficiencies and to take advantage of previously neglected export marketing opportunities.

II. The Program Proposed to Deal with the Perceived Problems

A. Assistance to Improving the Efficiency of the Agricultural Input Distribution System

This initiative is composed of 10 discrete actions phased over a 2-year period. These reform actions are linked in logical and complementary steps and are listed below by periods of disbursements. EPRP funding will be disbursed in three tranches to be paid once all policy changes programmed for each indicative period are completed. Should all changes for any one program period be completed in less than that period indicated, USAID would make earlier payments to the Government of Lesotho.

1. Tranche Period One

a) Issuance of a Government of Lesotho policy statement providing positive support to development of an open and competitive market for supply of agricultural inputs.

b) Government commitment to progressive removal of all subsidies on fertilizers over a four-year period starting with the 1988/89 crop season.

c) Government commitment to the progressive transfer of all Technical Operations Unit activities to private sector operators over the same four-year period.

d) A comprehensive national survey of agricultural input flows, sources of supply, and principal purchasers to clarify the present situation and provide baseline data from which to evaluate the progress of the policy reform measures.

e) An independent appraisal of all Coop Lesotho assets by an external accounting and appraisal firm.

f) A reconciliation and settlement of all government accounts with Coop Lesotho and of Coop Lesotho's outstanding debts with its creditors.

2. Tranche Period Two

a) Establishment and utilization of a line of credit through a local banking institution specifically for local input suppliers needing funds for operational credit and for capital purchases of transport, warehousing, and sales facilities.

b) A progressive selloff of Coop Lesotho depots, sales outlets, and other assets over a twelve month period to local private sector input suppliers, other general traders, and/or primary and secondary cooperatives.

c) A buyout of the government shareholdings in Coop Lesotho through repayment of the IFAD loan outstanding. This action to be co-financed by USAID and the World Bank, net of repayments generated by receipts from the sale of Coop Lesotho assets.

d) A Government of Lesotho/USAID-funded program to ease the transition of current Coop Lesotho personnel into other employment upon dissolution of Coop Lesotho as a parastatal enterprise.

B. Assistance in Development of an Integrated Livestock Management Process

This initiative is composed of 13 discrete actions phased over a 3-year period. These reform actions, as jointly proposed by the PAIP team and the Ministry of Agriculture's Livestock Task Force, are listed below by program year.

1. Tranche Period One

a) Conceptualization and dissemination by the Government of Lesotho of a comprehensive national livestock policy statement, accompanied by detailed and prioritized implementation process.

b) Design and approval by the Ministry of Agriculture of a detailed program for institution of a national grazing fee system.

c) Issuance of a government policy statement supporting an open market and free trade in live animals and livestock products to supply both the domestic and international markets and authorizing private sector agents to conduct such trade activities at any time and in all locations in Lesotho.

Such a statement would necessarily be accompanied by legal revision of the Livestock Marketing Corporation Act 1973 - specifically Part I - Livestock Marketing Corporation, Its Purpose, Powers and Duties - and all subsequent legislation pertaining to live animal and/or livestock product marketing in Lesotho to eliminate all effective bars to private agent participation in all aspects of livestock marketing in Lesotho and in export markets.

d) Government abolition of the current 12 percent sales tax on animal carcasses originating in Lesotho to equalize the terms of livestock trade between the Lesotho market and imports from the Republic of South Africa.

e) Certification of the national abattoir facilities for immediate export to the Republic of South Africa as part of a longer-term meat export strategy.

f) Securing of an expanded export quota for shipment of live animals and meat into most controlled urban markets in the Republic of South Africa.

g) Development of additional channels for live animal and meat exports into uncontrolled areas of the South African market.

h) Reorientation of the national feedlot complex from a commercial feedlot to primarily a holding ground for cull animals from the national range destocking program, with livestock fattening only for high-quality feeder stock.

i) Completion of a feasibility study of the prospects for installation of a meat processing facility at the national abattoir.

2. Tranche Period Two

a) Approval of the national grazing fee system at the highest levels of the government and gazetting of the program through the Law Office.

b) Development and issuance of a detailed government action program for privatization of the national abattoir, including changes in the legal status of the abattoir, as necessary, to facilitate privatization and strict separation of all accounts between the abattoir and the feedlot complex.

c) Institution of a national farm news service which would periodically provide livestock owners with information on prevailing livestock prices, and the sales dates and sites for livestock auction sales.

3. Tranche Period Three

a) Implementation of the first year of the grazing fee system in Lesotho.

C. Proposed Uses for Local Currency in Support of Economic Reforms in the Agricultural Sector

The principal and highest priority uses of the local currency generated by this program will be to fund essential elements of the two policy reform packages detailed above. As these proposed policy reforms are undertaken, complementary actions will be undertaken by the Government of Lesotho, in collaboration with USAID, using any residual local currency resources. Below is a listing of indicative actions to be jointly planned and implemented by the program participants.

1. Actions Which Complement the Agricultural Inputs Policy Reform Initiative

a) Improved government testing of agricultural inputs for introduction in the input distribution system, with emphasis on designing input packages adapted for the different agronomic regions of Lesotho.

b) Providing professional guidance and product use information to agricultural input dealers and the farming community.

c) Strengthening the capacity of the Ministry of Agriculture's extension service to effectively analyze farmers' problems and provide pertinent advice on use of inputs and adoption of new crop technologies.

2. Actions Which Complement the Livestock Policy Reform Initiative

a) Assisting a national livestock procurement and improvement program with the objective of introducing genetically improved livestock into farmers' herds and flocks.

b) Increasing efficiency and output of the regional breeding centers for sheep, goats and cattle.

c) Implementing the national grazing fee system and enforcing the allocation of grazing permits in accordance with sound range management practices.

d) Promoting small-scale, intensive livestock enterprises in, for example, dairying, cattle fattening, broiler and egg production.

e) Development of a program by which tax revenues collected under the grazing fee program are recorded by government and returned to rural communities for local development projects.

f) Initiating studies to determine equitable means of maintaining livestock numbers at desired levels once such levels have been attained.

3. Actions Which Support Accelerated Growth in the Agricultural Sector

a) Land tenure reform initiatives to promote long-term land leasing arrangements for rural agricultural land and freehold ownership for urban agro-industrial and commercial sites.

b) Reinforcement of efforts in agricultural policy analysis, planning, program development, project coordination, activity monitoring, and overall evaluation.

c) Improved collection and widened publication of key agricultural statistical series, including better monitoring of agricultural inputs flows by source, importer, and end-user.

d) Execution of selected feasibility studies for horticultural crop production schemes, agro-processing facilities, export marketing opportunities, small irrigation schemes, and similar activities.

e) Execution of a baseline inventory of existing small scale agro-industry enterprises and selective analyses of their technical efficiencies and financial profitabilities.

f) Development of appropriate produce marketing facilities and services in Lesotho.

g) Development of the Ministry of Agriculture's Agricultural Marketing Department, with efficient systems for provision of market information to producers on market prices, produce availability, marketing arrangements, and other relevant information.

h) Initiation of loan guarantee and supervised credit programs for agricultural input dealers, agricultural produce marketing agents, and agro-industrial enterprise development.

i) Strengthening the Cooperative Credit Union by upgrading the performance of about fifty credit union managers through a credit union manager training program followed by a manager support program.

j) Technical assistance to farmers and traders for grading, preparation, and packaging of produce.

k) Promoting the formation and operation of genuine agricultural and livestock producer associations for activities in input and product marketing, provision of custom tractor services, and vertically integrated agricultural production enterprises.

l) Supporting via BEDCO - or other appropriate vehicles - training courses for small-scale agricultural input dealers, produce marketing agents, and agro-industry entrepreneurs in practical business management, accounting, marketing analysis and development, and other similar topics.

m) Implementing extension training for farmers in appropriate land conservation and range management practices and offering practical education in range conservation and livestock management techniques through the primary schools directed at herd boys.

n) Continuation of training for Ministry of Agriculture staff to upgrade job skills and professional expertise.

III. Linkages Between the Proposed Program and the Prospective Structure Adjustment Facility Arrangements

Lesotho has no adjustment lending (i.e., no quick-disbursing policy-reform lending) agreements with the World Bank. It has no standby agreement with the IMF, and it has no plans for one or for World Bank adjustment lending in the near future. However, the GOL and the staffs of the IMF and the World Bank have been negotiating the content of a Policy Framework Paper (PFP). The PFP is to be followed by a Structural Adjustment Facility Arrangement (SAFA), between the GOL and the IMF, that would establish the economic and financial policies that the GOL is to follow during 1987/1988. The PFP also anticipates SAFA II and SAFA III arrangements defining government policies for 1988/1989 and 1989/1990, respectively. The SAFAs would provide 7.0 million SDRs in assistance in three tranches of 3.0, 2.0, and 2.0 million SDRS.

This PAIP would provide support for economic policies closely linked with many of the policies the draft PFP and the Memorandum of Economic and Financial Policies (MEFP) propose for inclusion in the SAFAs. The following discussion examines these linkages with the prospective SAFAs whose content is implied in the draft PFP and MEFP.

All the elements in this proposed EPRP and in the prospective SAFAs are directed at providing an appropriate framework for sustainable economic growth. But many of the objectively verifiable conditions in the prospective

SAFA I are those found in most IMF standby agreements - i.e., constraints on net domestic credit creation, and on net credit to government, and obligations to increase GOL revenues. This EPRP does not touch specifically on those areas.

This EPRP and the prospective SAFAs would be most closely linked in four areas:

a) Strengthening Lesotho's balance of payments (BOP) position;
b) Reducing GOL expenditures by privatizing agricultural input marketing expenditures;
c) Raising agricultural production; and,
d) Increasing credit availability to small scale entrepreneurs.

To a great extent, the structural adjustment measures of the EPRP in each area overlap the EPRP's measures for the other two areas. The same is true of the prospective SAFAs.

The elements of this EPRP and of the prospective SAFAs would closely complement one another; yet, for the most part in each area, the emphases of the EPRP and of the prospective SAFAs are quite different. In several areas, the EPRP is much more explicit about reform implementation than are the draft PFP and EPRP.

Both programs would achieve a viable BOP in the medium-term with reduced dependence on miner's remittances. The proposed SAFA focuses on the insufficiently diversified export base so provides for supplemental incentives and policy packages to attract and expand production of new kinds of exports in the three areas of agro-industry using domestic raw materials, assembly-type operations using imported components, and horticultural crops. The PFP assumes consumption imports will remain a function of miners' remittances. In contrast with, but complementing that program, this EPRP would support expansion of traditional agricultural production to increase exports of livestock and livestock products and to increase grain and legume, as well as vegetable, production in order to reduce imports of foodstuffs.

To cut GOL expenditures, the prospective SAFAs may call for changes so no public enterprise will require budgetary support for current operations and so every public enterprise will eventually bear much of its own capital costs. The prospective SAFAs may provide for:

a) Increased water and electricity tariffs during 1987/88;
b) Completion in 1987, with World Bank assistance, of the first annual review of major government enterprises (including those, like the TOU, operating in government departments) to establish baseline information on and to help in setting up a reporting system for these enterprises;
c) Developing during 1987/88 of an action plan for pricing adjustments for these enterprises; and
d) Measures during 1987/90 to reduce subsidies, to promote the efficiency of parastatals, and to implement divestment of insolvent subsidiaries of parastatals.

While the prospective SAFA may provide for studies, measures to promote parastatal efficiency, and divestment of some subsidiaries, the EPRP goes further. It would phase out both Coop Lesotho and the TOU thereby ending their annual drain (estimated at U.S. $1.0 million in 1985/86) on the government budget, producing revenue from sale of their assets, and returning agricultural input markets to private competition.

If Coop Lesotho were simply to become "efficient" only in the sense of becoming able to cover its costs, and if it were then permitted to dominate input markets, Lesotho farm families would be denied access to the techuical advice and the on-farm demonstration of profitable technical packages that many private traders are motivated to provide. Worse, while a parastatal covering costs in a protected market will not drain the budget, it may still fail farmers with late deliveries, inappropriate quality in input supplies, and with all the other defects in Coop Lesotho cited in Section II-B-1 above.

By detailing the phase-out of Coop Lesotho all the way through sale of its assets, the EPRP assures both an end to the budget drain and unrestricted access by Basotho families to the wide range of private traders already or potentially operating in Lesotho.

Both this EPRP and the prospective SAFAs seek corrective measures to reverse degradation of grazing land, to encourage more open land leasing arrangements, and to increase the security of investments directed at raising the productivity of arable land. In June 1987, the Government of Lesotho is to take steps to recognize legally and to encourage more open land leasing arrangements.

The prospective SAFAs may report a GOL commitment to erect a legal framework giving grazing associations authority to control grazing practices within their defined areas and to institute range user fees. The SAFAs may also call for the introduction of range user fees by 1989/90. Without seeing the content of SAFA I, the PAIP team could not tell what its conditions would be. The draft PFP and MEFP indicate that the SAFAs would be more detailed on monetary and fiscal policies than on livestock policies.

The EPRP's livestock program, developed in consultation with the GOL, spells out the detailed steps the GOL is to take to implement a grazing fee system in 1989.

As Section II-B-2 above attempts to make clear, the principal requirement for progress is not new laws or more information about possible technical solutions. Various technical solutions have been described. The principal requirement now is a political decision to accept the costs of reform to individuals and to commit the government to programs and to discrete actions to address the major problems. The EPRP provides the incentives and the technical support that the GOL agrees will help it to conceptualize and disseminate the prerequisite statement of political commitment and to carry through the implementing steps detailed above in Section III-B. The IMF and the World Bank should be encouraged to support the EPRP lead.

In their final major link, both the prospective SAFAs and the EPRP would assist prospective small scale borrowers. At least some of the private entrepreneurs will have to obtain credit in order to buy Coop Lesotho and TOU facilities, equipment, and other assets and to obtain the working capital needed to enable them to replace Coop Lesotho and the TOU in agricultural input markets. The EPRP would establish a line of credit through a local banking institution for these purposes. The prospective SAFAs may introduce a loan guarantee scheme to improve access by small-scale entrepreneurs to commercial bank loans and may provide for other measures to improve the credit worthiness of such borrowers.

IV. Linkages with Existing Projects

The adoption of appropriate policies and a national commitment to their effective implementation is critical to a nation's social and economic development. This is true of Lesotho with respect to its Agriculture Sector, especially in regard to livestock. While there have been countless programs in agriculture since independence, many have had limited success and then frequently only in one limited geographic area or sub-sector. Numerous programs have suffered from a lack of clear, coherent national policy guidance structured and administered to assure that all the resources--human, material and financial-- are focused on the achievement of a common objective.

It is an unfortunate fact that, in the absence of policy and national commitment, much of a nation's resources, and those provided by their foreign donor partners in development, are wasted on limited technical changes and improvements which, in the long run, produce little serious growth and fail to lay a better foundation for needed growth to occur.

Both the Government of Lesotho and USAID have realized that the lack of clear and comprehensive national policies in the Agriculture Sector has limited the impact of donor contributions and hampered growth. Through the decade of the 80's, USAID and the Government of Lesotho have engaged in substantial policy dialogue flowing from numerous consultancies and over two years of design work for the multi-component Lesotho Agriculture Production and Institutional Support (LAPIS) Project.

This dialogue has borne fruit in key areas: first, the Government of Lesotho has initiated a major reorientation from its long-term persuasion that maximizing production in grains was the proper answer to its principal economic problem; now, current policy stresses production in high value horticulture crops and livestock products more appropriate to Lesotho's conditions. Secondly, it has become clear to Government that the Agriculture Sector offers a major avenue for creating employment opportunities for Lesotho's burgeoning population.

Despite the success of this dialogue to date, however, there has been much less effective result in effecting needed changes in policy in the sensitive areas of farm input supply and livestock production, control and marketing.

As noted herein, input supply has for too long been in the hands of the public sector which has been unable to introduce efficiencies in supply, price, quality and delivery of inputs through Coop Lesotho. In addition, in annual operating losses alone, its inefficiencies have impacted negatively on Lesotho's agricultural production capability.

In livestock, the long-term lack of national level livestock policies has severely handicapped efforts by the Government, USAID and other donors in introducing effective technical innovations for controlling livestock numbers, increasing range productivity and in marketing of large and small stock. By expanding the dialogue between the United States and Lesotho on needed policy changes, and by apportioning needed resources for their effective implementation, this EPRP will greatly facilitate the implementation, focus and positive impact of the Mission's Agricultural Sector Project portfolio in several important ways.

Since 1983, USAID/Lesotho has been in the process of phasing in existing agriculture projects with the LAPIS Project. For example, the Farming Systems Research Project ended in July, 1986 and all research activities were phased into LAPIS at that time. The Land Conservation and Range Development (LCRD) Project will be phased into LAPIS in late 1988. In addition, the existing Agriculture Planning Project was evaluated and changes in project activities were made to ensure meshing with LAPIS objectives. All project activities are now linked and strong lines of communication are now operating among American and Basotho personnel attached to these projects as well as with policy makers in the Ministry of Agriculture.

From the point of view of needed policy changes in Agriculture, the Mission has examined these inter-project linkages and project activities planned to be implemented into the next decade. The examination has revealed that in the area of policy reform in the areas of farm input supply and integration of livestock and production policy and planning, inadequate resources exist in our current projects to assist the Government of Lesotho to tackle these large and important issues. Although substantial progress has been made, for example, in the implementation of a grazing association under the Land Conservation and Range Development Project, the GOL has not issued definitive policies and programs, yet the issues of grazing fees, culling, reduction of livestock numbers and herd improvement on a national level. Therefore, although evident progress has been made in these areas in the existing grazing association program that has been underway since 1983, little or no effort has been directed to incorporating the lessons learned and meaningful successes achieved in the grazing association into an overall integrated livestock policy and action program for Lesotho. Without such a policy and action program, the LCRD activity will stand as a successful but isolated solution to a nationwide and ever-increasing problem.

Regarding farm inputs, the large LAPIS Project, through its Production Initiatives Component, is actively engaged in working with individual farmers and farmer associations to assist them in production of high value horticulture crops. As noted elsewhere herein, the experience of this Project in obtaining the right inputs on time, and in the right place, has been negative to mixed. Coop Lesotho stores near the production sites have been found to lack the needed seed, fertilizer and herbicides, forcing Project implementers to search far afield for sources of supply. And, as a result of GOL edict, local traders in these areas rarely maintain stocks of inputs. Project personnel are concerned that as the extent of Project activities grows input supply problems will increase in step with such growth.

The policy reform efforts to be undertaken through this program will directly benefit project activities in both the LAPIS and Land Conservation and Range Development Projects. LAPIS high value crop production activities will benefit from assured sources of input supply from more efficient private

sector sources. The LCRD Project activities planned (to be continued under the LAPIS Project in 1988) for the implementation of additional model grazing associations for national replication and for intensive livestock production will directly benefit from an integrated livestock policy and meaningful livestock production and action plans

V. Type of Assistance Proposed

The Mission requests that assistance be provided in the form of an ESF cash transfer instead of a Commodity Import Program (CIP). Lesotho's insular geographic position and its peculiar monetary and foreign exchange arrangements have implications for both the type of assistance to be provided and for the subsequent arrangements for monitoring use of the assistance and of the local currency obtained with the assistance.

The circumstances that would make a CIP unworkable also dictate that a single authorization should both release dollars to the GOL and prescribe the use of the local currency bought with those dollars. The authorization would release the dollars to the GOL to be used to obtain a maloti account with the Central Bank of Lesotho on condition that the maloti thus obtained be used by the GOL for expenditures specified in the authorization and included among the acceptable local currency uses cited in Section III-C above. This single-step process will rule out the two steps frequently used in which, first, cash transfer dollars are released on a Mission authorization of use for particular imports and, second, a counterpart fund is established and local currency is released from it on a Mission authorization of use for specified host government expenditures.

These proposals follow from the three circumstances that the GOL and Lesotho's citizens make little use of foreign exchange other than the South African rand, that the rand is for most practical purposes not foreign exchange for the GOL or for Lesotho's citizens, and that Lesotho experiences no foreign exchange shortage. Any one with maloti (with the minor exceptions noted below) can obtain all the foreign exchange they want at the going exchange rate. These circumstances deserve more elaboration in order to explain the two proposals for a cash transfer and for single-step budget support.

The loti and the South African rand are interchangeable for purchases within Lesotho. Exchange rates are realistic, and no black market exists for maloti. Maloti are freely exchangeable for rand for purchases in the RSA. Therefore, for most practical purposes, the rand is not foreign exchange. Since 95 percent of Lesotho's merchandise and nonfactor imports are paid for with rand and some 4 percent of merchandise imports are in-kind foreign assistance, Lesotho makes much less use of foreign exchange than do most nations.

During 1985, only 4.3 million maloti, during 1986, only 9.8 million maloti, were used to buy non-rand foreign exchange to pay for imports. During 1985, 26 million maloti, during 1986, 41 million maloti, were used to buy non-rand foreign exchange to be used for all other purposes; of that 67 million total during 1985-86, some 80 percent was used for debt service.

If that pattern is repeated during 1987 and 1988, when debt service is to be smaller than during 1985-86, some $5 million in non-rand foreign exchange will be bought and used each year to pay for imports; and some $15 million in non-rand foreign exchange will be bought and used each year to service debt and to cover all other non-rand foreign exchange uses. Given such small use of foreign exchange, one should not be surprised that the GOL and Lesotho's citizens are able to obtain, from the Central Bank of South Africa, all they can afford.

A few restrictions do exist. Merchandise imports are licensed according to the RSA's import regulations, but such licenses entitle their holders to whatever foreign exchange is required to pay for imports from outside the CMA. A "financial loti" exists, in parallel with the "financial rand" created to arrest capital flight from the RSA; and in a thin market, it trades at half the value of the ordinary loti (4 maloti to the dollar). But its role is negligible. Some limits also restrict availability of foreign exchange for foreign travel, but these limits exist because Lesotho's foreign exchange regulations must imitate the RSA's. In short, it is only limited income that constrains the ability of the GOL and of Lesotho's residents to buy abroad. Regulatory restraints have only small effects. Lesotho has no foreign exchange shortage at the current realistic exchange rate.

VI. Estimated Dollar Amounts Required

The requested dollar amount for the proposed economic reform initiative is $15,000,000. Four considerations bear on the choice of the dollar size of this EPRP:

1. The direct cost to the GOL to implement the EPRP plus the USAID would need to reserve for the directly funded support activities specified in VI-4 below.

2. The minimum financial leverage required to enable the GOL to take the political-economic steps (with their consequent short-term losses for particular social groups) specified in the conditions.

3. The extent to which EPRP resources can provide imports that will reduce the declines in per capita imports, GNP, and private consumption projected by the PFP, for 1987-90, assuming implementation of the structural adjustment measures described in the PFP and MEFP.

4. The implications of the fiscal deficit of 4-5 percent of GNP (projected under the prospective SAF structure adjustment program) for the fiscal measures cited for support from the local currency counterpart fund and needed to complement the elements in the EPRP.

The direct implementation costs have not been estimated. The team drafting the PAAD should make those estimates.

The minimum financial leverage required to enable the GOL to take the required political-economic steps is a matter of judgment by AID/Maseru. If the amount offered is too small, the reform program may fail.

The third consideration responds to the prospect that even if a series of SAF agreements are implemented, the typical Basotho family will be worse off in 1990 than in 1987.

The draft PFP and MEFP indicate that if SAF agreements are implemented, the performance of Lesotho's balance of payments, fiscal budget, and growth rates will be superior to their likely outcomes in the absence of structural reform. However, the draft PFP projections of a 3 percent decline in per capita GNP and a 5 percent decline in per capita private consumption, 1987-90, show both the severity of the constraints on Lesotho's immediate economic future and the possibility that additional quick-disbursing assistance can improve that future.

Behind the projections of lower per capita GNP and private consumption is the Bank-IMF expectation of continued import compression. Since 1983, despite 2.3 percent per year population growth, Lesotho's import volume has fallen. The draft PFP projects further decline during 1987-88, a leveling off during 1988-90, and small increases during 1990-92. With prospective 2.6 percent population growth, per capita imports would fall, throughout the period. This import compression largely explains the draft PFP projections of falling per capita GNP and private consumption despite the structural reforms.

Lesotho's imports of intermediate supplies, machinery, and equipment are on the order of $125 m a year. Therefore, annual $4 m increments to input and capital imports could add some 3 percent a year to their volume and so to the basis for increased production.

The IMF Executive Directors established the SAF in part to provide a catalyst eliciting additional bilateral support for countries undertaking reforms extensive enough to qualify for SAF arrangements. Lesotho is an archetypical case of a country in which government and citizens will receive few medium-term benefits from extensive reforms unless they receive supplemental quick disbursing assistance.

Without a structural adjustment program, the GOL can expect budget deficits between 8-9 percent of GNP during 1987-92. With the adjustment described in the draft PFP and MEFP, the deficits will be between 4 and 5 percent of GNP, 1987-92. With SAFA restriction on its borrowing, the GOL would be constrained in the range and extent of the programs it can fund. As the list of local currency uses (in III-C above) shows, a wide range of GOL activities complement the elements in this EPRP. If budget constraints restrict those activities, the success of the EPRP might be jeopardized.

The EPRP will alleviate the budget constraint in two ways: first, by reducing the subsidies to Coop Lesotho and the TOU (the PAIP team could not determine the extent to which the PFP deficit projections assume cuts in those subsidies under SAFAs). Second, the EPRP will alleviate the budget constraint through its cash injections to GOL revenue -- net of the added costs the EPRP imposes on the GOL. Since Lesotho's GNP is now at about $600 million per year, each net injection of $3 million will reduce the deficit by one-half of one percent of GNP.

The GOL has embraced reform in large part because of the pressures it has felt to reduce its fiscal deficit. The $15,000,000 is calculated to provide, after meeting the EPRP's direct costs, the incentive of deficit reduction that will induce the GOL to go forward and, simultaneously, the budget support that will help the GOL to maintain the activities listed in III-C as complements to the EPRP.

Fifteen million dollars is recommended as the minimum required to achieve EPRP objectives. With $1.25 million reserved, $13.75 million would be released over some 3 years. With this sum, the GOL could cover the direct costs of the programs, assure provision of the supportive activities, cited in III-C, and overcome political resistance. Part of each tranche would be spent by the GOL to import from the RSA, the rest would be spent in Lesotho, raising residents' incomes and permitting them--in one or in a few rounds of spending -- to import more from the RSA (or, to a small extent, from other countries). These added imports may provide the margin that protects the medium-term welfare of Lesotho's residents and that induces and permits the GOL to carry through its structural adjustment program of economic reforms.

The following disbursements are envisaged:

A. The Input Distribution Reform Package

As objectively verifiable evidence is presented that the Government of Lesotho has executed the reform actions listed for Program Years One and Two in Sections III.A.1 and III.A.2 above, USAID will issue payments for $1,250,000 for Program Year One accomplishments and $3,000,000 for Program Year Two accomplishments.

B. The Livestock Management Reform Package

As objectively verifiable evidence is presented that the Government of Lesotho has executed the reform actions listed for Program Years One, Two and Three in Section III.B.1, III.B.2 and III.B.3 above, USAID will issue payments for $1,500,000 for Program Year One accomplishments, $3,000,000 for Program Year Two accomplishments, and $5,000,000 for Program Year Three accomplishments.

C. Technical and Financial Support for the Reform Packages

In order to facilitate timely implementation of the discrete reforms listed under Sections III.A. and III.B. above, USAID will reserve a total of $1,250,000 from total program funds for the following directly funded support activities:

1. The Resident Program Technical Assistance Team

This team will consist of one specialist to support Government of Lesotho efforts and monitor USAID interests in implementation of the Input Distribution Package reforms and a second specialist to support implementation of the Livestock Management Reform Package. The total cost for this support team is projected at $675,000 (4.5 person/years of assistance at $150,000 per person/year).

2. Short-Term Technical Assistance Requirements

Under the reform program, certain studies and other actions will require direct USAID provision of short-term assistance personnel. These studies and actions are expected to be: the projected national inputs supply survey ($100,000); the meat processing feasibility study ($75,000); the independent appraisal of Coop Lesotho assets ($50,000).

In addition, a total of $100,000 will be retained by USAID for those complementary studies and other actions needed to facilitate implementation of the stated policy reforms.

3. Financial Requirement for the Coop Lesotho Shares Buyout

A total of $250,000 will be reserved by USAID for the direct buyout of the Government of Lesotho's shares in Coop Lesotho and repayment of a portion of the outstanding IFAD loan. However, should receipts from the sale of Coop Lesotho's assets be sufficient to repay the outstanding IFAD loan without USAID financial assistance, the reserved $250,000 will be paid directly to the Government of Lesotho at the end of Program Year Two of the Inputs Distribution Reform Program, provided that all reform actions specified for that Program Year have been properly and fully implemented.

VII. Special United States Interests

U.S. interests in Lesotho lie in the development of its economic and social stability and its long-term economic viability. These interests stem from concern over Lesotho's position as a poor country with severe unemployment, income and quality-of-life problems in the geographical center of an important region of Africa which is undergoing social, political and economic transition.

U.S. development strategies in Lesotho are focussed on agriculture and education. The strategies link agriculture and education in important ways. For example, it is crucial that the primary and secondary educational systems be strengthened in order to provide the kinds of human resources required to contribute to agriculture development in the future. On the other hand, new agricultural technical skill development activities now being developed in our agriculture programs are being adapted for inclusion into the primary and secondary educational systems. This balanced and linked program assistance will aid Lesotho to achieve its long-term goal of self-reliance in terms of decreasing imports and increasing exports of agriculture products, especially with neighboring South Africa. There are, however, significant gaps in the development of needed agriculture sector policy reforms in key areas which, if not completed, will significantly impede the timing for increasing self-reliance.

Adoption and implementation of appropriate agricultural sector policies will support our strategy in Lesotho to increase income and employment opportunities for long-term self-sustained development. Our goals are to assist the nation to transform subsistence agriculture into a commercial, market-oriented sector; to provide opportunities to establish light industries based on agriculture; and to help the Government of Lesotho enhance the relevance of its education system to crucial development needs. Improvement in both sectors will contribute to a more self-sustainable economy, decrease dependence on South Africa, and provide greater social and economic viability and stability.

VIII. Additional Requirements for Preparation of the PAAD

In order to adequately prepare for the preparation of the PAAD, it is recommended that, if possible, the Mission develop the terms of reference for the Agricultural Inputs Survey described in Section III.A.1.d. above and fund the survey for completion before the arrival of the PAAD team.

Additionally, a legal review of all legislation pertaining to agricultural input/output marketing and live animal and livestock product marketing in Lesotho should be conducted in mid-1987. The starting points for such a review are, respectively, the Produce Marketing Corporation Act 1973 and the Livestock Marketing Corporation Act 1973.

With respect to the team required for preparation of the PAAP, it is recommended that it be a four person expatriate group, with appropriate Basotho counterparts. The expatriate specialists should be composed of:

A. An agricultural economist, with experience in analysis of agricultural input supply and output marketing policies;

B. An agricultural economist, with experience in analysis of livestock policies.

C. A macro-economist, with experience in analyzing national accounts and IMF/IBRD economic reform programs; and

D. A business management/financial specialist, with experience in parastatal divestment and private sector business incentive programs.

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GLOSSARY OF TERMS

BLS	Botswana/Lesotho/Swaziland
BEDCO	Basotho Enterprise Development Corporation
BOP	Balance of Payments
CID	Commodity Import Program
CMA	Common Monetary Area
EPRP	Economic Policy Reform Program
GOL	Government of Lesotho
LAPIS	Lesotho Agricultural Production and Institutional Support Project
LCRD	Land Conservation and Range Development
MEFP	Memorandum of Economic and Financial Policies
PAAD	Program Assistance Authorization Document
PAIP	Program Assistance Identification Paper
PFP	Policy Framework Paper
RBSA	Reserve Bank of South Africa
SACU	South Africa Customs Union
SAFA	Structural Adjustment Facility Arrangement
TOU	Technical Operations Unit

NOTICE OF MEETING

TO: See Distribution

FROM: AFR/PD, Carol Peasley

MEETING: Issues Meeting for Lesotho Economic Policy Reform PAIP Submission

● SUBJECT: Attachment to Submission

	ISSUES		ECPR
DATE:	09/16/87	DATE:	09/22/87
TIME:	10:30 - 12:30a.m.	TIME:	2:00 - 4:00p.m.
PLACE:	Room 5951	PLACE:	Room 6941 NS
CHAIRPERSON:	P.B. Thorn	CHAIRPERSON	E.L. Saiers

Attachments: Lesotho AEPRP PAIP Submission

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● ATTACHED PLEASE FIND AN ATTACHMENT TO THE LESOTHO AEPRP PAIP WHICH ARRIVED AFTER THE INITIAL DISTRIBUTION OF THE SUBMISSION. THE TITLE OF THE ATTACHMENT IS "COMMENTS OF THE MINISTRY OF AGRICULTURE, COOPERATION AND MARKETING TO THE USAID POLICY REFORM PAPER."

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Your Reference:

CPO/C/6/01
KMM/GIM

Telephone: 323811 Maseru

CENTRAL PLANNING AND
DEVELOPMENT OFFICE
P.O. BOX MS 630
MASERU 100
LESOTHO

4th September, 1987.

Mr. Jesse L. Snyder
Mission Director
AID
P.O. Box 333
MASERU. 100

UNITED STATES
AID
MASERU LESOTHO

Dear Jesse,

RE: USAID ECONOMIC POLICY SUPPORT PROGRAMME

Please refer to your letter to the Hon. M. Sefali of the 21st July 1987 on the above subject. I hereby enclose a document entitled "Comments of the Ministry of Agriculture, Cooperation and Marketing to the USAID Policy Reform Paper" for your information. These comments represent the Lesotho Government observations on the draft Program assistance Identification Paper (PAIP) and reflect the Government approach to the reform program in the sector under consideration.

As the paper clearly states, Government fully supports the reform actions indicated and is in agreement with the basic thrust of the proposals. As you will note, the comments aim to suggest editorial changes that, in our view, would better represent the situation as we see it. Since we do not have any difficulty with the basic objectives of the reform program, we would highly appreciate your agreement that we move into the next stage of project formulation.

Yours faithfully,

K.M. MANYELI
PRINCIPAL SECRETARY - PLANNING

NAN
Action Taken
File:
Initial
Date

CC: Hon. E. Sekhonyana, Minister, Ministry of Finance
Hon. M.M. Sefali, Minister, Ministry of Planning
Hon. Dr. D. Phororo, Minister, Ministry of Agriculture
Hon. M. Mokoroane, Minister, Ministry of Trade
P.S. Finance
P.S. Agric
P.S. Trade.

Encl..

September 4, 1987

COMMENTS OF THE MINISTRY OF AGRICULTURE, COOPERATIVES AND MARKETING TO THE USAID POLICY REFORM PAPER

Overall, the report needs more editing. It is repetitive and the specific policy intentions are not always clear. A major example is the expected policy relative to Coop Lesotho. The implication from the action statements is that Coop Lesotho will be liquidated while the intention of Government is to achieve privatization by transferring ownership to farmer owned cooperatives.

The paper quite rightly needs to refer to failure of previous policies but the continual emphasis on lack of policy rather than the more judicious acknowledgement that in some cases, notably livestock culling, the issue was lack of implementation rather than lack of policy. Hence, we suggest that instances where there was a policy orientation but limited or no implementation should be identified. We point out where this is the case in this response.

Overall, the Ministry supports the reform actions advocated but we point out below where desired reform policies have been accepted or are already underway. We hope that these comments will be included in the next draft of the report. Hence, our comments to the report should not be taken as indication of a negative response to the document, but an attempt to refine and assist in formulation of a document that provides the reader with a more accurate perspective of the description and implementation of a program of reform which has the basic support of the Ministry of Agriculture Cooperatives and Marketing.

We suggest that all acronyms be included in a Glossary and spelled out the first time for the reader. There are many new terms involved in understanding the new initiatives and a paper such as this one can assist in educating the audience to them.

Similarly, the paper frequently refers to specific facts or conclusions gained from other sources. We suggest that they be cited as they occur.

p.i, para 2

We suggest that the paragraph be rewritten to say:

High levels of employment, in RSA mines, resulting in a reduced

agricultural labor force, combined with recurrent drought which reduced crop yields and retarded pasture recovery has led to overall decline in agricultural productivity from that obtained in the late 1970's. The lack of effective policies designed to curtail the importation of cattle has led to serious rangeland degradation. Existing cropping policies were unable to bring about improved crop production during the period. Repatriated earnings from the export of labor has resulted in a large difference between GDP and GNP accounts. As a result, GDP is less than half of GNP making the country heavily dependent on the continued flow of repatriated mine earnings to maintain current income and spending patterns. Although a predominately rural nation with only 15percent of its population living in urban centers, agriculture provides less than 20 percent to the country's GNP.

p i. para 3, 2nd sentence

We suggest that this sentence be reworded (suggested changes in bold face) Inappropriate government policies and programs, including **costly** subsidies on agricultural input supplies, inefficient and [costly] loss producing parastatal agencies, etc.

p i para 5

The GOL subsidy is incorrect as stated. While the actual GOL subsidy for fertilizer, for the 1987/88 crop year, is 30 percent of cost, the actual subsidy to the farmer is about 21 percent. The remaining 9 percent is absorbed by Coop Lesotho. We are unsure of your source for the level of TOU subsidy and suggest that this figure should be recalculated. Our records indicate that the charge to the farmer for machinery services (plowing, discing, planting and input supply to the field) were M 77/acre in 1986/87. The estimated current cost of providing these services, exclusive of labour cost is about M69/acre based on purchase prices of machinery acquired during the last three years. To achieve the 65 percent subsidy level (e.g. the farmer pays only 35 percent of the total cost of the service, implies that the actual TOU cost to provide the service is about M 220/acre with labour costs at M 151. The total direct GOL administration and operating costs per acre, primarily salaries, wages and transport, (which includes all of TOU operations) were about M 64 in 1986/87. Thus, the 65 percent figure is clearly incorrect.

p. 2 section 1.a), last sentence of the 2nd para

The sentence correctly interprets the desired goal as encouraging

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miners to invest earnings in the agricultural sector. To make this point more forcefully, we suggest the last sentence be rewritten as: "Such improvements are expected to increase incentives for miners to invest their repatriated earnings in the agricultural sector".

p. 3, last paragraph

We question the accuracy of the first sentence of the last paragraph. Mine wage earnings have increased in real terms since the mid 1970's. Wage agreements in the RSA since that time have decreased the gap between earnings of black and white workers and annual earnings increments of black workers have consistently been above the annual rate of inflation. It is reasonable to expect that this trend will continue. Black unions, which have been in existence only since 1979, have been partially responsible for boosting annual wage adjustments of black mine workers above annual increases in inflation levels. The elimination of scheduled worker provisions which, in the past, have prevented blacks from attaining skilled and management positions are likely to be effectively eliminated in the near future. Expected increases in gold prices and improved mine efficiency also will permit mining houses to continue to afford wage increases above inflation rates for black miners. It is estimated that the breakeven gold price is about $300/oz at current cost of production levels. Past trends and expected continuation of relatively favourable wage settlements for black miners suggest that annual increases in wage rates for black miners will continue to exceed inflation levels, at least over the next five years.

p.4 second para from bottom

The reference to farmer subsidies under the FSSP statement differs considerably from that contained in the Executive Summary. In the first instance the 65 percent was associated only with field services provided. In this case the implication is that TOU subsidises 35 percent of the cost of inputs and services and the GOL subsidizes 65 percent implying that either the farmer pays nothing or that they pay an unspecified amount of the 35 and 65 percent, respectively. The statements are very confusing to the reader and do not convey an accurate picture.

p. 4 last paragraph, 1st sentence

The quoted figure of M754,000 represents a net loss of Coop Lesotho from all its operations not just input supplies. This is not clear from the statement in the report.

p 5. 3rd para

It is not clear why the projected decline in import levels is considered a negative factor. During periods of fiscal stress recommended policy is to reduce dependence on imported items. assuming no loss in real terms of mine remittances and a decline in level of imports suggests an increase in net savings which could be invested in the domestic economy. This could well be a positive economic scenario from the perpsective of increasing investment in agriculture.

p.5 last para last sentence

We suggest that this sentence be rewritten in the present tense. Implementation of this programme has already been initiated.

p.6 para 4

The existance of falling miner's remittances requires additional explanation. The decline has occurred during a period of continuing increases in total mine earnings and reflects, in part, leakages in the remittance system. From a macro perspective the loss of these additional earnings has a negative impact on the Lesotho economy but it most likely represents an increased rate of saving and expenditure in the RSA economy. An interest rate gap between Lesotho and the RSA continues to exist which provides incentives for miners to invest an increasing amount of their earnings in the RSA rather than Lesotho savings institutions.

p.6 last para

We suggest that CIP be fully written out since it is the first time it is used.

p. 8, first para, section d

Some additional explanation is required. Lack of information is often cited as a constraint to better market performance. The gains from this added information could be elusive. Prices for grains and pulses are announced by the MOA and remain relatively constant over the year. Fluctuations occur in prices for fresh fruits and vegetables. Low prices at times of peak supply are an expected phenomenon in all fresh produce markets. This is one of the sources of risk to all farmers engaged in production of

horticultural crops. The statement implies that better information can lead to price stability and as such is misleading to the reader. We concur with the statement that transportation costs can be high, especially in remote areas.

p. 8 para 2, 1st sentence

The term "South Africa Customs Union" should be corrected to read "Southern Africa Customs Union".

p.8 para 3, 4th sentence

The statement that Coop Lesotho was established "solely as an apex organization is incorrect". It was established as a farmer cooperative in the late 1950s and was saved from bankruptcy in the early 1960,s by infusion of Government capital. It has provided inputs to farmers since it's initial organization. It did not become the apex organization (which implies organizational leadership of the cooprative movement) until 1980 as part of the restructuring of the organization in light of the demise of PMC.

p. 8 last para

We suggest that the last sentence end with the word "program". TOU has always purchased inputs from Coop Lesotho only the change in the way they were distributed occurred in 1983.

p 9 para 2

Again we question the use of the 56-66 percent subsidies on FSSP as they reflect Coop Lesotho. This is the third different formulation of the cost of the subsidy package provided on FSSP inputs. This one implies that the higher subsidy exists on non-fertilizer programme inputs provided by Coop Lesotho. Because the programme consists of a combination package of inputs and services it is difficult to estimate values of individual components. The total cost reduction to the farmer from use of the complete package of inputs and tillage services is about 40 percent. We suggest that the report use the 40 percent figure as it is the concept most easily understood and conveys an accurate picture of the benefits accruing to farmers.

p.9 para 3

Since the paper was written the Government has adopted and has begun implementing a policy to phase out the existing fertilizer

subsidy.

p.9 second from last para

It would add clarity to the discussion if the paper indicated that Coop Lesotho was formed as a farmer owned cooperative in 1957. It has had a long history of service to Lesotho farmers.

p. 9 last para

The statement that Coop Lesotho is costly to the farmers is technically not correct. Because it is able to provide inputs at costs below those available in the private sector, farmers are better off in the micro sense. They, along with other Lesotho residents, of course, share in the macro loss due to overall inefficiency.

p. 10 first sentence

We suggest that this sentence be rewritten to say "Coop Lesotho has not **functioned** as an Apex organization." This provides a better distinction between what it is as a legal entity and the way it operates in practice.

p. 11 last sentence

The implication of the last sentence that the road system in the highlands of Lesotho is good is not true.

p. 12 last two para

The implication that the private sector can easily provide technical information to the farmer based on experience in other countries is probably overstated. In developed countries where this is true, farmers are a very small minority of the total population reducing the per person cost of providing information. It would not be possible for private traders to provide technical information to all of the Basotho small holders, as implied. It would be possible, however to provide such information to the larger "progressive" farmers.

p. 15 para 1 line 4

The reference to 650,000 animal units is incorrect. We suggest that it be changed to read "in excess of 1,000,000 animal units".

p.15 para 2,3,4

The justification of cattle holding by Basotho in terms of milk production capacity is not accurate. It is surprising that holding cattle for wealth accumulation was not mentioned as a factor. It is suggested that these paragraphs be rewritten and simplified using available MOA Range Management Division source material. For example, the first sentence of para 3 could be improved by substituting the following: "Because of the low proportion of breeding age females in cattle herds, it is necessary to retain all cows to satisfy reproductive requirements".

p. 15 para 6 line 3

change "all" to "most"

p. 16 para 4

We suggest that this paragraph be rewritten in light of policy developments now taking place using appropriate source material.

p.17 first para

We suggest that the first paragraph be rewritten in view of policy changes adopted since the first draft was written.

p.17 sect a) lines 2-3

We suggest that the reference to payment of full economic costs be changed to read "pay economic costs associated with maintanence of livestock enterprises."

line 6

We do not believe that it is possible to implement taxes that are commensurate with the actual amount of damage that is presently occurring.

p.17 general

The summary of the three elements of the livestock management program provide useful guidance to the reader concerning the PAIP programme content. It is suggested that such a summary be provided for the cropping section as well. Perhaps the last section of the livestock section should be moved to a new section under Part II called "Policy Assistance Under the Program". This could

provide an introduction to the specific programatic actions contained in part two. As it now stands, the reader does not really know what the policy initiatives are which are supported by the action statements. This is especially confusing with respect to Coop Lesotho. In this case the Government is committed to transfer of ownership from Government to farmers by reorganizing it as a true cooperative. The suggested action program implies that it will be liquidated. Is this in fact the policy advocated? If so, it or the desired policy should be clearly articulated so that there will be no confusion as to what is advocated.

p.17 sect b

The implication that current MOA policy statements do not reflect a sense of priority is an incorrect interpretation of the available literature. Policy statements, by themselves, do not express a sense of urgency, priority, or action. They simply provide a coherent statement of direction. The resource levels or expected target output associated with implementation statements indicates policy priority and expected emphasis attached to existing policy statements. Thus, combining the policy statements in the MOA 4th Five Year Plan with the Implementation targets yields the priority focus intended for each area. This approach provides Government with an implementation flexibility necessary to respond to unforseen emergencies. A careful reading of the current literature does not result in the conclusion that Government is committed to expanding simultaneously in all directions. If Government did not have policy statements covering all of its areas of activity it would not be possible to develop consistant implementation strategies.

p. 20, para 1 d

The reference to sales tax abolition is not clear as stated. We suggest that it be rewritten

p.21 para 2b

Privatization of the NAFC cannot be carried out within the short time being suggested or implied given its current performance. The authors should rather be talking of supporting an indepth study of that organization which will pave the way for its gradual privatization.

p.22 para 3 (a)

The current land leasing arrangements for urban industrial and commercial sites are inadequate. It may only be added that leases and subleases need not be arranged through LNDC as is the case now with most sites. Freehold ownership is outmoded as the owner could non-develop, underdevelop or misdevelop the land without any governmental control.

p. 25 last para

The system for collecting the annual fee from the owner of each animal needs to be described as the reader is not aware of what is being referred to. The MOA is not aware of the system which is referenced by the report.

p 26, para 5

The last sentence indicating that it has become clear to Government that the Agricultural Sector "offers the best (if not the only) avenue for creating employment opportunities for Lesotho's burgeoning population" is dangerously untrue. The Planning Division of the MOA has developed a model which suggests that if Government is able to achieve the very optimistic target of 2,000 ha. of horticultural crops (this is about double the amount projected by the end of the MOA Five Year Plan) assuming average farm size of 1 1/2 ha., half time employment would be provided for 2660 farm household workers, and for about 1300 seasonal workers working half time for about 11 weeks. (These calculations assume a full time worker is employed 8 hours per day for 6 days per week.) Additional workers can be employed if less work is performed by household workers. These figures suggest that the Lesotho agricultural sector, while able to provide a portion of the necessary jobs for an expanding labour force cannot be viewed as the panacea implied by the statement quoted above. Sectors other than agriculture must share the employment creation efforts.

p. 27 3rd para

It is still too early to develop an overall integrated livestock policy based on lessons learned from Sehlabathebe. Because of the uniqueness of this region it is necessary that other similar programs are shown to be successful. It must be recognized that programs in the improvement of livestock and range management take much longer than the four years experience gained from Sehlabathebe.