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LEAKAGES IN AFRICAN ECONOMIES AND THEIR IMPACT ON AVAILABLE DEVELOPMENT RESOURCES AND ON THE INCREASE OF THE EXTERNAL DEBT

PART II: The Case of Lesotho

The Socio-Economic Research and Planning Division, ECA
and The Council for the Development of Economic and
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REPORT ON

LEAKAGES IN THE ECONOMIES OF AFRICAN COUNTRIES AND THEIR IMPACT ON AVAILABLE DEVELOPMENT RESOURCES AND ON THE INCREASE OF THE EXTERNAL DEBT.

PART II

THE CASE OF LESOTHO

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1.0 HISTORICAL BACKGROUND

Part I of this report showed that Lesotho is the most structurally dependent of the BLS countries. This situation is largely a result of the geo-political position of this small state, since it is entirely enveloped by South Africa and has no access to the outside world except through South Africa and thus lives by the latter's"grace and favour". Although a treaty for British assistance of 1834 confined Basotho[1] to the lands between the Orange and Caledon Rivers and beyond the Caledon to a distance of twenty-five or thirty miles[2], territorial wars with Boers in 1866 resulted in Basotho's serious loss of land when Basotholand was proclaimed British Territory in 1868.[3] Today, Lesotho comprises a tiny 30,000 square kilometres of bare rock between the Caledon and Orange Rivers with only 13%, highly eroded lowlands classified as suitable for cultivation.

The question of loss of land, and the inception of the gold mining industry in South Africa in 1886 were the root causes of the extreme form of dependency found in Lesotho today. The emergence of a wage-earning class through the operation of market forces was clearly inadequate to meet the needs of the South African mining industry. Therefore "extra-economic" methods had to be used to re-inforce the process of forced proletarianization of the Basotho. Central here was the use of the legislative power of the state, particularly the Hut tax which was doubled in 1879[4]. This was followed by the establishment of the monopsonistic South African Chamber of Mines in 1887 and two labour recruiting agencies which established recruiting monopolies. In other words, on the supply side of mine labour were harsh taxes and recruiting monopolies to prevent the competitive determination of wages. On the demand side was the maximum average wage system, a collective agreement of the mining companies (through the Chamber of Mines) not to permit the average wages to exceed a very low maximum rate, together with servile labour laws like the pass laws, the Master and Servants Act etc. This conscious effort by capitalist mining interests (supported by the South African State power) divorced the relationship between demand and supply of Basotho labour and established a system of institutionalised migrant labour composed of a cheap, rightless, and unorganized labour force as is typical even today.

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1. Lesotho Nationals
2. Lord Hailey, The Republic of South Africa and the High Commission Territories, London, OUP, 1963
3. Spense, J.E. Lesotho: The Politics of Dependence, London, OUP, 1968
4. Spence, op cit.

Soil erosion and its reduction of land available for arable farming, the slump in agricultural prices caused by the depressinn of 1928-33, as well as the accompanying sharp drop in Basotholand's exports from £811,057 in the period 1926-29 to £301,872 in the period 1930-33, and the high prices of imports from abroad caused by South Africa's protectionist fiscal policy, forced Basotho men to offer their labour to South African mines."This was essential if taxes were to be paid,exports to balance imports, and a host of new needs to be satisfied. It is estimated that 50% of Basotho men were absent in this way for the greater part of the year and those who worked in the gold mines - 28,653 in 1930,for example - earned a total of £495,686".[5] It has always been argued that improvements in agricultural productivity were very unlikely so long as a sizeable proportion of the menfolk were absent for long periods.

Problems of structural dependence began to show in the fiscal year 1955/56 with a small deficit of R232,000. Grants-in-aid from the British Government were first received in 1960/61, being of the order of R780,000. By 1965/66, the grant-in-aid had increased six times to R4.7 million. However, in October 1965, an ODA mission noted that "This very large increase in the budget deficit financed by the grant-in-aid should have had a stimulating effect upon the economy, for it should have led to a considerable increase in the purchasing power in the hands of the general public. It appears, however, the effect upon economic growth has been relatively small........... As a result, instead of savings being ploughed into urban development .... they have been drained to the Republic of South Africa through the commercial banks, the Post Office Savings Bank and the building societies. Finally, a great part of the increased incomes .... must have led to an increase in imports, with few secondary effects which might otherwise have occurred through the development of local industries".[6]

When the First Five-Year Development Plan was drawn up, the overall objective was to lay foundations for economic development and economic independence. - "For Lesotho, economic independence and economic development are mutually inter-dependent.

5. Spense, J.E. op cit., p. 19
6. "The Development of the Basutoland Economy, Report of the Ministry of Overseas Development", Economic Survey Mission, October, 1965.

Lesotho is dependent on foreign countries for employment and incomes, and even for balancing its budget"[7]. Indeed at this time, almost half of Lesotho's labour force was at any time employed in South Africa; customs revenue formed 53% of local revenue; although heavily dependent on foreign aid for development,Lesotho was a net exporter of capital through the banking system; Lesotho's trade deficit had increased from R3.1 million in 1961 to R20.6 million in 1968, showing that the domestic market was strongly oriented towards the imports of South African manufactured consumer goods, resulting in large balance of payments deficits. These structural distortions are still found today. They account for the largest portion of resource leakages from this tiny poor country to the outside world, especially South Africa.

Lesotho's foreign trade relations and the external sector in general are dominated by South Africa. As such, most of the discussion, except in a few cases related to foreign aid and exports, will largely be confined to Lesotho's relations with South Africa. This, however, does not play down the significance of leakages suffered by Lesotho to some countries other than South Africa.

2.0 THE PRESENT STATE OF DEPENDENCY

Roger Bohning defines dependence as "one-sided and assymmetrical control over welfare and resources"[8] Using the welfare and resource indices for measuring dependence, he found that Lesotho is the most acutely dependent of the foreign labour reserves. Although his measure is more sociological than economic, what is significant is to note that Lesotho's migrant labour earnings explain the vast difference between the Gross National Income and Gross Domestic Product, and largely determine the level of investment, consumption, imports, and Government revenue and expenditure. Lesotho formalized its integration into the South African Labour market in an Agreement signed in 1973.

In 1965/66, 53% of Lesotho's recurrent expenditure was covered by grants-in-aid from the United Kingdom.[9]

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7. Kingdom of Lesotho Lesotho: First Five-year Development Plan 1970/71 - 1974/75, CPDO, Dec. 1970.
8. Murray, C. Lesotho, A Country Case Study, Liverpool Univ. 1981.
9. The Development of the Basutoland Economy, Report of the Ministry of Overseas Development, Economic Survey Mission, Oct. 1965.

However, by 1979/80, customs union revenues had long taken the place of UK grants-in-aid, being 84% of total recurrent revenue and 136% of recurrent expenditure.[10] The Southern African Customs Union Agreement (SACUA) of which Lesotho is a member was formalized in 1910 and its revision in 1969 introduced a new form of dependence which forms the largest single source of leakages from the Lesotho economy by turning the latter into a market for South African products. This integration of Lesotho into the South African economy is re-inforced by the Rand Monetary Agreement (RMA) of 1974 which formalized the circulation of the South African Rand as the sole legal tender currency in Lesotho, South Africa, and Swaziland, and makes way for a free transfer of funds within the monetary area.

Although both SACUA and the RMA incorporate compensation arrangements, what is unique is the inequality of the partners involved in this economic integration, and the overwhelmingly dominant position of South Africa. This encourages streams of resource outflows from Lesotho into South Africa which seem to strongly outweigh the compensation elements. Because of considerable inconsistencies in alternative data sources and therefore a number of questions regarding validity, it is not easy to quantify the extent of Lesotho's dependence. The problem is compounded by the existence of many other forms of integration in the fields of power, communications, tourism, family ties etc. A further complication comes from the fact that the oppressive system of apartheid in South Africa has produced streams of refugees who have strained the meagre resources in Lesotho. This problem is linked to South Africa's policy of distabilizing Lesotho which has led to a diversion of vast resources to non-productive allocations.

Economic distortions caused by this extreme form of dependence force the government to rely heavily on borrowing from commercial banks and on foreign aid. In the fiscal year 1981/82, the budget deficit reached R67 million or 11.7% of GNP. This chronic deficit has stretched the use of foreign resources to include the financiang of large elements of public consumption. The country's propensity to import is also increasing.

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10. Annual Statistical Bulletin, Kingdom of Lesotho, 1981.

In 1966, imports formed 48% of private consumption and 61% of the GDP. However, in 1979/80, they formed 81% and 115% respectively. On the other hand, the percentage of imports covered by exports remained minimal during this period. Looking at the same problem differently, in 1966, private consumption formed 122% of GDP, but in 1979/80, this percentage had risen to 142%. This is a strong measure of the impact of migrant earnings on the Lesotho economy, and signifies a unique ratio of foreign - to domestically - generated income. The JASPA report estimated that in 1969, 50% of customs union receipts were generated by migrant earnings.

In 1980/81, when launching the Third Five Year Development Plan 1980 - 1985, a five page preamble revealed Lesotho's concern over growing dependence. The commodity market, the money market and the labour market form a system of formal agreements which re-inforce leakages from the Lesotho economy in general, and South Africa's capital accumulation in particular.

3.0 Commodity Trade-Related Leakages

Figures for 1980 show that 97.4% of Lesotho's imports come from the Southern African Customs Union area or Common Customs Area (CCA). In addition, 40.6% of Lesotho's exports go to the CCA. When one talks of international trade, therefore, in the case of Lesotho, one is practically talking of the trade relations that Lesotho has with other members of the Southern African Customs Union Area (SACUA). This limitation is strengthened by the fact that customs revenue (1979/80 figures) forms 84% of total revenue and 51% of recurrent expenditure.

Section 3 of PART I of this report made a detailed analysis of the customs union arrangements inSouthern Africa. SACU provides its members with duty - free trade, equal customs and excise duty rates, revenue - sharing arrangements which, since 1969, are related to the current import consumption and production of dutiable goods and have a 42% enhancement factor which acts as compensation for negative effects on less developed members, up to 8 years protection of infant industries in less developed countries against South African competition, and mutual consultation from time to time. In 1965 an ODA Economic Survey Mission concluded that "Under the [customs] arrangements described, import duty and excise revenue cannot be increased in accordance with the fiscal requirements of Basutoland, nor can protective duties be imposed to foster local Basotho industries. To the extent that the Republic has built up South African industries by means of tariff protection and import control, consumer costs will have been raised and Basutoland revenue will have been reduced beyond what it would otherwise have been although there has been no absolute decrease in the yield of the South African tariff, owing to the Republics need to increase dutyrates for fiscal purposes[11]. An analysis of the 1969 revision to the customs union will indicate if the situation has changed, or whether, if there is no change, there is adequate compensation for these adverse effects.

3.1 Lesotho's Economic Position in SACUA

In accordance with article 10 of SACUA, Lesotho passed laws and regulations[12] aimed at implementing the agreement. The map of Lesotho below shows that Lesotho exhibits the true characteristics of an open economy, marked by an innumerable number of border posts, some not even manned by customs officials. It has thus not been possible to get correct estimates of imports into Lesotho. There is a clear case of undercoverage at border posts. Lesotho's settlements are more concentrated . near the border with South Africa, and each of them is independently connected with a trading centre in South Africa. Since imports of goods and services go directly into the numerator of the revenue-sharing formula, under-coverage has a net-effect of reducing the amount accruing to Lesotho. The situation is worsened by the fact that the postal system has become a significant agent of purchasing South African goods but there is no record of declarations by private residents (see Table I). Even if, in terms of the Customs and Excise Regulations, 1972, it is a crime to fail to declare imported goods and services, there is no strict enforcement. The main reason seems to be the fact that imports are not directly connected with revenue collection. A recent development involves the case of unlicenced venders. Many South African companies get unlicenced contacts in Lesotho who import goods through the post office and sell them sometimes up to double their South African prices. . There are no statistics for this kind of trade but the losses to Lesotho involve under-recording of imports, failure to collect licence fees and income tax. Even if SACUA offers Lesotho the opportunity to alter domestic policies to take advantage of the revenue distribution formula, the impact of such policies will always be defused by the openness of the economy. For example, even if the liquor distribution laws provide for the Lesotho Liquor Commission (a parastatal) to be the sole importer of liquor into the country, this law has not been enforced country-wide in that it is generally cheaper to import liquor through neighbouring South African towns than to have it distributed from a single town in the country.

11. Economic Survey Mission op cit. p. 90.
12. The Customs and Excise Order No. 14 of 1970 and the Customs and Excise Regulations, 1972.

MAP OF LESOTHO: BORDER POSTS.

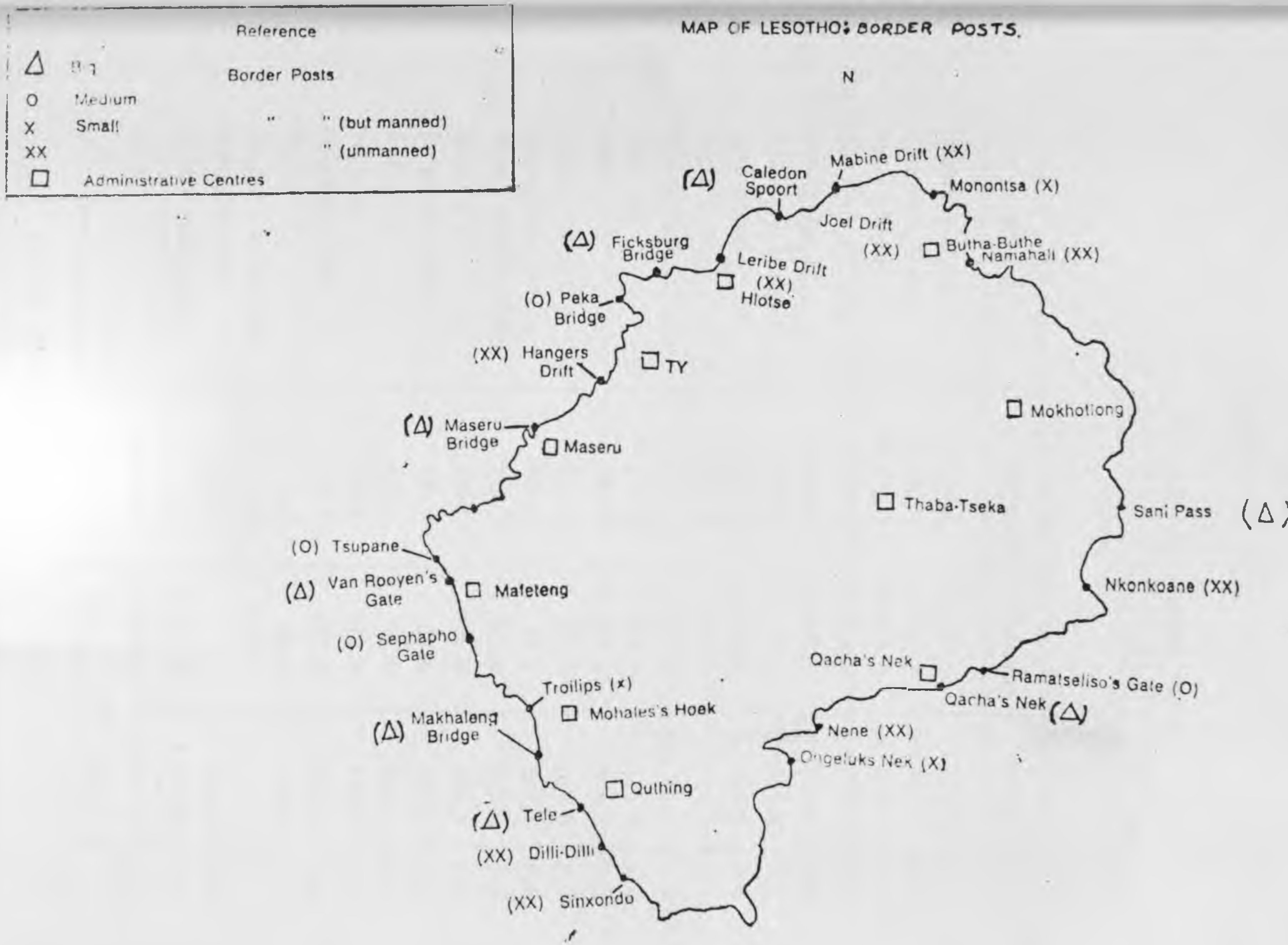

TABLE I

DECLARATIONS AT BORDER POSTS
OF LESOTHO'S IMPORTS BY RETURNING
RESIDENTS AT BORDER-POSTS, 1977/78[1]
(R000'S)

BORDER	PRIVATE	TRADERS	TOTAL	%
Maseru Station	4,463,0	42,666.0	47,129.0	25.3
Ficksburg Bridge	19,888.0	26,477.0	46,365.0	24.9
Maseru Bridge	10,325.0	20,528.0	30,853.0	16.6
Van Rooyen's Gate	5,553.0	10,456.0	16,009.0	8.6
Caledonspoort	1,604.0	7,430.0	9,034.0	4.8
Makhaleng Bridge	2,009.0	5,643.0	7,652.0	4.1
Tele Bridge	2,006.0	4,491.0	6,497.0	3.6
Qacha's Nek	1,875.0	4,149.0	6,024.0	3.2
Maseru Post Office	-	3,384.0	3,384.0	1.8
Sani Top	417.0	1,694.0	2,111.0	1.2
Peka	192.0	1,314.0	1,506.0	0.8
Leabua Airport	325.0	278.0	603.0	0.3
Mokhotlong Airport	986.0	53.0	1.039.0	0.6
Ramats'eliso's Gate	238.0	619.0	857.0	0.5
Monontsa'a	205.0	139.0	344.0	0.2
Ts'upane's Gate	430.0	83.0	513.0	0.3
Sephapo's	143.0	77.0	220.0	0.1
Trollips	53.0	142.0	195.0	0.1
Ongeluk's Nek	21.0	133.0	187.0	0.1
Morifi	6.0	54.0	60.0	-
Hanger's Drift (UM)	-	-	-	-
Mabine's (UM)	276.0	-	276.0	0.1
Liquor Commission	-	5,024.0	5,024.0	2.9
Total	51,015.0	134,839.0	185,854.0	100.0
%	27.4	72.6	100.0	

Source: Customs and Excise Dept.

UM - Unmanned. 1. Several border posts did not have records see Map 1

Table 2 shows Lesotho's revenue receipts from the common customs pool. With the revision of the SACUA in 1969 and the sharp increase in miner's wages in South Africa (and therefore of imports), the significance of customs revenue earnings was clearely established in the late seventies. In real terms, however, the earnings have been somewhat stagnant since 1979/80. Associated with this increase is the distortion in the balance of trade. Table 3 shows that Lesotho is suffering from a chronic balance of trade deficit which has risen from a 1965 figure of R12,835,000 to a 1980 figure of R328,168,000. While there is no doubt that increases in mine labour earnings in South Africa are responsible for the recent sharp increases in imports, part of this increase comes from the impact of customs revenue earnings. Table 4 shows the growing importance of Government as an invester, its share in gross fixed capital formation having risen to 73%. However, the amount is quite small in absolute terms. Of equal importance is government consumption expenditures 70% of which goes towards salaries and wages. It is through this item that customs revenue earnings leak into imports of South African products. In any case, other than the support of imports through civil servants' earnings, the government is itself a very large single net-importer of South African goods and services. Associated with the balance of trade is the distortion of sectoral incomes. As will be shown below, the free flow commodity market, and the domination of the Lesotho commodity market by South African imports have the net-effect of suppressing local productive capacity. Table 5 shows the superiority of the commercial sector in its share of sectoral incomes. This is the sector which services imports of South African goods and services. The ready availability of the latter as well as their superior quality undermine the growth of the manufacturing sector in Lesotho.

TABLE 2

LESOTHO'S CUSTOMS REVENUE
FROM THE SACU REVENUE POOL
1965 - 1984 (R000'S)

FINANCIAL YEAR (t)	AMOUNT RECEIVED (FE+FAs)[1]	INDEX OF AMOUNT RECEIVED	(A+B+C)[2] IN FINAL YEAR (t-2)
1965/66	1,399	22	-
1966/67	1,566	25	-
1967/68	1,934	31	-
1968/69	1,916	30	-
1969/70	4,739	75	-
1970/71	6,317	100	-
1971/72	5,932	94	
1972/73	6,717	106	28,939
1973/74	14,627	232	41,842
1974/75	17,286	274	54,261
1975/76	15,257	241	68,145
1976/77	14,099	223	86,033
1977/78	32,841	520	130,881
1978/79	56,137	887	180,379
1979/80	71,493	1132	205,092
1980/81	71,396	1130	251,378
1981/82	70,806	1121	325,991
1982/83	78,746	1247	377,534
1983/84	109,889	1740	494,585

Source: Department of Customs.

Notes 1. FE - First Estimate, FAs - Final Adjustments.
2. CIF.

TABLE 3

LESOTHO: BALANCE OF TRADE

(M000)

YEAR	IMPORTS	EXPORTS	BALANCE OF VISIBLE TRADE	EXPORTS AS % OF IMPORTS
1965	17,525	4,690	- 12,835	26.75
1966	22,917	4,387	- 18,530	19,14
1967	23,800	4,168	- 19.632	17,51
1968	23,938	3,380	- 20,558	14,11
1969	23,907	4,069	- 19,838	17,02
1970	22,876	3,716	- 19,160	16.24
1971	27,997	2,197	- 25,800	7.84
1972	42,972	6,093	- 36,879	14.17
1973	64,575	8.770	- 55,805	13,58
1974	81,652	9,809	- 71,843	12.01
1975	122,817	9,240	- 113,577	7.52
1976	178,757	14,645	- 164,112	8.19
1977	195,670	12,180	- 183,490	6.22
1978	241,401	30,224	- 211,177	12.52
1979	315,391	37,698	- 277,693	11.95
1980	360,757	44,554	- 328,168	11.95

<u>SOURCE:</u> DEPARTMENT OF CUSTOMS & EXCISE

TABLE 4

GROSS FIXED CAPITAL FORMATION, GOVT EXPENDITURE & VALUE - ADDED (R000'S)

YEAR	GROSS FIXED CAPITAL FORMATION (R000'S) TOTAL	GOVT		GOVERNMENT CONSUMPTION EXPENDITURE	VALUE-ADDED	COMPANSATION OF EMPLOYEES	PURCHASES OF GOODS & SERVICES		
	(1)	(2)	(2)÷(1)	(3)	(4)	(5)	(6)	4)÷(3)	(5)÷(3)
1967/68	4,371	1,680	0.38	6,818	4,033	-	-	0.59	-
1968/69	4,902	3,275	0.67	6,192	4,308	-	-	0.70	-
1969/70	4,912	1,766	0.36	6,137	4,405	-	-	0.72	-
1970/71	5,145	2,761	0.54	6,223	4,321	-	-	0.70	-
1971/72	7,148	3,826	0.54	8,299	4,696	-	-	0.57	-
1972/73	8,642	3,461	0.40	10,756	4,985	7,322	4,794	0.46	0.68
1973/74	10,696	5,220	0.49	12,077	5,505	9,075	3,818	0.46	0.75
1974/75	14,486	5,643	0.39	15,787	5,277	9,535	7,386	0.33	0.60
1975/76	23,490	12,559	0.53	23,126	7,780	15,026	8,781	0.34	0.65
1976/77	38,213	20,862	0.55	25,551	10,461	18,237	8,495	0.41	0.71
1977/78	67,960	51,462	0.76	30,481	12,163	21,068	10,311	0.40	0.69
1978/79	59,617	43,665	0.73	44,369	18,964	31,104	14,031	0.43	0.70

Source: Kizilyalli, H. Options for the Lesotho Economy: Perspective Plan Alternatives, CPDO, Maseru, February 1982.

TABLE 5

SECTORAL INCOMES, GDP AND GNP AT CONSTANT (1970/71) PRICES.

YEAR	Manufacturing mining and energy (1)	Building & construction (2)	Transport (3)	Other +/ services (4)	GDP at factor cost (5)	GDP at market prices (6)	GNP at market prices (7)	Indirect taxes (8)
1967/68	2 902	1 885	290	22 231	48 382	50 841	62 500	2 459
1968/69	2 361	1 909	293	21 985	48 183	50 597	63 000	2 414
1969/70	3 195	1 627	284	21 843	47 485	51 359	63 900	3 874
1970/71	2 873	1 440	305	22 273	47 933	52 486	74 800	4 653
1971/72	2 654	1 923	419	22 857	43 394	47 555	71 900	4 161
1972/73	3 360	2 301	1 004	24 643	52 130	56 700	84 500	4 570
1973/74	4 923	2 847	1 522	27 250	62 826	71 498	107 400	8 672
1974/75	6 995	3 133	1 860	30 811	65 926	75 790	119 300	9 864
1975/76	4 839	3 068	1 258	30 398	61 468	69 514	134 000	8 046
1976/77	4 729	4 238	1 555	30 768	72 927	81 100	153 300	8 173
1977/78	7 136	8 667	2 207	35 410	85 560	95 426	170 500	12 866
1978/79	11 863	6 895	1 939	35 559	90 315	110 045	182 600	19 730

+/ Other services include trade, communications, catering; finance, real estate and business services, non-profit services, community and personal services.

Source: D. Miljkovic, "National Accounts - Lesotho: 1967 - 1979" Bureau of Statistics, March 1981.

3.1.1 Problems of the Revenue Sharing Arrangement

The revenue accrual from SACUA is calculated using the following formula:

$$R = 1.42 \frac{(A+B+C)}{(D+E+F+G)} \cdot H$$

Where R = the amount of revenue that will accrue to Lesotho in respect of a given year t.
A = CIF value (including duties paid or payable) at border of all imports into Lesotho in year t.
B = the value of excisable and sales duty goods produced and consumed in Lesotho in year t.
C = the excise and sales duties paid on goods referred to in B in year t.
D = CIF value of merchandise imports into the SACU area in year t.
E = the customs and sales duties paid on D above.
F = the value of excisable and sales duty goods produced and consumed in the SACUA in year t.
G = the excise and sales duties paid on F above.
H = the common revenue pool of customs, excise and sales duties collected during year t (H = E+G).

Other than problems of double counting and inconsistencies relating to rebates and refunds which were discussed in detail in PART I of this report, we see that since 97.4% of Lesotho's imports come from South Africa, Lesotho directly assists the industrialization of South Africa at the expense of its own productive capacity. However, undermining the latter means a lower B and C which, until now, is almost insignificant.[13] As long as the system of industrial rebates and refunds and the use of tariff and non-tariff barriers favour the industrialization of South Africa at the expense of that of Lesotho, as long as Lesotho's consumption patterns are moulded by South African standards and thus oriented towards the importation of South African consumption goods, B and C in the compensation formula will always remain insignificant.

13. Kizilyalli H. Options for the Lesotho Economy in the Year 2,000: Perspective Plan Alternatives, CPDO, February, 1982

This reduction in the enumerator results in a lower accrual to Lesotho. It must be added that since the incorporation of the stabilization range in the formula to limit the deviations to between 17% and 23% (for BLS as a whole) of the common revenue pool, the difference between revenue accruals and actual payments for Lesotho has always been positive.[14] This means Lesotho still continues to give South Africa an interest-free loan which is equivalent to the compounded difference.

3.1.2 The Price-Raising Effects of Tariff and Non-Tariff Barriers in SACUA

Many Studies have concluded that the present levels of revenue stabilization or compensation in SACUA are inadequate because of the price-raising effects of tariffs in the CCA.[15] Gray and Hoohlo used a sample of 42 commodities representing 29% of Lesotho's imports in 1977, and found that Lesotho's imports from South Africa carried a total tax burden (implicit plus explicit taxes) of 23%. They also suggested a mark-up of 20% over South Africa's ex-factory or ex-farm gate prices for transport charges and wholesale profit margins.

The difference between world prices and South African prices of imports into Lesotho is caused by (i) the explicit taxes, and (ii) the effects on South African prices of imports quotas, restrictions, licensing, of the monopolistic market structure of the South African economy, and of restrictive business practices (these can generally be termed the implicit tax burden). The Lesotho Study showed that for a limited number of commodities, South African ex-factory prices were on average 37.3% higher than the comparable world prices[16].

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14. Department of Customs and Excise.
15. (i) "Estimate of Duty Content of Botswana's Imports" paper presented to the Study Group on the Revenue - sharing Formula, Pretoria, 6 May 1981.
    (ii) Gray, J.G. and Hoohlo, S.G. "The Direct Duty Content of Lesotho's Imports and the Protective Price Raising Effect of Tariff Protection by South Africa", Ford Research Project, Nov. 1978.
16. The Study used 1977 prices. The South African surcharge was ignored and cif prices were obtained by marking up prices by 9%. For transport charges (South Africa to Lesotho) and for other mark-ups, an addition of 20% was made to the South African ex-factory prices to obtain the prices at the Lesotho borders.

The finding of this study is that the total implicit tax burden (including explicit taxes and effects of other protective measures, restrictions, etc on Lesotho's imports amounted to 23.35% or R84.24 million in 1980. This is an indication that the present compensation level is very inadequate.

A study of Tables 6 and 7 gives a false picture in that it gives an average all duty rate of 13.05% for the whole SACU area yet the one for the 1976 imports into Lesotho was given as 6.2%.[17] This would mean the 17% stabilized and compensated revenue rate represents over-compensation for Lesotho. However, a thorough analysis of Table 8 reveals certain hidden elements. In a study of the price-raising effects of duties introduced for the protection of South African industries on the input and output of industries which produce specific product groups, the South African Board of Trade and Industries investigated both the nominal and the effective rates of protection. Lesotho's imports of raw materials are quite insignificant, so the area of concern is the rates of protection for outputs. The mode of the nominal rate of protection for intermediate and final products and capital goods ranges between 21.4% and 24.3%. On the other hand, the mode of the effective rate of protection (excluding raw materials) ranges between 21.6% and 27.9%. This shows that the 17% stabilized and compensated revenue rate does not contain any compensation element in it. These results show that South Africa's manufacturing GDP is increased 22%-28% by protective duties which is a good indicator of the polarization of incomes within the SACUA, and which has to be incorporated into the compensation formula.

Since 1924-25 when South Africa embarked on an explicit and regorous policy of promoting the develop ment of secondary industry behind tariff protection and import control, the distribution of benefits to Lesotho and other small SACUA members was undermined. Industrialization has taken place in South Africa and Lesotho has suffered the trade diversion costs. On the other hand import controls have undermined the revenue arrangements of the agreement and the shares distributable to BLS by reducing the volume of imports into SACUA. The common tariff is simply and carefully tailored to meet the protection requirements of South African industries although in 1978 it generated 4% of the South African Government revenue.

17. Gray, J.C. and Hoohlo, S.G. op cit. see Table 7

TABLE 6

Rates of duty in the SACU Area
(percentage)

YEAR	Total import duty rate 1/ (1)	Sales duty (local) rate 2/ (2)	Escise duty rate 3/ (3)	All duty rate 4/ (4)	All duty rate after compensation 5/ (5)	Rate of revenue paid to BLS after stabilization 6/ (6)
1969/70	8.30	9.97	31.93	14.57	20.69	-
1970/71	7.82	8.32	37.11	13.72	19.48	-
1971/72	7.80	11.15	36.43	14.81	21.04	-
1972/73	6.43	11.16	33.45	14.07	19.98	-
1973/74	6.20	9.28	31.80	12.76	18.12	-
1974/75	5.12	7.32	25.94	9.92	14.08	17.04
1975/76	5.39	8.70	28.50	11.43	16.23	18.11
1976/77	5.21	10.71	30.60	12.98	18.44	19.22
1977/78	9.94	12.72	30.67	16.50	23.42	21.71
1978/79	8.37	10.29	29.94	14.83	21.06	20.53
1979/80	6.26	19.93	21.96	11.40	16.19	18.09
1980/81	4.57	18.03	19.47	9.62	13.65	16.83 7/

Source: Customs Union Commission, in Kizilyalli, H. op cit.

1/ Total amount of customs, sales and ad valorem customs (excise) duties and surcharge collected on imports as a percentage of the duty inclusive value of imports into the SACU area (i.e. cif. value of imports plus the duties collected on them).

2/ Amount of sales duties (local) collected as percentage of the duty-inclusive value of the (sales) dutiable goods.

3/ Amount of excise duties collected as a percentage of the duty-inclusive value of the excisable goods.

4/ Total pool revenue as a percentage of the denominator of the revenue-sharing formula (H/(D+E+F+G)).

5/ Column (4) multiplied by the compensation factor, 1.42.

6/ Stabilized rate applied from 1974/75 on, when the stabilization factor was introduced.

7/ In lieu of this rate the lower limit of the stabilization rate, i.e. 17.0% would apply in the calculation of revenue shares of BLS countries, by section 3 (a) (iv) of the amended Article (14) of theAgreement.

TABLE 7

ESTIMATES OF DIRECT DUTY CONTENT OF IMPORTS TO

LESOTHO - 1976

Item	Imports 1976	Origin		Duty Liability			Direct Duty Content			Total Duty Content 1976	Duty as % of C.I.F.
		RSA	Other	CUS.	1-S	EXC.	CUS.	1-S	EXC.		
Live Animals	2,427	2,427	-	-	-	-	-	-	-	-	-
Foodstuffs	35,301	34,301	1,215	-	-	-	-	-	-	-	-
Beverages & Tobacco	7,863	7,500	363	42.9%	4.8%	36.8%	155.9	17.5	2,760.1	2,916.0	37.1%
Crude Materials	1,295	1,243	52	1.3%	1.3%	-	0.7	0.7	-	0.7	-
Mineral Fuels & Lubricants	11,742	8,881	2,862	43.7%	0.2%	39.1%	1,249.3	6.5	3,476.1	4,725.4	40.2%
Animal and Vegetable Oils	1,561	1,459	102	9.2%	7.6%	-	9.4	7.8	-	9.4	0.6%
Chemical Elements & Compounds	9,525	7,172	2,353	7.6%	7.9%	2.2%	179.4	185.8	160.2	339.6	3.6%
Manufactured Goods Classified by Material	41,809	34,568	7,239	11.1%	7.0%	-	804.6	508.6	-	804.8	2.2%
Machinery & Transport Equipment	22,730	14,083	8,647	6.3%	4.2&	7.2%	541.1	359.7	1,014.4	1,555.5	6.8%
Miscellaneous Manufactured Articles	45,140	39,349	5,791	13.3%	6.3%	2.9%	768.3	362.4	77.3	845.6	1.9%

TABLE 8

RATES OF PROTECTION IN CCA

	Raw Materials	Intermediate Products	Final Products other than capital goods	Capital goods
(1) NOMINAL RATES OF PROTECTION(%)				
Nominal Duties on OUTPUT				
Average	14.9	18.3	23.5	18.7
Median	15.0	18.8	22.6	18.8
Mode	11.1	21.4	24.3	22.5
Nominal Duties on INPUTS				
Average	14.9	14.9	18.3	18.3
Median	15.0	15.0	18.8	18.8
Mode	11.1	11.1	21.4	21.4
(2) EFFECTIVE RATES OF PROTECTION(%)				
Median	13.6	20.2	24.3	17.1
Mode	10.1	27.9	25.1	21.6

Notes: (1) Throughout, the calculations are based on customs duties which exceed 7.5% ad valorem.

(2) The duties on inputs for intermediate products were assumed to be equal to those on the outputs of raw materials; the duties on inputs for final products were assumed to be equal to those on outputs of intermediate products.

Source: Customs Union Commission in Kizilyalli, H. op cit.

The distribution of the welfare benefits and costs of a tariff in SACUA depends on the location of import-substituting protected industries, the location of consumers of their products, and the distribution of revenues and expenditures accruing from the tariff effect. The benefits have almost entirely acrued to South Africa. Lesotho has been affected by the consumption effect of the tariff through higher prices paid for imports and protected goods produced in South Africa. This is the case with all protective instruments used by South Africa ie for all import control measures, quotas, voluntary export restrictions, and non-tariff barriers to trade. While revenues generated by the impact of the tariff on imports from outside the CCA are redistributed to member countries from the common pool, there is no revenue flow from the price-raising effect of South African produced protected goods, and this should be treated as a real cost to the Lesotho economy. On the other hand, it was estimated that in 1976, the trade creation effects of SACU brought South Africa some benefits to the order of R66.1 million yet the Lesotho figure was a mere R1.5 million.[18]

3.1.3 Additional Losses Through SACUA: Transportation

Article 16 of SACUA reads " A contracting party shall afford freedom of transit without discrimination to goods consigned to and from the areas of the other contracting parties" except in the case of prohibited imports. This article is very significant for a landlocked country like Lesotho which has no link with the external world. Since Lesotho has a limited local market, it means it depends heavily on transportation facilities, both for inputs as well as output. Lesotho depends very heavily on transport links with South Africa and long-distance transport for many products inside South Africa is virtually monopolised by the South African Railways (SAR) and permission to use alternative modes of transport is often refused on grounds that the South African Railways has to be protected. Moreover, the tariff structure of the SAR favours foodstuffs and raw materials over manufactured consumer goods. The former are only important for large industries and markets located in South Africa.

Restrictions on transportation and their associated high transport costs make Lesotho unattractive for certain industries, especially footloose industries. These find it difficult to compete with South African industries as a result of high transportation costs for their inputs and products. The tariff rates are not only high, but the rate of losses is also very discouraging. As such, it has proved very difficult to attract assembly industries to take advantage of low labour costs. High transport costs also lower the returns on Lesotho's exports and increase the import bill. The transport tariffs provide an important source of revenue to South Africa without a single element of compensation to Lesotho.

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18. Gray and Hochlo, op cit.

3.1.4 Additional Losses Through SACUA: The Question of Industrial Protection

There is wide scope for selective import substitution in Lesotho in view of the fact that the country imports almost all its consumer requirements and capital inputs mainly from South Africa. Article 6 of SACUA specifies that the smaller members of SACUA may levy additional duties on imports from other SACUA members to enable its new industries to be sufficiently competitive for a period not exceeding eight years. An evaluation of the sources of spare parts, raw materials, energy and expertise, likely implications for transport of manufactures through South Africa or in conveyances controlled by South Africa (ie cargo planes and ships, railway rolling stock, road conveyors etc) and possible new vulnerabilities to South African policy changes in SACU have constrained lesotho in taking advantage of this close.

There is no scope in SACU for Lesotho to develop an independent commercial policy. Indeed when describing this situation, Percy Selwyn says "Small poor countries usually cannot afford highly protective tariff structures, and may indeed have few industries to protect, import duties are more likely to be mainly for revenue purposes."[19] Any protection is likely to lead to changes in the South African tariff shcedules and increased transport tariffs for inputs. South Africa has even used non-tariff barriers to prevent other members from benefitting fully from SACU. In 1971, South Africa prevented Honda from setting up a motor assembly plant in Lesotho, and several sources report disappearances of imports for Lesotho required for manufacturing which go beyond the occassional human error and reflect a conscious pattern of disruption.[20]

Lesotho has thus no option (within SACU) and has resorted to a system of industrial incentives. The Pioneer Industries Encouragement Act, 1969 provides tax incentives for certain manufacturers, hotel and casino keepers, and building companies that are being established or want to expand their operations in Lesotho. The caption from one of the para-statals goes:

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19. Selwyn, P. "Industrial Development in Peripheral Small Countries in Selwyn, P. (ed) Development Policy in Small Countries Univ. of Sussex, 1975.
20. Knotts, M.A. "An Assessment of the Membership of of Botswana Lesotho, and Swaziland in the SACU", Washington DC April 1978.

Table 9

COMPARATIVE TAX INCENTIVES IN BLS COUNTRIES

TYPE	BOTSWANA	LESOTHO	SWAZILAND
Tax Holiday	On application	6 Yrs	None
Investment Allowanes			
(i) Machinery	25%	45%	30%
(ii) Industrial Buildings	15%	25%	30%
Initial Allowances:			
(i) Machinery	None	100%	20%
(ii) Industrial Buildings	None	50%	10%
Depreciation Allowances			
(i) Machinery	Any Rate	Covered above	10-15%[3]
(ii) Industrial Buildings	10% (straight line)	"	4% (str.lin
(iii) Hotels	10% (straight line)	"	10% for 5yrs 5% for 10yrs
Employee Housing Allowance	R1000 per house	25% Inv. Allowance [4]	10-20% p.a.
Employee Training Allow.	125% of cost	210% of cost	200% of cost
Company Tax Rate[6]	30%	37.5%	37.5%
Losses Carry Forward	5 years	Indefinite	Indefinite
Citizen Wage Allowance	None	110%	None
Additional Consessions	Available on Application	Available on Application	Available on Application

Source: Matsebula, M.S. "Tax Incentives in Swaziland, Some Efficiency Considerations" in the Journal of Southern African Affairs. Vol. 2 No. 4, P. 7.

Notes:

1. Includes Hotel buildings
2. Remainder claimable over 20 years on a straight - line basis.
3. Diminishing Balance
4. Remainder claimable over 4 years.
5. 20% of cost written off in first year (but not exceeding M100) 10% in subsequent 8 years (but not exceeding M500)
6. This is 43% in South Africa.

"We know that negotiations with developing countries normally go as smoothly as a car with square wheels. We are in competition with these areas for your investment. That is why we in Lesotho are different."[21]

The 1969 Act in Lesotho was followed by the Botswana Income Tax of 1973 and the Swaziland Income Tax (Consolidated) Act of 1975. Assuming that the aim of industrial incentives is to induce foreign investment at minimum revenues foregone, this heavy competition and the competition with South Africa for industrial location imply that the amount of revenue foregone is higher than the minimum essential to induce the establishment or expansion of foreign owned/financed operations. Table 9 shows that Lesotho offers the most generous incentices among BLS countries. It has however been shown that there are many far more important considerations in industrial location in SACUA than tax incentives.

The amount of financial leakages through highly generous tax incentives can only be appreciated if one considers the fact that the Lesotho Government, through the Lesotho National Development Corporation (LNDC), handles company registrations, licence applications, feasibility studies, equity and /or loan participation, supplies industrial estates (if requred), undertakes several trade/marketing promotion missions abroad, and provides certain services at subsidized rates, eg manpower training. All these subsidies together with incentives which are over and above that minimum which is necessary to induce foreign companies should be treated as financial leakages. It is difficult to assess their magnitude, but since LNDC has led to the birth of 50 subsidiaries in 15 years, this revenue loss is quite significant.

3.2 Marketing Arrangements within SACUA

The marketing of agricultural produce in Lesotho is closely integrated with the South African market. Until mid - 70's, marketing was conducted entirely by traders who were connected to South African marketing boards. The latter regulated the marketing of produce, operated floor price schemes and sometimes introduced subsidies which were extended to Lesotho.

21. LNDC "The Longest Tax Holiday" Maseru (undated brochure).

Local prices in Lesotho thus closely followed those in South Africa. However, the situation was different for those places in remote areas. Because of lack of information and good transport systems, selling prices were much higher further inland, and those for agricultural products, were very low.

In an attempt to rationalize the marketing of agricultural products, the Government passed the Agricultural Marketing Act in 1967, and this empowers the Minister of Agriculture to set up floor prices. Agrarian produce prices are thus gazetted at the end of each harvest season, and they are still heavily determined by South African prices. It should be noted that South African farmers enjoy substantial subsidy schemes and thus produce at lower cost than Lesotho farmers. On the other hand, the Price Control Act, 1979 empowers the Minister of Commerce and Industry to control the prices of manufactured goods in Lesotho but there is no evidence that this power has ever been utilized. We have already seen that under SACU, manufactured goods of South African origin carry a high price-raising effect caused by many protective practices. Monopolistic, traders in the Lesotho inland are thus free to charge anything, yet the farmers have their prices gazetted. Unlike the South African counterpart who is subsidized heavily, the Lesotho farmer suffers from a clear case of transfer of resources through the remote trader to South African industry.

Lack of local productive capacity, as well as lack of information on South African prices opens a lot of room for speculation in the marketing of imports from South Africa. This is worsened by the fact that these imports are dominated by items of necessity with their inelastic demand characteristic. Besides, it is very difficult to envolve a sound price policy for items which are not locally produced as there are no records of inputs used. It is clear therefore that the SACU market structure favours the marketing of South African products at highly monopolistic prices, a transfer element to South African traders and industries.

Lack of productive capacity means that Lesotho's exports are largely dominated by raw materials, particularly wool, and mohair, and grains. These items, purchased at low prices, contribute to the South African transport revenue and taxes, and create imployment during the processing stages before they come back to Lesotho as high-priced imports. For 1979/80, 41% of Lesotho's exports were destined to South Africa, a value of R18.4 million.

3.3 Other Problems with SACU

SACU has intensified Lesotho's dependence on customs union revenues, Since 1969, customs union revenues have ranged between 43.9% and 84% of government recurrent revenues. Since these revenues are budgeted against recurrent expenditures and the latter is dominated by the "Compensation of employees" item, (see Table4), the drain of resources from Lesotho through the continued operation of loopholes in the existing revenue - sharing formula is self-reinforcing, a trend which will be very difficult to reverse.

In SACU, tariff, excise, and sales duty rates are set by South Africa (articles IV and VIII provide for the South African tariff, excise and sales duty rates to prevail throughout the CCA), and rebates, refunds and drawbacks applied in Lesotho (and other smaller members) are those applicable in South Africa. The net effect is that Lesotho has no control over rates of indirect taxation. The geographical position of the country and the free flow of products provided by article2 inhibit action with regard to increased indirect taxation even where this is possible under SACU. The main population centres lie quite close to the frontiers, so it is always possible for increases in tax to be frustrated in effectiveness as a result of movements of goods across borders. On the other hand, since 62.6% of total consumption and capital formation is covered by imports, the implicit cost structure due to SACU taxes and South African protective practices leave little scope for the imposition of additional indirect taxes. This problem has been execerbated by the instability of the revenue yield from customs which has ranged from as low as 9.2% to as high as 26.3%.[22] The flow of revenue itself is threatened by the fluid political climate in Southern Africa. The formula itself, as has been discussed in detail in Section 4 of PART I, has several omissions and elements which undermine accruals to Lesotho.

The loss of fiscal discretion has another implication for industrialization in Lesotho. Inspite of the fact that the GNP in 1979/80 was 591% more than that in 1970/71, the responsiveness of the manufactu-ring sector has only changed very little from a

22. Gray, J.G. "Lesotho's International Economic Relations - Towards Integration or Disengagement in Southen Africa? Ford Research Project, August, 1979.

1972/73 share of GDP of 4.72% to that of 1979/80 of 4.74% The expanding local market demand is thus matched by increased importation of South African manufactured goods. By undermining local productive capacity, therefore, SACU reinforces the polarization of development by encouraging the outflow of resources from Lesotho to support South African industrialization.

Article 20 of SACU provides for consultations amongst members through the Customs Union Commission. However, at the October, 1982 annual meeting of the Commission, South Africa refused to endorse a revised revenue-sharing formula which had been drawn up after 18 months of investigation by an all-party study group.[23] If endorsed, BLS would increase their revenue shares by 10%. The main elements of negotiation were a higher rate of stabilisation factor in duty payments (19% to 25%) and the elimination of a two-year lag in the receipt of full payments.[24] This would have meant a total lump sum payment of R200 million to BLS. After his "Confederation" summit with South African homeland states on 11th November, the South African Prime Minister declared:

"We see the Customs Union not in isolation as a revenue-sharing arrangement, but as part of a comprehensive regional development strategy"[25]

It is obvious from this statement that instead of signing the revised formula, South Africa wants to use the Customs Union as a political lever, specifically to pull BLS into the orbit of the constellation of States that will include the South African homelands and be politically and economically dominated by South Africa.

3.4 Other Aspects of Trade

An examination of Lesotho's exports reveals that 54.6% of their value in 1981 was made up of diamonds and 98.8% of these are destined for the EEC. The sorting and valuation of diamonds as well as selling at the Central Selling Organization in London were the responsibility of De Beers, a subsidiary of the Anglo-American Corporation, until the mine closed down in 1982.

23. African Business, January 1983
24. The Stabilisation formula and the difference between revenue accruals and actual payments were discussed in sections 5.0 and 6.0 of PART I of this report.
25. Rand Daily Mail, 12th November 1982.

Lesotho, other than acquiring some shares, had little control over the operations of this multinational corporation which is based in South Africa. Because of various stages of processing outside Lesotho, and because of commissioning and subcommissioning, the proceeds accruing to Lesotho as well as the multiplier from the export earnings as a whole remained small. In addition, because of wide fluctuations in the diamond market, this single item is responsible for the instability and unreliability of the export sector.

The remaining 1.2% of diamond exports is sold to South Africa. This percentage is handled by several licenced private dealers. It is through this channel that a lot of diamonds are smuggled into South Africa. Official sources think that several millions of Rand worth of diamonds are involved. This is worsened by the nature of deposits which encourage small-scale diggings by a multitude of private concerns not easily supervised. Smuggling is also rife in agricultural marketing. Since 1981, no trader is allowed to purchase agricultural produce except Co-op Lesotho, a national marketing company. To avoid lower prices paid by this company (in order to incorporate transport costs, handling and storage and a mark-up), farmers are known to smuggle their output across the border to take advantage of higher prices paid by dealers in South Africa.

A growing development in recent years involves massive smuggling of cars and high-value commodities stolen from South Africa into Lesotho, by South Africans. These are not declared at the borders and in several cases which are discovered, they are impounded by police who wait for South African claims.[26] The loss to Lesotho here involves reduced Customs revenue earnings, financial losses by Lesotho residents, and administrative costs.

Finally, some foreign aid inflows carry donor conditions which tie procurement to the donor or donor-dominated country even at prices which are far above world prices. Lesotho's Second-and Third-Five-Year Development Plans are dominated by large projects requiring a lot of construction and engineering equipment.

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26. Lesotho Weekly, 9th July, 1982.

This condition, other than raising the level of the external debt for less value (in real terms) implies perpertual reliance on high-cost parts during the maintenance life of a project.[27] Besides, because of undersupply in Lesotho for many project inputs, whatever comes in the form of foreign aid leaks into South Africa through trade diversion. In several cases where donors approve waiver applications to . enable Lesotho to buy from lower cost sources, transport costs and costs resulting from delays in deliveries compel the latter to buy from South Africa. It is estimated that more than 95% of construction materials in Lesotho are imported from South Africa with an inflation rate of 23%.[28] In addition, most of the back-up services for major projects are supported by South African economic infrastructure eg. transport, fuel, electricity, as well as parts. In this way, foreign resources should be seen to be having a large element of direct support for South African industries.

3.5 The Migrant Labour Market

It is not conventional to treat labour as a traded commodity, but from the point of view of migrant labour's contribution to Lesotho's foreign earnings, one should reserve moral judgement. In the 1976 population census, 12.5% of the population was classified absent, and of those absent, 88% or 134,450 were classified as economically active people working in South Africa. Of these 89.7% were males. Table 10 shows and sectoral classfication of those who were 10 years and over (age)by place of work. It can be seen that 41.4% of all the economically active men or 66.3% of all the males employed for wages were employed in South Africa. The volume of wage employment in Lesotho is still very small. In 1980, it accounted for 6.4% (39,328 people) of the total available labour force.[29] Migration to South Africa is therefore the only alternative for a majority of Lesotho's economically active population, particularly males.

The capitalist creation of a labour reserve in Lesotho as well as some of the institutional factors that cement the integration of the Lesotho labour market into the South African one and make Lesotho a typical labour exporting economy have been discussed in sections 1 to 3.

27. It was decided not to cite examples in this case as many projects are either in the pipe-line or second phases.
28 Ministry of Works, Quantity Survey Section.
29. Appiah, K. O.A. "A Report on a Survey of Employment and Manpower in the Private and Parastatal Sectors in Lesotho in 1980, NMDS, October 1981.

TABLE 10

LESOTHO PERSONS 10 YEARS AND OVER EMPLOYED FOR WAGES BY INDUSTRY AND PLACE OF WORK, 1976.

INDUSTRY	PLACE OF EMPLOYMENT LESOTHO MALES	LESOTHO FEMALES	SOUTH AFRICA MALES	SOUTH AFRICA FEMALES	TOTAL MALES	TOTAL FEMALES
Agric. Hunting, Foerstry	2,713	770	458	137	3,171	907
Mining & Quarrying	24,550	703	101,835	1,401	126,385	2,104
Manufacturing	1,852	1,331	2,758	583	4,610	1,914
Electricity, Gas & Water	401	136	260	2	661	138
Construction	6,072	376	3,436	62	9,508	438
Commerce	2,047	2,602	549	493	2,596	3,095
Transport & Communication	2,428	86	1,681	18	4,109	104
Finance	130	50	58	2	188	52
Social Services	18,702	12,987	3,170	7,505	21,872	20,492
Other	1,581	1,037	4,755	1,993	6,336	3,030
TOTAL (i)	60,476	20078	118,960	12,196	179,436	32,274
PERCENTAGE (ii)	33,7%	62.2%	66.3%	37.8%	100.0%	100.0%
ECON. ACTIVE POP'N (iii)[1]	166,465	122,967	120586	13,864	287,051	136,831
(i) as % of the Total in (iii)	21.1%	14.7%	41.4%	8.9%	62.5%	23.6%

Source Annual Statistical Bulletin, 1979.

Note

1. The Economically Active population includes those less than 10 years old.

It is important to emphasize here that the Lewisian models are totally inapplicable in that the South African Labour market threw overboard all the market forces. The gap between supply and demand is closed by the application of extra-economic institutional forces which in general imply heavy costs on the economy of Lesotho.

It has already been said that about 50% of Lesotho's imports are financed from migrant earnings. An analysis of the contribution of the latter on the Lesotho economy is therefore necessary. Section 1.0 above attempted to show how the monopsonistic Chamber of Mines of South Africa manages to pay subsistence wages and still gets an assured supply of labour. This practice itself, as will be shown below, undermines what is due to Lesotho migrants, and largely determines what is finally destined for Lesotho.

The two most important items of migrant earnings are deferred payments and remittances. Those which resulted from Basotho employed in the mines of South Africa use from 1970 to 1979 are shown on Table 11. First of all, these two items are strongly determined by the wages paid to the migrants. Since Lesotho's migrant mine labourers are predominantly black, they earn the lowest tier of wages, averaging R140.0 per month in 1979[30]. The average for white miners was R889.0 per month. The amount which can go to Lesotho, therefore, in the way of deferred payments and remittances is limited. The question of numbers is also important. It can be seen that since, 1976, the numbers of miners recruited began to fall as the South African government began to mobilize black labour within South Africa itself.[31] Even if the relative share of Lesotho in the mine labour market initially increased by 2.5 percentage points up to 1978, the impact of reduced recruitment began to show in 1979 with a fall in the average number employed. On the other hand, the absolute level of deferred payments and remitances increased because of wage increase which were aimed at attracting South African blacks to the mines.

30. "Manpower 2000: Report of the National Manpower Commission", Department of Manpower Utilization, South Africa, 1979.
31. See Table 7 in PART I.

TABLE 11

EARNINGS AND EXPENDITURES OF LESOTHO MINE LABOUR MIGRANTS IN SOUTH AFRICA, 1970 - 1979

YEAR (1)	NUMBER RECRUITED (2)	AVERAGE NUMBER EMPLOYED (3)	AVERAGE WAGE IN MINING[1] (4)	TOTAL EARNINGS IN MINING[2] (5)=(3)x(4)	DERERRED PAYMENTS[3] (6)	REMITTANCE PAYMENTS[4] (7)	OTHER REMITTANCES (8)	RESIDUAL PURCHASING POWER [6] (9)=(5)-[(6)+(8)]
1970	97,185	87,384	18	18,875	2,376	2,062	4,907	9,530
1971	88,012	91,080	19	20,766	2,690	2,018	5,399	10,659
1972	101,515	98,822	22	26,089	3,425	2,393	6,783	13,488
1973	110,978	110,477	29	38,446	4,679	3,963	9,996	19,808
1974	104,374	106,231	45	57,365	7,327	5,136	14,915	29,987
1975	134,261	112,507	74	99,906	12,836	7,160	25,976	53,934
1976	160,516	121,062	88	127,841	17,822	8,240	33,239	68,540
1977	143,204	128,941	100	154,729	16,648	10,956	40,230	86,895
1978	115,044	124,491	118	176,279	20,343	12,925	45,833	97,178
1979	92,823	124,393	140	208,980	22,696	15,441	54,335	116,538

Source: Department of Labour, Mine labour Organization Annual Reports, The Financial Mail.

Notes

1. Rand per month.
2. Rmillion
3. Thousand Rand
4. These have been derived through the application of the Work of A.C.A. Van der Wiel and the JASPA team (see p. 16 of PART I). The assumption here is that the two items involved, cash and goods taken home in hand, have always claimed a fixed share of migrants earnings. This is a crude estimate because it does not take into account adjustments resulting from the implementation of the Deferred Payments Act , changes in transport costs etc.
5. This item refers to migrants purchases of goods and services which are never transfered to Lesotho. It however excludes expenditures - in - kind which are financed from earnings - in - kind and were valued at R200.00 per migrant in 1977/78.

3.5.1 The Disposal of Migrant Labour Earnings.

A fraction of Migrant earnings is deferred until the end of the contract period. The balance is either remitted to the migrant's family or spent on goods and services in South Africa. It can be seen that more than 50% of migrant earnings are "wasted" ie they are spent on goods and services which have absolutely no impact on the Lesotho economy as they are not taken across borders. It is concern over this portion of migrant earnings which made Lesotho pass the deferred Pay Act of 1974 which was replaced by the Deferred Pay Act of 1979. According to this Act 60% of a migrant's earnings should be deducted by the employer and paid into the Deferred Pay Fund which is managed by the Lesotho Bank in Lesotho. An examination of column (6) of Table 11 shows that deferred payments formed a mere 10.9% of total earnings in 1969. This is because of the following loopholes:

(i) If an employee's desired level of remittances is in excess of 20% of his earnings, he is free to request that the excess be set off against 60%.

(ii) An employee can make a written request to spend part of his remittances in the case of emergency.

(iii) Some emploees have "No objection permits" which exempt them from the 60% requirement. Similarly, even if migrants' passports are renewed every four years, an average contract is 6 months. After the first "tour," a migrant can renew his contract without coming back to Lesotho. The 60% requirement is not applicable to subsequent renewals in South Africa. The Act is therefore limited to those cases which have been attested in Lesotho.

(iv) Many migrants do not go through the attestation process as they have private contracts.

It can be seen therefore that by underpaying Basotho migrant workers, and by encouraging expenditure in South Africa, migrant labour promotes an accrual of vast sums of money to South Africa. In 1979, in the mining industry alone, it is estimated that R116.5 million was spent in South Africa on goods and services which were not imported into Lesotho.

Mine wages are unilaterally fixed by the South African Chamber of Mines. If we assume that mine wages are allowed to be as competitive as those in manufacturing[32], we find that in 1979, the total underpayment of Basotho migrant labour amounted to R71.6 million or 34% of actual total earnings (see Table 12).

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32. In South Africa black labour is generally not unionised and it is also controlled by institutional laws like Pass laws which limit the degree of competitiveness.

TABLE 12

COMPARISON OF TOTAL EARNINGS OF BASOTHO WORKERS IN MANUFACTURING AND MINING INDUSTRIES IN SOUTH AFRICA (R000'S, 1970-79)

YEAR	AVERAGE EARNINGS IN MANUF.[1]	AVERAGE NUMBER EMPLOYED	TOTAL EARNINGS (R000'S)	ACTUAL TOTAL EARNINGS IN MINING	RESIDUAL EARNINGS
1970	52	87,384	54,528	18,875	35,653
1971	57	91,080	62,304	20,766	41,538
1972	62	98,822	73,524	26,089	47,435
1973	71	110,477	94,126	38,446	55,680
1974	88	106,231	112,180	57,365	54,815
1975	106	112,507	143,108	99,906	43,202
1976	125	121,062	181,593	127,841	53,752
1977	141	128,941	218,168	154,729	63,439
1978	161	124,491	240,517	176,279	64,238
1979	188	124,393	280,631	208,980	71,651

Source: Department of Labour and Mine Labour Organization Annual Reports.

NOTE. 1. Rand per month.

TABLE 13

WORKING PROFITS IN GOLD MINING CONTRIBUTED BY LESOTHO MIGRANTS (Rmillion, 1971-1978)

Year	Average Number Employed	Profit per Black Employee (Rand	Total Profit Contributed by Lesotho[1]
1971	91,080	929.15	84.6
1972	98,822	1484.54	146.7
1973	110,477	2645.08	292.2
1974	106,231	4556.63	484.1
1975	112,507	3996.82	446.7
1976	121,062	2667.36	322.9
1977	128,941	3671.08	473.4
1978	124,491	4150.00	516.6

Source: Department of Labour, Mine Labour Organization Annual Reports, the Financial Mail.

1. I assume that all Lesotho migrants recruited by the mines were actually employed in the gold mines. This is not an unreasonable assumption bearing in mind that on average, gold mines absorb over 70% of mine recruits.

This amount accrues to South Africa in the form of profits of the Mining industry. Table 13 shows that in 1979, Lesotho contributed R516.6 million to the total working profits of South Africa's mining industry. Lesotho does not gain from this appropriation, either in the form of increased employment or dividends or taxes. According to the Labour Agreement signed in 1963 between South Africa and Lesotho, the employment of Basotho in South Africa is controlled by South Africa in terms of numbers as well as choice of job and level of wages. Even if the agreement provides for the appointment of a Labour Representative (article 1), the functions of such representative (article2) are limited to the collection of deferred pay and remittances, as well as ensuring that the mines have a smooth supply of labour. The agreement does not give him even a limited degree of mandate to negotiate for higher wages or better working conditions.

3.5.2. Additional Losses in the Migrant Labour Market: The Supply Side.

It has been shown above that some migrants do not go through the normal recruiting channels and others will renew their contracts while in South Africa until the expiration of their passports. All these, estimated by the Labour Department to be a very significant proportion of the total supply, are not attested. The Lesotho Government collects an attestation fee of R12.0 per recruit, so the loss in terms of fees foregone (not estimated) is quite significant. This loss in revenue is much higher if one considers the fact that migrants earnings are not taxed. At an average income tax rate of 20%, the revenue foregone in respect of migrants employed at the mines was of the order of R41.7 million in 1979.

The motive force of migrant labour is the increasing effort-price of agricultural production which itself was a result of the expropriation of Basotho from their rich agricultural land by Boers in 1886-7. With the system of migrant labour, women now play a very significat role in agriculture. In 1956, it was estimated that nearly 3/4 of those engaged in agriculture were women[33]. LASA estimates that about 70% of the farm households are managed by women[34] Their analysis of the relationship between migrant manpower "exports" to South Africa and agricultural production gives the following results:

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33. Economic Survey Mission, ODM, Oct. 1965.
34. Wykstra, R.A. "Farm Labour in Lesotho: Scarcity or Surplus? Lasa Discussion Paper No. 5, Min. of Agriculture, Sept. 1978.

	1950	1960	1970	1976
Gross Crop Prod (000MT)	322	248	190	133
Mine Labour Supply (000'S)	34	51	87	120
Area Planted (000 acres)	738	797	856	556
Gross Yield/Acre (200lb bags)	4.8	3.4	2.4	2.6

It is clear therefore that the process of migration, by removing experienced farm managers of able-bodied men and substituting them with women who are already overburdened with a multitude of roles, effectively transforms a significant portion of Lesotho's agricultural output into South African profits. This loss to Lesotho includes outlays relating to preparatory education. In 1977, it was found that 31% of the migrants had standard 4 or higher level of education[35]. There is no arrangement at all for the compensation of this outlay which involved more than 38,200 migrants in 1981.

3.5.3 Additional Losses in the Migrant Labour Market: The Demand Side.

Lung and Skin diseases are very common mine hazards. These and other mine-related diseases were responsible for 27.6% of mine deaths in 1981[36]. In general, mine labour is a risky business, claiming an average of 2.5 lives per 1000 employees. Because there is no comprehensive medical insurance for foreign mine workers, Lesotho bears all the accident and sickness "insurance" costs in check by those who remain in Lesotho, largely women.

The process of migration is largely responsible for the creation of attitudes which do not support the development of Lesotho. Migration is associated with consumption patterns and preferences which are incongruent to the supply situation in Lesotho, and since this can only be satisfied from massive imports from South Africa, migration should be seen as largely responsible for the chronic visible trade deficit suffered by Lesotho. In this way, Lesotho suffers the loss of support for the development of local productive capacity.

35. ILO/NUL Migration Study.
36. Bureau of Statistics Annual Statistical Bulletin. 1981.

4.0 Invisibles and Leakages from the Lesotho Economy

So far, only those leakages resulting from Lesotho's participation in the commodity and labour markets have been considered. These leakages are, however, strongly associated with leakages found in the realm of invisibles. To be discussed below is the integration of Lesotho's monetary and financial markets with those of South Africa as well as Lesotho's public sector. Very little information exists on the former, as well as on a number of other invisibles eg. insurance, technical assistance expenditures, freight etc. This is due to the fact that their significance in terms of impact on the economy (except technical assistance) is somewhat small.

4.1 Lesotho's Monetary System

Part I of this report (section 8.0) gave a brief monetary history of Southern Africa and attempted to show how monetary arrangements in Southern Africa operate and in the South African - dominated Rand Monetary Area. Like Swaziland, Lesotho has utilized Section 2 of Article 2 of the RMA. In 1978, the Lesotho Government passed legislation[37] establishing a Monetary Authority (LMA) with the following functions:

(i) to issue and redeem notes and coins;

(ii) to promote and maintain internal and external monetary stability, an efficient payments mechanism and the liquidity, solvency, and proper functioning of a soundly based monetary and financial system in Lesotho; and

(iii) to foster monetary, credit and financial conditions conducive to the orderly, balanced, and sustained economic development of Lesotho.

The Act, however, specifically stipulates that the currency issued (Maloti) shall be 100% backed by Rand,[38] shall also not violate provisions of the Rand Monetary Agreement.[39] Maloti can only be issued by withdrawing an equivalent amount of Rand from circulation.

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37. Lesotho Monetary Authority Act No. 13 of 1978.
38. Sections 22 (2) and 33.
39. Section 32.

The net effect of this limitation is that the supply of currency by the LMA is automatic with the change in the flow of external funds, ie the currency issued is automatic and not discretionary.

Of interest, however, is a wide range of powers conferred on the RMA by the Act. These include setting ceilings on the required reserves of banks and other financial institutions, regulation of interest and credit, control of foreign assets holdings, advice to government, and performance of incipient functions of banker-of-last-resort. It is worth evaluating what qualitative changes have resulted from the introduction of this legislation. Of course, the apparent observation is that policy makers have no more power than in the original situation where Lesotho was in the monetary circulation area of the Rand. However, a deeper analysis shows steps in the positive direction.

For the first time, there is a deep analysis of monetary affairs, and continuous research and policy recommendations to government.[40] In addition, foreign reserves which were held solely by commercial banks are now channelled through the LMA and invested as a block by the latter. Commercial banks are now required by law [41] to maintain minimum local assets amounting to 85% of the total value of their liabilities in Lesotho, the required paid-up capital, and the reserve account. This means that a pool of liquidity is now possible in the economy. The pooling of earnings and reserves makes it possible to have a diversified portfolio of foreign reserves, and thus offers chances for maximising interest rate earnings by investing in countries where interest rates are more attractive, as well as possibilities for exchange rate speculation. In other words, Lesotho can now spread the risk of exchange rate instability by holding a diversified portfolio of reserves. It can now make direct payments in non-Rand currencies.

Legislatively, the LMA[42] is aimed at being an instrument of achieving economic automony through the use of internal monetary policy, the development of inward-oriented financial institutions, and some degree of control of the external sector through reserves and exchange rate management.

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40. See Central Bank of Lesotho Quarterly Reviews.
41. Financial Institutions Regulations, 1981 (Legal Notice No. of 1981)
42. Now termed The Central Bank of Lesotho, even if its functions have not changed.

Before making an evaluation of success or failure in the objectives of the LMA, it is necessary to make a critical review of the monetary arrangement.

Under an automatic currency issue, the Lesotho Government is deprived of the opportunity to finance a deficit by borrowing at a lower cost from the LMA. This is because there is no part of Maloti currency which is backed by the Lesotho Government securities (ie no fiduciary issue). Since this is a very attractive short-term alternative to direct taxation, Lesotho foregoes a real potential resource. In many African countries, this has been found to be at least 22.1% of the Central Bank claims.[43] This would represent M19.42 million in March 1983. On the other hand, and as is the practice with many central banks, assuming a ceiling of 20% of average annual revenue for the past three years, it means Lesotho is currently foregoing a potential borrowing capacity of M29.29 million, or 75% of the projected deficit in 1983/84.

Even if a large part of maloti currency is imported by giving up real resources to South Africa, there is an "internalized" currency which circulates purely as a medium of exchange and will never be presented for conversion into foreign currency. The Rand that is backing this type of issue is as good as hoarded. This represents a loss in potential funds to finance development expenditure as well as in employment creation and possible additional national income. Generally estimated at 25% of the total currency in circulation, "internalized" currency was more than 4.3 million in March, 1983.

The automatic monetary system deprives Lesotho of effective monetary policy neasures which may be required to stimulate and stabilize the economy especially through exchange rate insulation of the economy from foreign disturbance. It may be argued that it is doubtful if Lesotho could make use of such an instrument, judging from the fact that instruments like moral suation, directives, legislation relating to interest rates, reserve requirements, local assets ratios and credit ceilings, and taxation or subsidization, are there but have been passively used. It is, however, pertinent to note that Lesotho has lost substantial resources through South African exchange rate changes which are only

43. Muzorewa, B.C. "A discretionary Monetary System for Lesotho. Benefit Cost Analysis"

relevant to the promotion of the South African economy.

During periods of moderate inflation, there is a transfer of real resources from money holders to the South African Reserve Bank as the public attempt to maintain the initial real value of their desired balances by adding to their nominal balances. This inflation tax can be estimated as:

$$R = {}^{M}/_{P} \times {}^{dP}/_{P}$$

where R = inflation tax paid to South Africa
M = nominal money stock held by the public in Lesotho,
P = the price level, and
${}^{dP}/_{P}$ = the rate of inflation.

Table 14 shows that using constant 1975 prices, Lesotho has lost an average of M10.68 million a year from 1968 to 1982. This represents 27.5% of the projected deficit for 1983/84.

It should be noted that Lesotho still has no effective lander - of - last resort. This lack of a re-discounting facility possibly explains why (other than the Lesotho Bank) (indigenous) financial institutions have developed slowly. Because of this lack of a true and effective lender-of-last-resort, the Government has often found itself in an embarrasing situation of illiquidity caused by delays in the payment of quarterly customs revenues by South Africa from the SACUA pool, and by delays in disbursements by donors for projects where payments are made on a claim basis.[44] In addition, because of its simplicity, the automatic monetary system will not enable Lesotho citizens to acquire skills required to manage a central banking system.

Lesotho also foregoes the possibility of earning revaluation profits that could accompany well-managed foreign reserves in a discretionary system. However, more revealing on the passiveness of the LMA or the Central Bank of Lesotho is the failure of the whole system to transform savings into domestic investment through the creation of money and credit. Tables 15, 16 and 17 show that there is a progressibe accummulation of surplus liquidity in the commercial banking sector.

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44. Minister of Finance "Budget Speech Presenting the 1983/84 Estimates of Revenue and Expenditure, Parliament of Lesotho, 18th April, 1983.

TABLE 14

LESOTHO: PAYMENT OF INFLATION TAX TO SOUTH AFRICA (CONSTANT 1975 Rmillion)

Year (Y)	Nominal Money (M)	Price Level (P)	Real Money (M/p)	Inflation Rate (dP/p)	Inflation Tax (T)
1978	102.48	1.4025	73.07	0.113	8.26
1979	125.87	1.6120	78.08	0.149	11.63
1980	145.71	1.8745	77.73	0.163	12.91
1981	171.82	2.1820	78.74	0.164	12.91
1982	184.90	2.4080	76.79	0.104	7.95

Source: Calcualted from money and price data in Quarterly Review, Central Bank of Lesotho March, 1983.

Notes:

1. Money (M) is defined as Maloti and Rand with the public together with all bank deposits of the private sector and statutory bodies.
2. The Price level (P) is the Lesotho retail price indices for all items with 1975 set = 1.00.
3. The Inflation rate (dP/p) is the proportional increase in P over the previous year.
4. The Price indices used are those for all urban areas.

TABLE 15

BANK DEPOSITS[1] AND COMMERCIAL BANK'S CLAIMS ON PRIVATE SECTOR AND STATUTORY BODIES

(Mmillion)

	1981	1982				1983
	DEC.	MARCH	JUNE	SEPT.	DEC.	MARCH
Deposits	134.3	147.8	159.7	159.3	167.7	181.6
(a) Private Sector	90.7	98.2	101.8	93.8	99.8	106.0
(i) Demand and call	38.7	42.6	43.8	33.2	37.3	38.8
(ii) Savings	41.7	45.0	46.6	48.6	48.3	51.8
(iii) Time	10.3	10.6	11.4	12.0	14.2	15.4
(b) Statutory Bodies	7.4	9.3	10.5	14.0	17.5	21.8
(c) Deferred Pay[2]	36.2	40.3	47.4	51.5	50.4	53.8
Credit	47.6	53.4	59.5	57.0	57.9	56.4
(a) Private Sector	37.2	43.3	47.0	45.1	47.0	42.5
(i) Businesses	28.5	34.0	36.2	35.4	36.3	30.5
(ii) Households	8.7	9.3	10.8	9.7	10.9	12.0
(b) Statutory Bodies	10.4	10.1	12.5	11.9	10.9	13.9

Source: Central Bank of Lesotho: *Quarterly Review*, March 1983.

Notes:

1. Excluding Government.
2. Deposits of contract migrants. This item should be treated as part of private sector deposits.

TABLE 16

BANK DEPOSITS AND COMMERCIAL BANK'S CLAIMS
1981 - 1983 (Mmillion)

	1981		1982			1983
	Dec.	March	June	Sept.	Dec.	March
Deposits	146.7	161.5	172.6	171.8	180.2	190.8
Private Sector	126.9	138.5	149.2	145.3	150.2	159.8
Statutory Bodies	7.4	9.3	10.5	14.0	17.5	21.8
Government	12.4	13.7	12.9	12.5	12.5	9.2
Credit	77.9	90.7	106.6	82.7	123.3	103.8
Private Sector	37.2	43.3	47.0	45.1	47.0	42.5
Statutory Bodies	10.4	10.1	12.5	11.9	10.9	13.9
Government	42.7	51.0	60.0	60.2	54.5	56.6

Source: Central Bank of Lesotho Quarterly Review, March 1983.

TABLE 17

COMMERCIAL BANKS' MAJOR RATIOS 1978-1983
(M Million)

End of Period	Deposits (1)	Loans and Advances (2)	Credit-Deposit Ratio(3)	Liquid Assets (4)	Liquidity Ratio (5)	Long-term Time Deposits (6)	Ratio of Long-term Deposits to Total 6
	1	2	3	4	5	6	6
1978	65.12	39.44	60.6	34.28	52.6	7.82	12.1
1979	83.99	49.96	59.5	47.06	56.0	8.26	9.8
1980	99.86	69.09	69.2	60.21	60.3	7.76	7.8
1981							
March	105.92	77.40	73.1	74.48	70.3	8.43	8.0
June	102.06	83.81	82.1	65.14	63.8	7.92	7.8
September	100.02	90.64	90.6	63.53	63.5	6.17	6.2
December	110.46	90.25	81.7	82.85	75.0	6.28	5.7
1982							
March	121.23	104.39	86.1	79.30	65.4	6.19	5.1
June	125.25	119.39	95.3	84.30	67.3	8.72	7.0
September	120.38	117.17	97.3	97.45	81.0	11.74	9.8
December	129.77	112.39	86.6	106.23	81.9	8.39	6.5
1983							
MJanuary	133.37	107.32	80.5	114.50	85.9	9.09	6.8
February	137.25	108.41	79.0	121.84	88.8	8.39	6.1
March	136.94	112.97	82.5	114.38	83.5	8.67	6.3

Source: Central Bank of Lesotho.

(1) Excludes Deferred Pay Fund and deposits of non-residents.
(2) Excludes loans and advances to non-residents. Includes Treasury Bills held by banks.
(3) Column 2 as percentage of column 1.
(4) Covers cash reserves, call or demand deposits with banks in RMA, and short-term government securities
(5) Column 4 as percentage of column 1.
(6) Time deposits with a term of more than esix months, as defined in Financial Institutions Act 1973
Deferred Pay Fund deposits are excluded.

TABLE 18

DISTRIBUTION OF COMMERCIAL BANK'S CREDIT[1]
(M Million)

	1981		1982		1983 (March)	
	M.	%	M	%	M	%
Mining	2.6	7	5.0	12	.6	1
Manufacturing	3.0	9	4.1	10	4.2	10
Construction	5.0	14	2.7	6	2.2	5
Other Development Sector	2.9	8	4.8	11	7.1	19
Distributive Services	18.6	53	23.9	55	24.1	59
Other Services	3.0	9	2.6	6	2.4	6
Total	35.1	100	43.1	100	40.6	100

Sources: Central Bank of Lesotho: Quarterly Review Volume II No. 1, March 1983.

1. Excludes Government.

Table 18 shows the distribution of commercial credit. More than 50% of credit goes to support distributive services. This sector is not only dominated by South African traders, transport, and goods, but becomes one of the major channels of channelling funds out of Lesotho through monopoly pricing, inflation, profits repatriation, as well as through undermining the productive potential in Lesotho and increasing the propensity to import consumption goods. The distribution sector's favourable position in the banking system comes from the fact that it has short-term, quick returns, is less risky, and is closely tied to the South African economy. It is thus obvious that the automatic currency system has done little to re-orient the banking sector. Substantial funds still find their way out of the country.

It should thus be stated that Lesotho benefits substantially from its membership of the RMA through pooling of the foreign exchange reserves in the monetary union, guaranteed foreign exchange allocation from the South African Reserve Bank, and revenue from compensation for Rand in circulation. It has been shown above that the open money market carries with it a drain on Lesotho's funds which probably substantially outweigh the benefits. It is obvious that a discretionary monetary system[46] might be more beneficial since it would permint the economy to fully exploit the potential money base which is already implicit in the present automatic monetary arrangement. However, given the conditions of dependency - the weakness of the local productive economy, the commodity trade imbalance, heavy reliance on migrant remittances in an unstable labour market, a high propensity to import, an inadequate domestic resource base for local revenue instruments - there will certainly be a limit as to the degree of monetary independence.

4.2 Leakages Through The Financial system

The integration of Lesotho into the financial system of South Africa dates back to the beginning of the 20th century. The Union Post Office Savings Bank was granted sole right to collect savings from Lesotho in 1911.[47]

46. ie Withdrawal from the RMA
47. Muzorewa, B.C. "The Development of the Monetary and Financial System in Lesotho" Ford Research Project, NUL/CPDO, February, 1979.

The net effect of this joint colonial South African decision was a repatriation of surplus funds from Lesotho to South Africa as well as lower interest accruals to Lesotho citizens (banking in Lesotho), made possible by lack of competition. It also discouraged the development of indigenous savings institutions. It is not possible to establish the exact magnitude of interest costs to Lesotho, but it is known that in 1966, UPOSB collected M887,448 deposits from Lesotho citizens (residents). There is no record of this institution being involved in any medium or long-term projects during this period. The amount of leakages involved in the UPOSB operations can only be seen against contributions that were made by the Lesotho Post oOffice Savings Bank (LPOSB) which replaced UPOSB in May 1966.

LPOSB existed between 1966 and 1971 and by this time, commercial banks were already active in Lesotho, thus, forcing it to pay a competitive interest rate of 4% on savings deposits[48]. What is interesting from Tables 19 and 20 is that by 1966 the savings bank invested zero percent of their funds either to Government or to LNDC. However, in 1971, the share of these two in LPOSB's total investments was 85.1%. Up to 1966 therefore the leakage in ivestment funds was 100% .

Until 1972, there were only two commercial banks in Lesotho which were privately-owned foreign multinational banking companies. Standard Bank of South Africa Ltd (now Standard Bank Ltd) was formed in 1907, while Barclays Bank D.C.O. (now Barclays Bank International) was formed in 1957. Until 1973, these banks operated in a policy vacuum and developed leakage trends whose characteristics and effects are still traceable in the banking sector in Lesotho today. They were not active in the field of savings mobilization since their operations were limited to the urban areas, and also, since they required very high minimum deposits for new accounts in a country marked by general poverty [49]. In 1971, the two banks collected 80% of the total deposits in the country. However, in March 1967, their loan/deposit ratio was only 13%.[50] Even if one allowed them very high cash-reserves ratios, the only reasonable assumption is that their deposits were invested outside Lesotho.

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48. LPOSB collected savings deposits, not fixed time deposits.
49. The minimum savings deposit at Standard Bank is M50.00.
50. Muzorewa, B.C. op cit..

TABLE 19

THE LESOTHO SAVINGS BANK ACCOUNTS
1966 - 1971

	1966	1967	1968	1969	1970	1971
Balance due to depositors (M'000)	880	1014	1041	992	963	1026
Transfers from S. Africa (M'000)	887	178	71	28	19	18
Value of Active Accounts (M'000)	11	14	16	17	19	22
Average Amount/depositor	84	72	65	58	51	46
% interest on dep. acc.	4	4	4	4	4	4
Investments (M'000)	837	1015	1015	1015	995	1081
% interest on investiment (Ave.)	6	6.25	6.5	6.25	6.25	6.25

Source: LPOSB: Annual Reports and Accounts, 1966 - 71 in in Muzorewa, B.C. op cit.

TABLE 20

LPOSB DISTRIBUTION OF INVESTMENT
(Percentage)

Borrower	1966	1967	1968	1969	1970	1971
Lesotho Government	-	17.2	17.2	31.5	32.2	29.6
LNDC	-	-	-	23.0	60.3	55.5
Commercial Banks	60.6	69.0	65.1	45.5	7.5	12.5
S.A. National Industrial Credit Corporation	30.4	13.8	17.7	-	-	-
Total (M'000)	837	1015	1015	1015	995	1081

Source: Culculated from LPOSB: Annual Reports and Accounts, 1966 - 1971 by Muzorewa, BC. op cit.

The short-comings of these foreign banks was recognized shortly after independence. It became evident that a national bank whose objectives were congruent with national goals was necessary. The Government thus established the Lesotho Bank-National Development Bank by Order No. 8 of 1971. Among many, its terms of reference were as follows:

(i) Mobilization of savings in the country with particular emphasis on the rural communities;

(ii) Making loans and advances to industry, trade, agriculture and other development projects in the country bearing in mind the needs to recircle the funds back to the rural communities which supply them; and

(iii) Endeavour to assist Basotho to establish themselves in the various fields of commerce and industry.

The Lesotho Bank is wholly-owned by Government, and according to the First-Five-Year Development Plan, it was supposed to be active and create domestic demand for credit by assisting in the formulation of project proposals. There are indications that the Lesotho Bank has successfully executed its first term of reference. The Bank's total deposits rose from M4 million in 1973 to M121 million in 1982.[51] It has increased its branch network tremendously by penetrating very remote areas. Its success was reinforced by the Deferred Pay Act of 1974 which compels all Lesotho citizens engaged with the mining industry in South Africa to remit 60% of their wages to be kept by the Lesotho Bank until the conclusion of their contracts. Thus, it can safely be said that the Lesotho Bank has demonstrably reduced the wastage of financial resources, thus releasing a lot of resources for development.

A glance at table 21 shows a remarkable shift of balance in the Lesotho banking sector. However, the amazing fact is that despite this success, the Government still banks with the Standard Bank. An examination of Table 22 confirms the Lesotho Bank's assestion that "Lesotho Bank became a pioneer investor in areas which were considered risky and dangerous by other banks".[52] The structure of the Bank's management has been more aggressive in their investment behaviour and thus less subject to risk aversion than foreign owned banks. This is seen by ventures into fixed assets and buildings and loans to government and statutory bodies.

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51. Lesotho Business, Jan. - Feb. 1983
52. Lesotho Business, Jan. - Feb. 1983

TABLE 21

LESOTHO BANK'S POSITION IN THE LESOTHO BANKING SECTOR, 1981[1] (M Million)

ITEM	ALL BANKS	LESOTHO BANK Rand	%
Non-fixed Assets	155.6	100.2	64.4
Total deposits[2]	115.6	63.0	54.4
Fixed Assets	14.8	11.3	76.7
Total Assets	173.9	111.5	64.1
Total Advances[3]	68.6	41.2	60.1
Balances with Central Bank[4]	75.6	50.9	67.4

Source: Lesotho Bank Statement to mark the 10th Anniversary, Ja January, 1983.

Notes:

1. Figures rounded up.
2. Excludes deferred pay.
3. Includes loans.
4. Includes Short-term Investments.

TABLE 22

ASSETS: LESOTHO BANK, 1973-1976[1]
(M Million)

Assets	1975	1974	1975	1976
Investments	2.15	0.06	4.07	4.00
Cash & Bank Balances	0.28	1.10	3.67	7.20
Advances to Customers	2.00	0.90	1.48	4.75
Loans to Gvt. & Statutory Bodies	-	2.47	3.27	4.18
Investment in Fixed Ass. & Building Projects	0.96	2.18	3.04	4.38
Interest in Subsidiaries	-	-	-	-
Costomer's Liabilities	-	-	-	0.21
Per Contra	0.03	0.22	0.35	0.29
Total	5.17	6.93	16.24	24. 99

Source: Lesotho Bank, Annual Reports, 1973 - 76.

It will be interesting, therefore, to examine if there has been a pervassive change in the banking sector which has been introduced by the Lesotho Bank, and if so, what the situation of leakages is like in the face of these changes. Gray[53] used the IMF international Financial Statistics to gather data on 37 African countries for the purpose of computing indices of the commercial bank lending behaviour and deposit structure. .The results are shown on Table 23 Indices (i) to (iii) measure the degree of participation of the commercial banking sectors in their domestic economies. Index (iv) measures the extent of finaincial intermediation by commercial banks, and index (v) gives a crude measure of the stability of the deposit base.

Gray's results show an abnormally low-level of participation by commercial banks in Lesotho's domestic economy.Lesotho also shows the lowest ratio of private sector lending to total financial assets. On the other hand, Lesotho had the highest ratio of foreign to total financial assets (44.2%)[54]. In addition, Lesotho commercial banks had a very low-level of intermediation marked by massive net absorption of private funds. The share of demand deposits in the total deposit base of these banks is very low ie they have a high share of savings and fixed deposits in their total private deposit base. These results are very significant if it is borne in mind that 1977 was a year of high economic activity, with a sudden increase in migrants remittances and aid inflows. These results show that the banking system in Lesotho fails to function as an effective financial intermediary, and the reason can only be found in the abnormally high degree of Structural dependency of the Lesotho economy in general and financial system specifically.

The commercial banks in Lesotho maintained chronic excess liquidity even in circumstances which allowed them to use their overseas head offices [55] as well as the South African Reserve Bank [56] as lenders - of - last - resort. The Commissioner of Financial Institutions noted that excess liquidity was maintained at more than 100% greater than the minimum liquid assets requirement.[57] This observation sheds a lot of doubt whether the presence of a Central Bank would make a difference.

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53. Gray, J.G. "The lending behaviour and Deposit Base of the Commercial Banks in Lesotho - A comparison with 37 countries, Ford Research Project, NUL/CPDO, April, 1979.
54. It should be borne in mind that some countries place ceilings on the amount of foreign asset holdings of commercial banks. However, the difference in this statistic is quite significant.
55. This applies to Standard and Barclays Banks only.
56. Utilizing the Rand Monetary Agreement of 1974.
57. Report of the Commissioner of Financial Institutions, 1977.

TABLE 23

COMPARISON OF LENDING BEHAVIOUR AND DEPOSIT BASE COMPOSITION FOR 37 AFRICAN COUNTRIES WITH LESOTHO (IFS REPORT FIGURES, 1977)

INDEX (Ratio)	RANGE (37 Count.)	MEAN (37 Count.)	LESOTHO (Dec. 77)
Total Domestic Lending To Total Bank Fin. Assets (i)	48.3%-97.1%	82.08%	49.3%
Private Sector Lending to Total Bank Fin. Assets (ii)	24.9%-92.1%	67.1%	24.5%
Foreign Assets/Total Financial Assets (iii)	0.1%-28.5%	7.64%	44.2%
Private Sector Lending to Private Sector Deposits (iv)	34.7%-353.0%	113.6%	34.7%
Demand Deposits to Total Private Deposits[1] (v)	28.5%-92.1%	62.4%	39.1%

Source: Gray, NUL/CPDO, 1979.

1. Note that some countries place ceilings to holdings by Comm. banks.

In granting loans to applicants, banks use standard criteria of collateral, maturity of applicants, risk, repayment period, etc. These are standards only suitable for a more developed economy like that of South Africa. As a result, they have always claimed that there are no "bankable projects" in Lesotho. This is complicated by the fact that, as will be shown below, interest rates in Lesotho banks are closely set against those in South Africa. The profit-maximizing behaviour by the Lesotho banks demands an equalization of marginal returns in Lesotho and South Africa (after allowing for higher "perceived" risk in Lesotho). This is made possible by the free flow of funds within the Rand Monetary Area. In addition, the banks are not aggressive in mobilizing loan customers and do not have specialized staff to assist in the formulation and appraisal of "bankable projects," ie they are passive and not "supply-lending".[58]

In 1973, the Lesotho Government enacted the first legislation[59] to attempt to curb the outflow of funds. This Act. which excepted the Lesotho Bank, stipulates a minimum capital requirement of R100,000 or 5% of liabilities in Lesotho as qualification of bank registration in Lesotho. It further stipulates the creation of a Reserve Account in each bank into which 50% of the net profit will be paid before repatriation or paying of dividends.[60] The minimum capital requirements were set at R50,000 or 5% of the liabilities or R200,000 or 20% of the liabilities for other financial institutions There was a further stipulation that the Government could require a financial institution to invest in Lesotho up to 5% of its liabilities, and to maintain local assets consisting of claims payable in Lesotho equivalent to the value of its liabilities to the public in Lesotho or to the sum of the minimum paid-up capital and the Reserve Account.

There is no evidence that the Government ever used these discretionary powers. The Insurance Act. 1976 is also coached on the same lines except that insurance companies were for the first time required to invest in Lesotho in assets equivalent to the amount required to meet their liabilities and the amount required to meet the liability on account of matured claims under life insurance policies. However, the Financial Institutions Regulations, 1981 increased the minimum local assets requirement to "not less than eighty-five per cent of the aggregate value of its liabilities to the public in Lesotho and its required paid up capital and reserve account."

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58. Muzorewa, B.C. op cit.
59. Financial Institutions Act, (No. 23) 1973.
60. When the reserve account rises to 50% of the minimum capital requirement, this contribution into it from net profit falls to 25%.

This new requirement, however, seems to apply to banks only.

It is thus clear that the Government in its legislation has avoided a direct confrontation with the foreign-owned financial institutions, perhaps for fear to cause chaos in the financial system. They have, however, chosen to work indirectly by creating two additional financial institutions aimed at mobilizing local resources for development in the country.[61]. However, a cursory analysis of the investments financed by these institutions shows that they are heavy promoters of inputs imported from South Africa.[62] The curbing of financial exports to South Africa is not even given prominence in the Lesotho Monetary Act, 1978. The irony of the whole story is that the government banks with the standard Bank Limited, a foreign-owned bank. It does not seem the local licensing of banks has done much in the way of dealing with financial leakages.

Table 24 shows a dramatic divergence between interest rates charged to borrowers (thus making credit very expensive) and the interest rates they pay to holder of time deposits. The average margins were 7.9% in 1981, 9.6% in 1982 and 11.5% in 1983. The situation is worse when savings deposits of the private sector are considered. These amounted to M41.7 million in December 1981 and 48.3 million in December 1981 and M48.3 million by the end of 1982. House-hold savings alone amounted to 92.4% in 1981, and 98.2% in 1982 respectively of the total private sector savings.[63]

These figures serve to underline the importance of household savings as contributors to total funds available to lend. However, the maximum interest rate paid on these (6% in 1983) contasts sharply with the miximum lending rate (20% in 1983), a serious revelation of contradictions in the financial system.

The above analysis attempts to demonstrate that banks in Lesotho (and many financial institutions) are guided by the profit motive. Higher interest rates on saving would be commensurate with the objective of mobilization of wasted resources. However, this would reduce the profit margin of the banks.

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61. See the Lesotho Building Finance Corporation Act, 1976, and Lesotho Agricultural Development Bank Act, 1976.
62. Largely building materials, heavy machinery and fertilizers.
63. When miner's defferred pay deposits are included the these percentages are lower.

TABLE 24

INTEREST RATES OF COMMERCIAL BANKS, PRIVATE SECTOR

1978 - 1983

Per Cent, Per Annum

End of	Interest Charged to Borrowers		Interest Paid to Depositors			
	Minimum	Maximum	Savings Deposits		Time Deposits	
			Minimum	Maximum	Minimum	Maximum
1978	11.0	16.0	3.5	7.0	3.0	8.0
1979	11.0	16.0	3.5	5.0	3.5	7.5
1980	11.0	16.0	2.5	5.0	2.0	7.5
1981						
March	11.0	16.0	2.5	5.0	2.0	7.5
June	13.0	17.5	2.5	6.0	9.0	10.0
September	15.0	18.0	5.0	6.0	9.0	10.5
December	15.0	18.0	5.0	6.0	8.0	10.5
1982						
January	15.0	18.0	5.0	6.0	8.0	10.5
February	15.0	20.0	5.0	6.0	8.0	12.0
March	15.0	22.0	5.0	6.0	8.0	12.0
April	15.0	22.0	5.0	6.0	8.0	12.0
May	16.5	22.0	5.0	6.0	8.0	12.0
June	18.0	22.0	5.0	6.0	8.0	12.0
July	18.0	22.0	5.0	6.0	8.0	12.0
August	18.0	22.0	5.0	6.0	8.0	12.0
September	18.0	21.0	5.0	6.0	8.0	12.0
October	18.0	21.0	5.0	6.0	8.0	11.0
November	17.0	21.0	5.0	6.0	8.5	11.0
December	17.0	21.0	5.0	6.0	8.5	11.0
1983						
January	17.0	20.0	5.0	6.0	5.3	10.5
February	15.0	20.0	4.0	6.0	3.5	9.0
March	14.0	20.0	4.0	6.0	3.5	6.0

Source: Central Bank of Lesotho

To make matters worse, there is a visible absence of foreign-owned banks in remote areas inside the country. These have mainly been limited to urban areas or foreign-dominated enclaves. The real explanation for the apparent lack of credit outlets lies in the existence of interest rates set in the core of the monetary area (South Africa) which prevent the local financial market from clearing without exporting funds to the core.

In conlusion, it should be stated that the structure and performance of commercial banks in Lesotho is so far incompatible with the savings mobilization philosophy and they find it difficult to develop inward or development-oriented policies because of the structural dependency of the financial system. This conclusion applies to theLesotho Bank as well. Even if it has been very successful in the mobilization of savings by establishing branches in the rural areas, the structure of its interest rates and loans distribution are determined by the financial core. This analysis has not gone into the field of insurance and credit companies. These are largely foreign-owned and have their headquarters in South Africa.[64] Insurance, policies are accepted and premiums fixed in South Africa. Transfer payments are immediate through the banks.[65] Credit is approved in South Africa where there are financiers of credit companies which sell goods from their mother companies in South Africa. This financial dependency will be very difficult to fight as long as there is a free flow of financial resources in the sub-region made possible by Lesotho's membership of the Rand Monetary Area.

4.3 Leakages from The Public Sector

Structural dependency has had very pervasive implications for economic management in Lesotho. We have seen that various structural deficiencies and bottlenecks facing the socio-economic system have prevented the optimum allocation of resources. What is evident is that the external/domestic resources ratio of the development budget has increased considerably since independence, reaching a record 2.82 in 1982/83[66]. It must be emphasized from the very onset, however, that heterogeneous and uncertain data makes reliable quantitative analysis of the financial performance of the public sector in Lesotho difficult. An analysis of the current revenue performance of the economy leads one to conclude that various sources of development financing were by passed

64. Except the Lesotho National Insurance Company.
65. The official view is that many Basotho as well as foreigners living in Lesotho maintain bank accounts in South Africa.
66. This ratio has slightly fallen to 2.64 in the 1983/84 budget. If directly-funded projects are included, the ratios increase to 4.21 and 3.75 for 1982/83 and 1983/84 respectively. The slight improvement in the 1983/84 budget is the result of the adoption of austerity measures, particularly in the recurrent budget.

in financial plans in favour of external resources especially that external aid is quicker to mobilize. This ratio of external/domestic resources could probably be lower.

Following the renegotiation of the Customs Union Agreement in 1969, customs revenues together with migrant labour earnings and remittances became a major source of economic growth. A further stimulus was given by the political crisis of the closure of the Lesotho-Transkei border in 1976/77 which resulted in a stream of aid inflows. However, "virtually none of the expenditures financed by borrowings have created a revenue flow back to the Treasury to assist with the servicing and repayment of the borrowing".[67] Most of the expenditure for this period went into the generation of infrastructure (especially roads and buildings)and into social services.

The second consequence of increased migrant earnings, remittances, customs revenues and aid inflows was the emergence of government as a major employer and spender. Mottura[68] found that in developing countries, the high unemployment rate still exerts a social pressure on the public administration to create new jobs. This situation favours the creation of oversized administrative structures which usually require a very low investment outlay per capital and imply an irreversible increase in recurrent expenditures. By 1978, the civil service establishment had grown from close to 5,000 jobs in 1966 to 10,000 jobs with a further provision of up to 2,000 daily paid jobs.[69] The growth of government and the civil service during this period was evidently customs-revenue and aid-induced.

The net-effect of the stimuli was a feedback-effect on customs revenues and further dependence on this single source of revenue by government. The concentration on construction activity and the payment of salaries for civil servants in an economy characterised by undersupply caused a serious hike in the level of imports[70].

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67. Ministry of Finance.
68. Mottura, P. "Savings Mobilization in Developing African Countries" in Mauri, A (ed) Mobilization of Household Savings: A Tool for Development, Millan, 1977.
69. Comparison of the Establishment lists. The vacancy rate was estimated at 20%.
70. For example, statistics show that Government final consumption increased progressively from M10.8 million in 1972/73 to M52.3 million in 1979/80.

Table 25.

Resources and Expenditure - 1970/71 to 1979/80

(in Current Prices)

Unit: Million Maloti

Period	Resources				Total	Expenditure			
	G.N.P. at Market Prices	Net Factor Income from Abroad	G.D.P. at Market Prices	Imports of Goods and Services		Private Consumption	Government Consumption	Gross Capital Formation	Export of Goods and Services
1970/71	74.8	22.3	52.5	28.6	81.1	63.2	6.2	6.0	5.7
1971/72	76.3	25.8	50.5	36.3	86.8	63.6	8.3	8.1	6.8
1972/73	95.8	31.5	64.3	52.0	116.3	85.5	10.8	9.9	10.1
1973/74	132.3	44.5	87.8	69.4	157.2	116.0	12.1	16.3	12.8
1974/75	158.1	60.1	98.0	96.1	194.1	146.9	15.8	17.3	14.1
1975/76	212.0	101.0	111.0	139.5	250.5	183.9	23.1	27.3	16.2
1976/77	269.1	125.8	143.3	191.0	334.3	241.0	25.6	46.7	21.0
1977/78	331.4	145.0	186.4	228.4	414.8	286.5	30.5	80.2	17.6
1978/79	405.9	156.1	249.8	266.1	515.9	351.4	44.4	79.7	40.4
1979/80	442.4	181.8	260.6	338.5	599.1	384.8	52.3	103.6	58.4

The accrual of customs revenue and migratory labour benefits (wage increases) and heavy aid inflows were directly related to the failure of the Lesotho economy to retain and circulate resources within the economy. This loss of purchasing power manifested itself from the fact that imports as a percentage of GDP rose sharply from 61% in 1966 to 129.9% in 1979/80 (see Table 25).

The combined effect of non-productive investment, revenue leakages and a large civil service is further dependence on foreign aid and customs revenues and remittances. In the first three years of the 3rd plan, the government heavily relied on short or medium-term borrowing at commercial rates of interest. Table 26 shows that the magnitude of public debt expenditures has risen sharply, its weight claiming 34% of budgeted recurrent revenues for 1983/84. The interest charge alone has risen forty-fold from 1978/79 to 1983/84.

If public expenditure commitments exceed expansion in the absolute revenue capacity of the public sector, the government may achieve subsequent investment levels only through underfinanciang of on-going projects[71], and thus, with losses of project productivity and further reduction in the revenue base and increases in the burden of debt. In presenting the 1983/84 estimates of revenue and expenditure, the Lesotho Minister of Finance, in addressing himself to the recurrent overexpansion, reiterated that the government would"see a continuation of the policy of consolidation and austerity."[72] We have already seen that the financial leakage to both the local private banking sector and donor sources operates through government indebtedness which is only partially caused by recurrent overexpansion. It is therefore very doubtful if a mere freeze on the growth of the development and recurrent budgets, without complementary policies (eg in investment selection), will produce the desired results.

There are additional possible explanations to the rapid increase in the public debt in Lesotho. The level and composition of investment is managed by the Central Planning and Development Office (CPDO) while the recurrent budget is managed by the Ministry of Finance. Their decisions are generally not integrated at the sectoral level.

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71. Heller, P.S. "Public Investment in LDCs with Recurrent Cost Constraints: The Kenyan Case" in Quarterly Journal of Economics, date?
72. Hon. K.T.J. Rakhetla "Budget Speech Presenting the 1983/82 Estimates of Revenue and Expenditure 18th April, 1983.

Table 27 shows that even if savings could be adequate at the macro-level, there would be no gurantee for intersectoral flexibility to meet induced budgetary flexibility in each sector. The allocations for 1982/83 form a good expample of disintegrated financial planning and possibilities for lower investment productivity.

The above problem has been worsened by the fact that past contractual obligations restrict the degree of flexibility in response to fluctuating financial conditions. In addition, the unwillingness of donors to finance the domestic component [73] of public investment (counterpart contribution) has caused a serious neglect of a thorough scrutiny of the recurrent allocation in preference for concentration on raising sufficient savings to "match-up". On the other hand, a lag (sometimes up to many years) between local direct financial support to the donor-funded development programme in the form of government advances on the one hand, and actual disbursements on the other hand has forced the government to turn to the commercial market and thus incur interest costs. Such advances against projects as well as to public officers (car-purchase advances) amounted to M1,550,734,44 or 1.5% of the development budget in 1982/83.[74]

National accounts figures show that the national saving rate averaged between 6% and 7% in the period 1972/73 to 1976/77, and reached its peak in 1979/80 when it averaged more than 10%. Between 1979/80 and 1982/83, gross national savings fell by 76%.[75] This trend can only be understood if balanced against final consumption and imports figures whose sky-rocketing only serve to underscore the amount of leakages into the South African economy as well as the chronic deficit facing the government. It has already been shown how the growth of the Lesotho economy is undermined by the price-raising effect of South African import controls into the Customs Union Area. Government final consumption, having increased progressively from M10.8 million in 1972/73 to M52.3 million in 1979/80 is partly responsible for this loss through imports. A pertinent point to raise here is that in the late seventies and early eighties, the Lesotho Government enacted legislation as an instrument of controlling the leakage of resources through bank financial transfers.

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73. This has become a very important project selection criterion in CPDO.
74. This was a year of severe austerity. The % must have been much higher for previous years.
75. See Table 28

TABLE 27

COMPARISONS OF CAPITAL (DEVELOPMENT) AND RECURRENT ALLOCATIONS: SELECTED MINISTRIES 1982/83* (R Million)

MINISTRY	Revenue	Capital Allocation	Recurrent Allocation
Agriculture	0.6	10.9	8.2
Health	0.7	2.7	8.0
Education	1.0	1.6	23.8
Commerce & Industry	0.8	0.9	1.2
Defence	0.1	0.4	17.8
Water, Energy, Mining	19.1	10.7	0.9
Works	0.0	13.8	9.8
Rural Development	0.0	1.6	4.2
Interior	1.1	2.4	5.1

Source: The Treasury.

* Notes:
1. The fact that some development projects have in-built costs has not been considered.
2. Intersectoral Projects (particularly buildings) have not been considered.
3. Some Ministries recurrent allocations are meant for development projects appearing in other Ministries allocations.
4. Production-functions differ from Ministry to Ministry although labour-using methods are generally encouraged.

TABLE 28

SAVINGS AND INVESTMENT 1979/80-1982/83
(R million current prices)

	1979/80	1980/81	1981/82	81982/83
Gross National Savings	82.3	63.0	33.6	19.7
Government	11.1	- 13.0	- 23.6	4.6
Private	71.2	76.0	57.2	24.3
Net Borrowing from Abroad	21.3	42.6	77.4	84.3
Gross Domestic Investment	103.6	105.6	111.0	104.0
Government	44.7	45.7	49.0	46.0
Private	58.9	59.9	62.0	58.0

Source: Ministry of Finance, Central Bank, and IMF.

However, banks have counteracted by actively financing imports of South African goods. There is a strong possibility that the effect of legislation has been neutralized through an active support of different forms of leakages, and harder ones to fight because of the provisions of the Customs Union Agreement.

The revenue and aid accruals of the 1970s as well as substantial inflows of migrant earnings and the proliferation of projects was accompanied by "a progressive decline and laxity in the management of the financial affairs of the Government".[76] The cases cited for the period 1975/76 to 1977/78 include lack of control over government transport, disregard of tenderboard procedures, loss of security consciousness, lack of prompt action on staff movements, lack of safe custody of accountable documents, lack of control over revenue collections, excessive motor mileage claims by civil servants, and lack of reliable records for the control of public assets. According to the audit report, the state of public accounts for these three years was "most appalling" and the contributory factors were as follows:

(i) Serious errors and omissions in the recording of financial transactions and accounting information;
(ii) Absence, in the majority of cases, of documents in support of recorded transactions;

76. "Report of the Auditor-General on the Public Accounts of Lesotho for the Three Years Ended 31st March 1978" p.5.

(iii) Chaotic storage of accounting records and source documents; and
(iv) High incidence of disagreement between financial statements data and the Treasury books of accounts.

There were vast differences during this period between the reconciled cash accounts and the relevant statements of cash balances for the three years as follows:

Financial Year Ended	Per Bank Reconciliation	Per Statement of Cash Balances	Progressive Difference
March 1976	R2,843,128	R2,965,323	R- 122,195
March 1977	2,737,333	1,860,630	876,703
March 1978	4,639,674	2,170,227	2,469,447

This form of financial mismanagement is summarized by the Auditor-General in his statement "Widescale financial indiscipline has led to disregard of financial regulations and instruction and has culminated in the breakdown of accounting controls that has reached catastrophic dimensions in recent years". Financial leakages involved during this period run into several million Rand and involved both large-scale mismanagement and embezzlement.

4.4 Foreign Aid-Related Leakages

Most of Lesotho's development projects are supported from massive inflows of foreign aid. As was seen above, the foreign/domestic resources ratio was 2.82 in 1982/83. Local resources are generally used to provide counterpart contribution. Lack of highly experienced local consultants managers, and technicians operates to undermine the foreign aid multiplier. Except board and lodging, consultant fees hardly find their way to Lesotho, and for large projects, these are very significant. For example, the feasibility study for the proposed Highland Water project (of an outlay of $1.5 billion) is estimated at R12 million.[77] Because of the shortage of local technical expertise, Lesotho has to resort to international tendering for most of the jobs requiring consultancy. Usually, most of the consulting engineering companies have subsidiaries in South Africa who actually do the execution.

77. Sunday Times 25th July, 198[illegible]. The Courrier No 77 of January - February, 1983 put this cost as ± 5 million ECU.

Judging from the mumber of these large scale projects in the development budget, the amount of foreign aid which leaks through this channel involves several Rmillion. Since there is no local preference in the selection of tenders, large projects in Lesotho should be seen to lead to losses in resources in the stages of prefeasibility and feasibility studies, that of contractors, and finally, in the stage of management contracts.[78]

Technical assistance agreements in Lesotho amounted to $49 million.[79] Salaries of technical assistance personnel do not only absorb a significant proportion of total development assistance but are tax-free. At an average of 20%, this represented a loss of $9.8 million revenue on the part of the Lesotho Government in 1979. Several bilateral and multilateral agreements only pay a small fraction of expatriate salaries in local currency. The major portion is paid into bank accounts in international metropolises of donor countries. The impact of expatriate salaries on the economy of Lesotho is therefore negligible. Closely related to this point is the question of training components of the development programmes. In 1969 it was estimated that 360 Basotho students[80] were in higher eduction institutions abroad. This represents 34.4% of those enrolled at the local university. Most of the scholarships offered by donor countries do not give Lesotho the option of where to train. Because of the high cost of education (and sometimes its irrelevance) only a limited number of students can be trained from donor funds abroad

Several donor inputs in many development projects are purchased by the donors themselves. The procurement of these, particularly in the case of vehicles and equipment, bypasses the Lesotho banking system as the money never reaches Lesotho. Other than costs caused by delays in delivery, money is lost into transport.

4.5. Other Public Sector-Related Leakages

A more pervasive and, recent phenomenon is the diversion of development funds in order to make good damages to Lesotho property and installations caused by South Africa's acts of distabilization and sabotage against its neighbours. An estimated R27 million has been diverted from development to security.[81] The damages here involve attacks on water installations, fuel depots,

78. Particularly in the Hotel trade.
79. UNDP "Development Assistance; Lesotho 1979" Maseru, 1980.
80. JASPA Report.
81. "Lesotho Uses Growth Funds for Security" in the Zimbabwe Herald, March 9, 1983.

TABLE 26

GOVERNMENT PUBLIC DEBT EXPENDITURE
1978/79 - 1983/84
(R million)

	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84 *
Interest Charges (1)	0.5	1.0	4.2	8.0	16.1	20.2
Amortization (2)	3.3	6.5	3.8	11.4	21.3	36.7
Total (3)	3.8	7.5	8.0	19.4	37.4	56.9
(3) as % of Recurrent Revenue **	5%	8%	8%	17%	28%	34%

Source: Ministry of Finance.

*Revised budget.
**The Public debt servicing is here related to Recurrent expenditure instead of exports because its impact on foreign exchange availability is totally absorbed by the Rand Monetary Agreement. However, it has a very pervasive impact on public sector liquidity.

on social and physical instrastructure and public buildings and private homes. The real cost to Lesotho include costs of repairs, compensation, an increased defence budget (22% of the total recurrent budget or R24.9 million in 1983/84), and a loss in revenue resulting from a slump in tourism.[82] Associated with the policy of Distabilization is the growing population of refugees from South Africa, Lesotho has to divert resources in order to look after a large number of refugees estimated at 10,000 in January, 1983[83].

The last points to mention here is that the government machinery for the collection of revenue is itself "ineficient and as such there is a considerable loss of revenue which could go a long way in alleviating Government financial ills"[84] The situation is complicated by the proliferation of out-of-market transactions particularly resulting from a fast expanding informal sector. In the Leribe District, basic tax revenue was reported to have fallen by 37% this year.[85] This decline cannot be explained by an increase in the migration of man rather than by clear evasion. Revenue collection points are only found at district headquarters and this limits the scope of their operations, and thus augments the total amount of revenue foregone.

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82. The Chronicle, Zimbabwe, 22 Jan. 1983.
83. The Sunday Times, 23 Jan. 1983
84. Mothepu, M.N. "The Management of Recurrent Costs: Lesotho's Experience," June, 1983, CPDO.
85. Radio Lesotho, 19th July, 1983. Basic tax is paid by every male citizen.

5.0 Conclusion

In this report, an attempt has been made to isolate leakages from the most structurally dependent of the small states of Southern Africa. Leakages themselves are a result of the forced integration of the Lesotho economy into that of South Africa, a process which began close to one century ago, and is characterised by calculated measures aimed at plundering Lesotho's productive capacity. Today, Lesotho is not only a labour-exporting dependency with 66.3% of all its male wage employees working in South Africa, but all its markets are totally in the orbit of South African domination. In particular, this domination, which is achieved through undermining local productive capacity, was formalized in agreements in the realm of labour exportation, commodity, and money markets.

Leakages from the Lesotho economy should thus be seen as a "Systematized" outflow of resources resulting from three factors:

(i) The historical plunder of Lesotho's economy which has not only proved difficult to reverse but has turned Lesotho into a market for South Africa's high-priced goods and a labour reserve for South African mines;

(ii) The membership of Lesotho to the Southern African Customs Union (SACU), a South African-dominated regional institution which is an instrument for promoting South Africa's industrialization, and which is partly responsible for undermining Lesotho's productive capacity; and

(iii) The Rand Monetary Agreement which provides for a free transfer of money from Lesotho to the South African financial markets, as well as to finance a growing volume of imports from South Africa.

These three factors have created extreme distortions in the Lesotho economy to the effect that customs revenues, 50% of which is estimated to result from migrants imports, account for 84% of the governments recurrent revenue. In addition, private consumption alone takes 142% of the GDP, making the country rely heavily on imports of South African consumer goods. The percentage of imports covered by exports has dropped from a 1965 level of 26.75% to a record 1977 low of 6.22%.

It appears that the highest leakages, in the case of Lesotho, come through commodity trade, especially imports, 97% of which come from South Africa. These have worked to weaken the foreign aid and migrant earnings multipliers in the economy. Imports from South Africa tremendously weaken the impact of both foreign aid and migrant earnings on the Lesotho economy. In addition, because of South Africa's use of both tariff and non-tariff barriers as well as monopolistic industrial structure, the prices of South African imports are above world prices. South Africa also contributes to inflation in Lesotho.[86] The benefits of both cases accrue to South Africa. Leakages through imports should not however, overshadow Lesotho's contribution to South Africa's economic development through the labour and financial markets in the form of high profits made possible by underpaying labour as well as in the form of transfer of funds through the banking system.

All the formal agreements signed with South Africa provide for consultations and renegotiation, but latest developments show that Lesotho's options are limited. Unlike its two companions, Botswana and Swaziland, Lesotho cannot embark on a radical course because of its 100% bordering on South Africa. Although there is a potential break-through in the fields of telecommunications, air transport and water and electricity, their success in eliminating leakages from the economy still has to be seen. The reduction of most of these leakages will only be fostered by the elimination of a hostile environment in Southern Africa and by the creation of regional authorities whose aim will be to rationalize the development of the sub-continent.

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86. In 1980, the inflation rate averaged 16-17%, food reached 28% in November 1980, see AED, 30th January, 1981.

APPENDIX I

FINANCIAL LEAKAGES AND THE PRODUCTIVITY OF FOREIGN EXCHANGE IN LESOTHO

The two-gap model specifies that the growth of an underdeveloped economy is constrained by two elements: the availability of domestic savings and foreign exchange. Foreign aid (grants, loans, and foreign capital inflows) plays a dual role of relaxing both of these constraints. This means that the transformation of domestically-produced goods into imports either through export-promotion or import-substitution is limited. For most African countries, both industrialization (import substitution) and the export sector (esp. agriculture) have suffered serious set-backs. The % coverage of the import bill by export revenue has also been minimal.

There are four policy aspects of the two-gap model:

(i) If foreign - exchange is the bottleneck, the marginal product of domestic savings is zero;

(ii) If savings is a bottleneck, the marginal product of borrowing is lower than in (i);

(iii) For a binding saving constraint, if the marginal propensity to save is higher than the average propensity, to save, then a potentially-attainable growth rate financed through foreign aid will eventually become self-sustaining.

(iv) For a binding saving constraint, if the marginal propensity to save is lower than the average propensity to save, a potentially - attainable growth rate financed through foreign aid will never be self-sustaining.

I will specify the model in somewhat traditional but simplified fashion with minor modification,* using the following variables:

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* See Mckinnon, R. "Foreign Exchange Constraints in Economic Development and Efficient Aid Allocation" in Economic Journal, LXXIV, June 1964.

$Q(t)$	-	Domestic Product
$V(t)$	-	Domestic Production
		($Q(t)$ + imported raw materials)
$K_d(t)$	-	Domestic component of capital stock
$K_m(t)$	-	Imported " " " "
$S(t)$	-	Savings
$\bar{S}(t)$	-	Maximum possible savings
$I(t)$	-	Investiment (+depreciation)
$F(t)$	-	Net foreign capital inflow
$E(t)$	-	Exports
$M(t)$	-	Imports
$\bar{E}(t)$	-	Maximum possible exports.
$\bar{M}(t)$	-	Minimum imports required
$L(t)$	-	Labour

With these specifications, let us assume away complications and use three factors of production: domestically-produced capital goods (K_d); imported capital goods (K_m); and Labour. Using a Leontief production function,*

$$Q(t) = \mathrm{Min}\left[\frac{K_d(t)}{\alpha d}, \frac{K_m(t)}{\alpha m}, \frac{L(t)}{B}\right]$$

(all marginal products greater than zero)

Since Lesotho is a labour-surplus economy (loosely), Kd and Km become simultaneously binding constraints, and

$$Kd(t) = \alpha d\ Q(t), \quad Km(t) = \alpha m\ Q(t).$$

Our investment will be split into investment from domestically-produced capital goods andinvestment from imported capital goods. This gives us:

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* With limited domestic resources and an undiversified external market for Lesotho, the combination of domestic and imported inputs will tend towards fixed proportions.

$$I(t) = \dot{K}_d(t) + \Pi \dot{K}_m(t)^* \qquad (1)$$
$$= (\alpha_d + \alpha_m)\dot{Q}(t)$$
$$= \alpha \dot{Q}(t)$$
$$\text{where } \alpha = \alpha_d + \alpha_m$$

Let us assume that $\bar{S}(t)$, the maximum possible savings, has a linear relationship to output and is either more or equal to actual savings. Therefore:

$$\bar{S}(t) = sQ(t) \geq S(t). \qquad (2)$$

Since Lesotho does not have sufficient savings, the balance on investment is covered with foreign capital inflows as follows:

$$I(t) = S(t) + F(t) \qquad (3)$$

A minimum level of imports is required for capital formation as well as consumption. This means that below this minimum, many things would go wrong.* Therefore actual imports are greater than or equal to this minimum:

$$M(t) \geq \bar{M}(t) \qquad (4)$$

$$= \Pi \dot{K}_m(t) + \alpha_c Q(t)$$
$$= \Pi \alpha_m Q(t) + \alpha_c Q(t)$$

$$\text{where } \alpha_c > 0.$$

Lesotho has difficulty in penetrating international markets, (esp. SACU) and suffers a severe scarcity of productive resources. The export sector is therefore heavily impaired. There is a limit in the amount Lesotho can export. Maximum-possible exports are a fraction of the domestic product, and actual exports are either smaller than or equal to maximum-possible exports:

Π = terms of trade or the relative price;
·(dot) = differentiation over time.
* This was experienced in Lesotho when South Africa closed its side of the border - see The Friend, 30th May, 1983.

$$\bar{E}(t) = \varepsilon Q(t) \geq E(t) \tag{5}$$

Foreign exchange available to a country is equal to the sum of export earnings, foreign capital inflows, and loan and grant finances, and this is also equivalent to the value of imports of both capital and consumption goods.

Therefore:

$$M(t) = E(t) + F(t) \tag{6}$$

Since Lesotho has no full control over foreign capital, loan, and grant inflows, F(t) will be exogenous in this model.

Let us assume that Lesotho has the highest Potentially-attainable rate of growth, r. This is the rate of growth which could be attained if this economy could eliminate most of the leakages. Then:

$$\dot{Q}(t) = rQ(t) \tag{7}$$

To enable a solution to this system of seven equations in six unknowns, Chenery et al* split F(t) into $F_s(t)$ which is the net capital inflow needed toachieve saving-investment equilibrium in equation (3) - the saving gap, and $F_r(t)$ which is the net capital inflow needed to achieve import-export equilibrium in equation (6) - the trade gap.

The assumption we made earlier was that it is difficult to transform domestic resources into foreign exchange. This means that even if Lesotho can realize enough savings to achieve the highest potentially - attainable growth rate, the latter cannot be achieved because of the difficulties of transforming domestic resources into foreign exchange either by export-promotion or by import-substitution. If F(t) was endogenous, the saving limited growth rate is

$$r_s = \frac{\dot{Q}(t)}{Q(t)} = \frac{s + f}{\alpha} \quad \text{where} \quad f = \frac{F(t)}{Q(t)} \tag{8}$$

* Chenery, H.B. and P. Dorfman "Optimal Growth Patterns in an Open Economy", paper presented to the Econometric Society, San Fransisco, December, 1966.

On the other hand, if a country has no control over foreign capital inflows, F(t), and conditions M(t) = $\overline{M}$(t) and E(t) = $\overline{E}$(t) hold, our trade-limited growth rate is

$$r_t = \frac{\dot{Q}(t)}{Q(t)} = \frac{\varepsilon + f - c}{\Pi \alpha_m}$$

By definition of the trade gap.

$$\frac{\varepsilon + f - \alpha_m}{\Pi \alpha_m} < \frac{s + f}{\alpha}$$

or

$$\frac{\alpha (\varepsilon + f - c}{\Pi \alpha_m} < s$$

it means that with a trade-limited growth rate, a portion of savings is lost because there is no foreign exchange component to sustain a potentially higher growth rate r_s. There is a waste of potential savings in the system.

The impact of foreign aid transfers in this model can easily be demonstrated to depend on which gap is binding. From equation (8) and (9),

$$\frac{\partial r_s}{\partial f} = \frac{1}{\alpha}, \text{ and}$$

$$\frac{\partial r_t}{\partial f} = \frac{1}{\Pi \alpha_m}, \text{ respectively.}$$

But $\alpha = \alpha_d + \alpha_m$ (Π only relative price).

Therefore $\frac{\partial r_t}{\partial f} > \frac{\partial r_s}{\partial f}$.

This finding tells us that foreign aid transfers will always have a proportionately greater impact on the growth rate if the trade constriaint holds or if there is a foreign exhange bottleneck than if a savings bottleneck holds. On the other hand, if the shortage of savings is the limit to growth, foreign aid transfers have to provide for both the domestic and imported component of the capital stock required to achieve the highest potentially-attainable growth rate. But if foreign exhange is the limit to growth, foreign aid transfers provide only the imported component of the capital stock required for growth, while the domestic component is being provided by using the under - utilized potential domestic savings.

Many African countries* have for the past two years or so frozen or even cut-down their development programmes because of the constraints introduced by the conditions for getting foreign assistance - the demand by donors that there should be counterpart contribution or a complementary supply of the domestic component. This immediately translates itself into savings limited growth. However, many studies show that $S(t) < \overline{S}(t)$.** On the other hand, the equations above show that for a savings constraint, there are many policy variables which could be utilized. One wonders therefore why Lesotho has not succeeded in utilizing these variables and still suffers from the position of chronic dependency on foreign aid, even for a significant portion of the domestic component.

This model is used here as a tool for demonstrating that there are leakages in the Lesotho economy which act to suppress potential - attainable growth rates even after increased injections of foreign assistance. All or some of the variables. $\Pi K_m(t)$, $S(t)$, $M(t)$ or $\alpha_c Q(t)$ and $E(t)$ are affected by these leakages and thus further increase the dependency of Lesotho on foreign aid transfers,

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*This is still the case in Lesotho, see: Hon. K.T.J. Rakhetla, M.P. "Budget Speech Presenting the 1983/84 Estimates of Revenue and Expenditure, Maseru, 18th April 1983.

** Mottura, P. "Savings Mobilisation in [illegible] Countries" in Mauri, A. [illegible] A Tool for Development, [illegible]

Even if the two-gap model has its own limitations, its value in demonstrating the importance of studying the subject of leakages has been demonstrated. It is clearly shown that as long as there exists serious leakages from the Lesotho economy, foreign aid translates itself into increased indebtedness without a significant impact. This was experienced in late seventies when substantial foreign aid inflows were largely associated with increased imports of South African imports.

Appendix II

DUTIES COLLECTED IN LESOTHO FOR THE COMMON CUSTOMS UNION POOL - 1978/79-1980/81 (ROOO'S)

Year	Customs Duties	Excise Duties	Ad Valorem Exc. Duties	Surcharge	Total
1978/79	12.9	289.8	52.3	13.3	368.3
1979/80	11.5	567.2	8.8	8.8	596.3
1980/81	25.1	4,006.9	12.3	1.7	4,046.0

Source: Dept. of Customs and Excise.

THE ORGIN OF LESOTHO'S IMPORTS FOR PURPOSES OF CALCULATING THE DIRECT DUTY CONTENT ~~CONTENT~~

Commodity or Group	S.I.T.C.	B.T.N.	Total c.i.f. Lesotho	Origin %		Origin by dutiable Value	
				R.S.A.	Other	R.S.A.	Other
Live Animals	00		2,427	100	-	2,427	-
Foodstuffs	01-09		35,518	96.6	3.4	34,301	1,215
Beverages and Tobacco	11		7,863	95.4	4.6	7,500	363
Crude Materials	21-27		1,295	96.0	4.0	1,243	52
Mineral Fuels & lubricants	32-35		11,742	75.6	24.4	8.881	2,862
Animal & Vegetable fat and oils	41-42		1,561	93.5	6.5	1,459	102
Chemical Elements and Compounds	51-59		9,525	75.3	24.7	7,172	2,353
Manufactured goods classified by Material	61-69		41,807	82.7	17.3	34,568	7,239
Machinery and Transport Equipment	71-73		22,730	62.0	38.0	14,083	8,647
Miscellaneous Manufactured	81-94		45,140	87.2	12.8	39,349	5,791
			179,608	84.1%	15.9%	150,983	28,624

Source: Gray, J.G. and Hoohlo, S.G. The Direct Duty content of Lesotho's Imports and the Protective Price Raising Effect of Tariff Protection by South Africa, Ford Research Project, Nov. 1978.