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COMMERCIAL BANKING IN LESOTHO

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INTRODUCTION

SECTION I

THE NEED AND ROLE OF MULTIPURPOSE DEVELOPMENT FINANCE INSTITUTIONS IN LESOTHO

The post-independence period in Lesotho was marked by a growing recognition of the need for strategies designed to mobilize and direct financial resources into desired channels of developmental activities. The rising expectations for higher levels of living, the approved five year development plans which declared aggression against poverty, more specifically the desire to reduce all forms of dependency on the Republic of South Africa and the emergence of industrial development institutions such as Lesotho National Development Cooperation created a strong demand for medium term and short-term finance. The financial infrustructure which a newly independent Lesotho inherited, however, was very narrow, with commercial banks tending to play a dominant role. Moreover, these banks were subsisdiaries of international banks and most importantly, they did not provide adequate amount of medium-term and long-term credit to local investors. On the other hand Lesotho lacked an adequate supply of indegenous financial resources mainly because, like most developing countries, its economy is characterized by subsistence agricultural production, labour surplus and capital scarcity. For reasons both economic and political, this situation was unacceptable and was soon modified through the establishment of a series of financial institutions particularly Lesotho National Development Bank (LNDB).

Lesotho, like most developing countries, is basically characterized by low rate of domestic savings especially when one considers the internal economic structures and their ability to generate adequate monetary income necessary to permit savings. However, the inadequacy of domestic savings rate should not be exaggerated. The

fact of the matter is that saving rate in this country has been found to be fairly high for a variety of reasons; first the country has a long history of monetized economy through its comprehensive integration with the Republic of South Africa. Secondly because of the migrant labour systems which absorb mostly the unskilled rural labour and is paying relatively high wages. This condition therefore permits the penetration of monetary wage income into the rural areas which, given their relative isolation from the commercial activities urban areas (lack of physical infrustructure to integrate rural areas to urban areas) always found themselves with excess money balances. Therefore, while we appreciate that the availability of savings hence the rate of savings is high, it should be noted that what is really lacking is the efficiency in the process, by which savings which are being accumulated in the economy are translated into savings useable for productive employment. This deficiency has always been covered by the inflow of foreign aid and this should be considered only as a temporary measure. That is foreign capital, no matter how large the inflow, cannot absorb Lesotho from the task of mobilizing domestic resources. In fact experiances have shown that foreign capital alone cannot create any permanent basis for high standard of living in future and that the greater dependence on domestic sources of finance facilitates more the successful implimentation of any planned economic development.

Greater dependence on domestic sources of capital, therefore requires a wide range of independent, well organized and adapted financial institutions which have to mobilize internal resources for the purpose of capital formation and allow the capital to be invested conviniently and freely into desired development ventures. Commercial Banks, the basic component of financial institutions, should be thus the major relevant important institutions which encourage and mobilize savings and channel them into productive investment first, because of their network officies, and secondly because commercial banks through normal credit operations often activate savings lying iddle both in urban and rural areas.

Commercial Banks operating in Lesotho have, for the most part enjoyed free and unrestricted growth. The Barclays Bank (Pty Ltd) D.C.O. and Standard Bank, the first banks to operate in Lesotho established their branches in the mid 1900s. These two banks comprised the commercial banking systems in Lesotho until they were joined by Lesotho National Development Bank (LNDB) in 1973, the only national bank.

The proliferation of branch offices and mobile units especially in the districts outside Maseru occured in the 1960s. At the end of 1959, the only two banks in Lesotho had between them, four offices, the main offices and each with only one branch were all concentrated in Maseru township. The emergences of bank branches in few districts, in the 1960s clearly proves the fact that commercial banks, which follow the traditional system of supply following demands, (1) move into areas where business is likely to develop rapidly. (Carls Bernett 1982). As Lesotho's modern sector is mainly a service economy(2) with very insignificant industrial sector, commercial banking growth rate is likely to be closely correlate or associated with rapid growth of the services sector, especially commercial distributive businesses, expansion of government administrative institutions, expansion of building and construction activity, growth of migrants in other regions of the country and, to a lesser extent, with the growth of agricultural sector. Thus the emergence, growth of commercial banking branches of the two operating banks occured in the 1960s as a result of first the expansion of government activities into other district particularly at the period of independence when government was attempting to take services to the people by embarking upon decentralization policy. In 1965 government expenditure rose with the inflow of foreign aid. It could therefore be concluded that the two banks moved into districts mainly because it was becoming profitable to provide banking facilities to the government civil servants, institutions etc. By the end of 1972, just before LNDB came into the picture, the two foreign owned banks had between a number of branches and agencies which include the main

TABLE 1

COMMERCIAL BANK BRANCHES AND POPULATION DISTRIBUTION BY DISTRICTS AND URBAN CENTRES

Districts	Urban Centres	Distrcts Population	Population by Urban Centres	Bank Branches and Agencies		
				Lesotho Bank	Barclays Bank	Standard Bank
Maseru	Maseru	257809	55031	4	2	2
	Morija		4915	1		
	Roma		5668	1		
	Masianokeng			1		
Butha-Buthe	Butha-Buthe	77178	7472	1	1	
Leribe	Hlotse	206,558	6297	1	1	1
	Maputsoe		15823	1	1	1
	Peka		4577			
Berea	Teyateyaneng	146124	8589	1		1
Mafeteng	Mafeteng	154339	8278	1	1	1
Mohale's Hoek	Mohale's Hoek	136312	5276	1	1	1
Quthing	Moyeni	88490	3528	1		
	Mount Moorosi			1		
Qacha's Nek	Qacha's Nek	76497	4837	1		
Mokhotlong	Mokhotlong	73508	1484	1		
Thaba-Tseka	Thaba-Tseka		4427	1		
TOTAL		1,216,815	136,202	18	7	7

offices in Maseru, branches in Maseru and other districts and mobil units.[3] Thus, with a total of ten bank offices throughout the whole country, the average number of customers per office is 121 000 (1966 population of Lesotho 1.2 million). Population distribution by districts and urban centres is shown in table 1 and, it can clearly be seen that a large proportion of the population did not have access to bank services.

However, with the establishment of LNDB since 1973, to 1983 bank branches have grown and spread into more districts so that all the three commercial banks have a total of thirty three bank offices between them eighteen to LNDB, eight to barclays bank and seven to standard bank. However, it should be noted, as will be seen in the latter sections, that LNDB has employed supply leading approach to commercial/development banking and the measuring yard stick for its performance should not be the same as that used in the case of the first two foreign owned banks.[4]

Until 1970s, the performance of the largely foreign-owned financial systems in Lesotho has received no official attention inspite of the fact that the country attained political independence in mid 1960s. The reason for this neglect lay not so much in satisfaction with the activities of these institutions as in the emphasis on foreign investment and the services provided by these institutions to the foreign investors as well as foreign trade. Foreign capital, personal and marketing ability of these foreign owned banks were expected to provide the necessary instruments of economic development while the financial system provide financial booster desired by the government and private businesses alike. However, in the 1970s, the government became aware of the fact that foreign investment depended more on financial resources mobilized internally rather than act as a source of funds flowing into a capital scarce country. That is Foreign private companies do not necessarily bring foreign financial funds in the country. Thus while foreign investors were providing managerial skills and marketing facilities, foreign owned commercial

banks were mobilizing domestic funds to finance investment into these activities. The net value of foreign investment was less than the norminal value. The Lesotho economy, after providing financial resources, is loosing a lot of revenue through (a) tax concessions or tax holidays[(4)] (b) through tax evasions made easy by transnational accounting systems of transfer pricing[(5)] (c) the economy is paying a heavy price in terms of interest differencial between the two countries (Lesotho and RSA) and between RSA heavy borrowers as again Lesotho lenders or surplus spenders. (See section III). The latter case is made possible by the fact that, given the commercial banks creteria of credit worthiness, and the short-term to medium term lending requirements of these banks, funds are always flowing in a unidirection manner into RSA and (d) the Lesotho economy is loosing income through profit repatration, and high management salaries of people who are resident and therefore spending their incomes in RSA while effectively, employed in Lesotho.

All these undersireable outcome brcught about one simple response from the local government politics of intervention in the financial system and this is reflected by the emergence of Lesotho National Development Bank (LNDB) together with other specialized credit institutions (which though important will not be discussed in this paper).

The purpose of this study is threefold: First, it attempt to analyse more fully the major contributing factors to the emergence of Lesotho national development bank (LNDB) which, given the competitive pressure put up by the traditional foreign owned commercial banks (Barclays Bank and Standard Bank) operating in Lesotho had no option but to deviate from its orginal inception and become operationally a commercial bank.[(6)] In this regard, the basic proposition is that LNDB did not only emerge as a result of an ordinary normal banking competition stimulated by profit incentive but largely by the government official disatisfaction with the performance of foreign owned commercial banks operating in Lesotho. The second purpose is

to focus essentially upon the willingness of both the LNDB and foreign-owned commercial banks to promote and produce within the financial system the structural changes which government official have expected of them. Thirdly, the study will analyse the possibilities and the impact of interest rate differentials between Lesotho and RSA upon the flow of funds in the region.

It is further hoped that the study will have implications for government policy making and will have wider application to the sub-region as Botswana and Swaziland have followed the same system.

The paper is organized as follows: the first-section deals with literature review specifically focusing upon commercial banking in Lesotho. The second section concentrates on a short note on statutory structure and original objectives of Lesotho National Development Bank with the view to illustrate that LNDB is a direct result of political intervention in the otherwise free financial market system. That Lesotho government officials' belief that foreign owned commercial banks are draining funds out of the country is not unfounded but based on observed undesirable tendencies. In section three, it will be shown that commercial banks' excess liquidity and under-utilization of funds over time was not necessarily due to lack of sufficient demand for loanable funds. That the creteria of credit worthiness in the context of developing country such as Lesotho is either ill-conceived or misplaced as it applies more in developed economics than in LDCS. That the commercial banks characteristic of short-term lending is not consistent with the needs of a developing labour-reserve economy such as that of Lesotho and other BLS countries. Finally this section will show that the interest rate regime as the determinant of the flow of funds between two sets of borrowers resident in two regions (Lesotho and RSA) of the same financial markets, is inappropriate as it forces the poor group to subsidice the more wealthier group. In fact it has backwash effects on Lesotho. It will be sbown that the statutory structure which establish, Lesotho

Lesotho bank reflects the disatisfaction of local government official with the participation eprformance of foreign-owned commercial banks in the economy of Lesotho. The fourth section discusses the source of funds for LNDB and further points out that the potential capacity of these source have not yet been exhausted and therefore LNDB has to be more aggressive than it has been. (However, the mechanism of its aggressiveness will be discussed in another study which is forthcoming).[7] In this section, the immediate identified sources of funds for LNDB are migrants deffered pay fund (MDPF) Foreign Aid (FA), Government Borrowing (GB) Net Capital Inflow (NKI). In addition, it will be shown that LNDB enjoys special monopoly conditions mainly because these sources are not open for competition by other similar financial institutions. In that regard, it is instructive to suggest that LNDB's investable funds permit more than just short-term and medium term loans. Hence the ability to perform a dual functions, Commercial and Development Banking.

SECTION II

THE POLITICAL ECONOMY OF LESOTHO NATIONAL DEVELOPMENT BANK (LNDB)

In this section attempt is being made to show that Lesotho National Development Bank (LNDB) or in short Lesotho Bank emerged partly in response to the growing, yet unsatisfied demand for banking services in the country and most importantly it emerged as a political response to what appeared to be undesirable moropolistic conditions enjoyed by foreign Owned Commercial Banks. We wish to illustrate that government officials are cetainly unhappy with the performance and participation of foreign owned banks in financing local economic activities and the initial conception of Lesotho bank reflects this disatisfaction. It was hoped that, as a locally owned controlled banks, it will redirect the flow of financial resources towards priority economic areas of this country. For this purpose therefore, it is important to examine briefly the government officials' perspective perception of Lesotho Bank right from its inception with the view to assess the extent to which Lesotho Bank participates in domestic economic activities as compared to other banks, its ability and prospects to produce, within the existing imperfect competitive financial system, the economic structural changes which government officials have expected of it. The main proposition which this section will attempt to discuss is that Lesotho Bank (LNDB) did not emerge as a results of a normal banking competition stimulated by profit incentive, but largely by the government officials' dissatisfaction with the performance of foreign-owned Commercial Banks operating in Lesotho.

As the name suggest, LNDB is a national development bank which was created by an act of parliament in 1971, (Bank order No.8 1971 gazette No.9 March 1971) though it started operating in 1972 and more specifically it is a state bank as against privately owned.

Before analysing the developmental aspects of Lesotho Bank, it is important to briefly examine its characteristic as a state bank. There are three reasons why it should be regarded as a state bank. First the Lesotho government is the main if not the only shareholder. The 1971 Bank order No.8 states the authorized share capital of the bank as follows:

> 25. (1) The initial share capital of the bank shall be the sum of five hundred thousand rand (500,000) divided into five hundred thousand one share all of which shall be taken up by the government.[8]
>
> (2) The shares in the bank shall be paid from moneys to be appropriated by the Council of ministers for that purpose.
>
> (3) The government of Lesotho may upon such terms and conditions as it may deem fit transfer shares to any person, corporation or public body: Provided that the norminal value of shares so transfered shall, in the aggregate not exceed R200,000.

Evidently, by provision of this order, the government is presently the only shareholder and, in the event that section (3) of the order becomes operative, the government would still remain the single majority shareholder. The immediate implications of this is that on the political level, the government is jealous of the bank least it becomes a private institute and consequently would deviate from its initial conceptual objective of being national development bank. That is private shareholders may strongly persuate the bank to become commercial rather than being developmental. It reflects the desire by the government to maintain a strick control and to monitor closely the activities because a shareholding gives the

majority shareholder an exclusive voting right.(9) Furthermore, the acceptability of the Lesotho bank by the banking community may be the function of the legitimancy of the government within the context of local politics. That is one does not have to be an expect in banking systems to realize that Lesotho bank, though a national bank, does not offer a serious competition to the foreign owned South African controlled comercial banks. The most obvious observeable fact in this regard is the banking attitudes of the business community especially the foreign enterprenuers who control a substantially large proportion of bankable funds are loyal customers of Barclays and Standard Banks. (Here a distinction should be made between the number of people who patronize Lesotho bank and the volume of financial resources controlled by such people).

On the economic level, the implication of Lesotho bank as a state bank is that the initial sources of funds are highly limited and constrained by government budgetary conditions which, as in most developing countries is certainly volotile. Thus, as a state bank, LNBD relies largely on government subsidy for the initial capital even though it may be argued that savings, deposits and reserved profits can be used as the running capital. Lack of the public commitment in the bank ownership in terms of investable funds will also affect people's attitude towards the bank especially when they have to make a choice between depositing and borrowing funds with either Lesotho bank or foreign owned banks. The fact of the matter is that it doesn't make any difference as both financial institutes are providing the same services. The second reason why Lesotho bank should be regarded as a state bank is that it is exclusively administered and controlled by the state machinery through the Board of directors whose appointment is not the function of shareholding but rather the decision of the minister of finance. In particular, it should be noted that the chairman of the board of directors is the minister of finance who, himself, has exclusive rights to appoint his own board. Section 4 of the 1971 bank order No.8 reads as follows.

4(1) The operation of the bank shall be managed and controlled by a board of directors who may exercise all the powers and who shall perform all the duties of the bank subject to the provision of this order.

(2) The board of directors shall consist of

(a) The chairman: and

(b) Not less than three or more than seven other directors appointed by the minister.

Thus, the Lesotho National Development Bank will be managed by a board of directors consisting of a chairman and not less than three or more than seven other directors to be appointed by minister. It should also be noted that the bank manager who are responsible for the day-to-day running of the bank are appointed by the minister and are directly responsible tc the board of directors. The important point to note and emphasize in this case is that within the afore said administrative bank framework, there is no room for non-governmental involvement in the bank decision-making. The administrative structure presuposes that the appointment of the board of directors is made on the basis of banking professional merits and competence as against political consideration which include both nepotism and rewards to political loyalists. It suggests that non-governmental participation in decision making will influence the investment decision otherwise in a country which relies on private enterprise system. It is quite clear that the government has an absolute control over the allocation of financial resources of this particular bank inspite of the fact that what may officially be percived as priority investment areas may not necessarily be regarded as such by the private investors.

The third reason why Lesotho Bank should be regarded as a state bank is that the minister of finance can give the bank direction of a general character as to the policy be followed in the exercise of its functions. Here once again one is being made to believe implicitly

that the minister knows it all either because he has been elected into that position on the basis of the expressed knowledge or because of his familiarity with the Five Year Development Plan.

It is quite clear from the preceeding analysis that Lesotho bank is a state bank and, as such, the main purpose of its establishment is to facilitate the process of development as perceived by government officials. The developmental path to be followed in Lesotho, from the official point of view is stipulated in the five development plans of 1970 - 1975, 1975/76 - 1980 and 1980/81 - 1985. In particular, the specific role which the state bank is expected to play within this broad quitelines is essentially as follows:

(a) To increase the level of local savings and their employment within the country.(10)

(b) To encourage and faster the development of Agriculture, Commerce and industry.(11)

Although the genral objectives of Lesotho Bank are clear and plausable, it is essential to explain why it was considered necessary to establish a new bank for that purpose. The question is why is it that the existing foreign owned commercial banks could not fulfill these objectives in the past fifteen years of operation since 1966 It is the view of this paper that "the explanation lies partly in the economic deficiences of the financial and banking system which falls within a wider context of the single currency circulating in the Rand Monetary Area (RMA) and the monopolistic conditions of South African controlled banks. It lies partly too in the perculiar perception the policy-makers have about the deficiences in the performance of foreign banks. Local policy-makers strongly feel that foreign banks are consistently mobilizing financial resources inside the country and, instead of employing these funds within the country, they provide loans, advances and other credit facilities to investors in the Republic of South Africa.(12) That even the

minimum that is employed inside the country, is not necessarily directed towards the economic priority areas of this country. Lesotho bank therefore, is perceived as a strategy to eliminate these deficiencies of foreign owned banks and, to ensure a successful achievement of this goal. In this regard, it could be said that the emergence of Lesotho bank has both economic and political background. On the political level it is convinient to illustrate this point by quoting, extensively, from the five year development plans which reveals the political dimensions to the emergence of Lesotho Bank.

> "The First Five Year Development Plan stated that it was government's policy to increase the level of local savings and their employment within the country. In accordance with this policy, the following measures were proposed.
>
> - To establish a Development Bank whose assets and liabilities would reach R2 million by 1974/75; most of the credit was to be for agricultural purposes.
>
> - To introduce legislation to allow building societies to operate in Lesotho.
>
> - To issue development bonds to provide an outlet for investment Funds.

The emphasis on the desire to increase the level of local savings and their employment within the country is suggestive of the strong dissatisfaction with foreign owned banks to perform this function. Futhermore, the intention to establish a development bank with the sole purpose of financing agriculture leaves no room for doubts as to the recognition that the Salvation of the economic growth of this country lies with agriculture and to the fact that the traditional foreign owned banks have not only neglected this sector but have drained resources out of it into the industrial

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(1) First Five Year Development Plan.

sector of RSA. National ownership is sought by policy-makers, not only for its own sake but also for the control over the disposition of resources which it mobilize. National ownership or government control, it is hoped, would bring about an allocation of credit more in keeping with plans for national development. This fact is further emphasized by the second Five Year Development Plan which states as one of its objectives

> "To maximize the mobilization and domestic use of national savings."

> "The major tenet of Government policy in this field remains the same, namely to attempt to maximize the mobilization of national savings and their productive use within Lesotho."

> "The principal means to carry out that policy is a well structured system of financial institutions. Therefore it is the aim of government to improve and complete the existing system by having institutions which deal predominantly with short-term and medium-term credit Commercial Banks ...."

The consistency in the official perception of the functions of Lesotho bank, namely to maximize mobilization of domestic financial resources and to use these resources to develop domestic economy is quite clear and appreciated. Lesotho bank is seen as partly, an improvement of the existing deficient financial system while other instituions such as Lesotho National Development Corporation (LNDC) is another form. The government official's perception of the use of mobilized funds by the state bank is evidently relfected in the statute that established Lesotho bank. Section 19 of 1971 bank order No.8 states as follows:

> "The bank may make loan for any of the following purposes:
>
> (a) the development, maintenance and improvement of immovable property;
>
> (d) The payment of labour and the purchase of supplies and machinery required to

plant, irrigate and cultivate lands
and to reap and make merchantable
the crop or produce there of;

(e) The purchase of rolling stock, dead and live stock and of manure and fertilizers;

(g) The financing of any trade, business or industry.

Thus, while the concern regarding the use of funds implicitely suggest that foreign owend commercial banks employ funds outside the country, section 19 of the bank order specific more directly that Lesotho bank is expected to finance development of estates for industrial purposes, agricultural activities (crop and live-stock farming), and marketing of both industrial and agricultural products.

This govenment official disillusionment regarding the participation of foreign owned commercial Banks is also shared by the general public whose expectations are being raised. To this end the local ~~Nes~~ news Paper (Moeletsi oa Basotho 27 March 1971) reports as follows:

> "Among other normal functions the development and saving bank will provide loans to enable effective development of agricultural, industrial and commercial sectors of the national economy.
>
> The Bank is the first of a series of national institutions that will be formed during the duration of the five year development plan in order to assist in the effective implimentation of the plan which was approved by the Council of ministers last month. Other areas of development in which the Bank will be involved is the reinvestment of funds into the national economy and the establishment of a Savings Bank that will also make provision a life assurance and Savings scheme."[13]

Evidently, the general public had very high hopes about Lesotho bank and felt encouraged that for the first time in the economic history of this country, the government is establishing a series of national financial institutions that will promote the development of the local economy. Implicitely therefore, there is a subtle

assumption underlying the public opinion regarding foreign owned commercial banks; and that is these banks are not engaged or committed to the developmental needs of Lesotho. Furthermore, the emphasis of justification for the establishment of Lesotho bank seem to be upon the implimentation of the recently approved Five Year National Development Plan. It would appear that the government was rather scaptical about the ability and readiness of then existing foreign owned banks to provide the necessary credit facilities to undertake the implimentation of development plan.

Concerned with the allocative performance of the foreing owned commercial banking system is clearly conveyed by the many annual reports made by the chairman (Minister of Finance) and academic research reports in the past ten years since the establishment of Lesotho bank in 1972. In the minister words;

> "Once again it is a pleasure to present a report and accounts six years since we started. 1978 like most recent previous years, has seen tremendous growth rates in most vital activities.
>
> We continued to aggresively mobilize savings from the nation and with the same tone velemently recycled the funds to persons, bodies, businesses, industry, construction, infrastructure and development projects.
>
> We have enjoyed increasing confidence from the nation and as a result have been able to open more and more brances in 1978. This we regard as one of our prime social objectives." (Lesotho Bank Report (1978).

The minister's of Finance view which obviously reiterate the Prime Minister pointed is supported by the public opinion which emphasis the fact that foreign owned commercial bank do not participate in the economic development of this country, but instead they mobilize funds for repatration outside the country. Moeletsi oa Basotho 1971 has this to say in this regard.

> "The formation of the development and savings bank falls within government's policy of preventing the continued outflow of locally earned money to foreign countries; a policy that has been constantly reiterated by the Prime Minister during the past few months."

The single most important point emerging from these essentially political observations is the fact that the establishment of Lesotho Bank is a reflection of government official perception of the financial problem in that foreign owned commercial banks perform the function of draining saving funds out of the country. That is Lesotho bank is seen, from the officials point of view as an institution which will reduce the rate of financial outflows. It is also important to note that even though the policy-makers are in full comprehension of the magnitude of the financial problem and are clearly disatisfied with the performance of foreign owned commercial banks, they do not see the solution as an out-right nationalization of these banks but instead prefer a competitive market approach by establishing Lesotho bank to compete with them.

The evidence presented so far, at least on the basis of statutory structure and public opinion, prove beyond any reasonable doubt that the performance of foreign owned banks has been unsatisfactory. That the present problem of underdevelopment in Lesotho could partly, if not completely, blamed on the door-steps of foreign owned commercial banks through backwash effects of financial resource drainage coupled with cummulative causation made possible by the long history of economic integration (product markets and labour markets) under the South African Custom Union Agreement (SACUA). One would expect that recognition of this evidence leaves the government with no option but an outright nationalization of these banks with the view to put an immidaite stop to these undersireable effects of financial capital outflow. The interesting question of research in this regard is what are the costs and benefits of nationalization of financial instituions. What are the necessary and sufficient condition for nationalization

policy? However, Lesotho government has opted for free competitive market approach as the means of reducing financial outflows from the country. Lesotho bank cannot concerviably compete successfully with existing commercial banks which are not regarded as traditional (given their long period of operation in Lesotho relative to Lesotho Bank) but are also international or multinational given their global sphere of operation. The fact of the matter is that the government has prescribed an in appropriate medicine for a genuane properly perceived problem i.e. the establishment of Lesotho bank while is an essential move in a right direction, is not necessarily a sufficient condition of restructuring the financial system with the view to put an immediate hast to the continously out flowing funds even though other purposes of financing internal economic activities are quite plausable.

The political observations and disatisfaction concerning the performance of expatrates commercial banks are further given a theoretical support and evidenced by academic emperical research reports. The academic approach advance a number of reasons for this annomalous behaviour of commercial banks two of which are; first lack of government control of these banks both legislatively and interms of management or administration and, secondly because of the economic relationship between the Southern African countries which belong to the Rand Monetary Area under a single currency, the South African Rand.[14] These two factors are closely related in the sense that the change of the second implies the first. That is an effective withdrawal of Lesotho from the Rand Monetary Area would imply that government would have to lagislate control of the outflow of dunds and the implementation of such regulations would require local management of these international banks if not to nationalize them. However, the two factors will be treated separately for purposes of clearity.

The proposition that the two expatrates commercial banks are successfully draining funds out of Lesotho because of lack of strick government control over this institutions has been raised

by Mareo Onado and Antonio Poster: 1971.

> "Lack of policy-making and controlling powers, which was discussed in the introduction, has particularly serious implications in the case of these two banks. Both have always been more interested in atracting local deposits rather than in lending in Lesotho, so that their domestic loan/deposit ration is very low. The banks say that this is because credit demand does not meet the requirements of sound banking. But even though these banks are, after all operating in a developing country, their managers seem to be more concerned with what real security a prospective borrower can offer than with the country's effective development needs."

In the same vein, M. Onado and A. Posteri made similar observations about other foreign owned financial institutions; specifically, the building societies with regard to the provision of investment funds.

> "On the investment side, building societies have always acted as a channel for draining funds away from Lesotho to South Africa. Until not so long ago they were actually being barred by South African law from investing in Lesotho in any form whatsoever, and things have not changed much since this prohibition was abrogated ......"

The Standard Bank Group Annual Economic review written in 1969, just before the emergence of Lesotho Bank made similar observations regarding the South African government prohibition ofCommercial banks' investment in Lesotho.

> "Because Lesotho is a member of the Rand Currency Union, there is no central bank, the South African Reserve Bank conducting most of these functions for Lesotho. Consequently, the Commercial Banks in Lesotho assume an important rle in handling monies moving between Lesotho and other countries ...."

The other major financial institutions in Lesoth are Lesotho Co-operative Savings Society and the Post Office Saving Bank in Maseru. Some savings are invested in the South African Building societies,

> but until very recently, under the South African Building societies Act, they were prohibited from granding loans outside the republic. A recent Act now permits loans to be made in Lesotho provided they are sanctioned by the Registrar of Building societies, but the land tenure system in Lesotho makes it difficult for loans to be granted ...."

It would seem to me that the South African government, inspite of its advantageous position of being a dominant member in the unequal partnership, has taken a concious effort and participated in the process of underdevelopment of this country. The fact of the matter is that investment funds are not freely flowing within the integrated financial markets in search of profitable investment opportunities as expected in a free market system such as this operating in Lesotho and South African. Instead extra-economic factor interplay to force funds towards a particular region to the detriment of the less developed partner. However, this is not to suggest that financial flows would have been different in the absence of such government logislative measures.

Two most important points emerge from this discussion, the first is that foreign owned financial instituions perform the functions of draining funds from Lesotho into RSA and it is suggested that this underable behaviour can be eliminated by instituting strick measures of control. Secondly, it is quite clear that initially these banks were prohibited by an act of parliament of RSA not to invest funds mobilized in Lesotho but to transfer them into South Africa. In this regard, the South African government interference in what would otherwise should be a free market system is undoubtedly visible. The question that arises therefore is wether the Lesotho Government authorities should adhere to the free market competition by establishing a bank with the view to counteract this behaviour? On what sentimental reasons, (political or economic) is Lesotho Bank expected to outcompete the already highly protected monopolistic commercial banks in order for it to successfully redirect the outflow of funds.

However, the view that foreign owned bank drain funds from

Lesotho is further discussed by Basil C Muzorewa 1976 (Lesotho Notes and Records Vol. 10 1974). He argues that Lesotho, like many African economies have suffered for decades from the drain of domestic savings to the more financially and economically developed countries. He asserts that in 1976 these two commercial banks controlled over 90% of total deposits of the whole credit system. The main reasons for this commercial bank behaviour as he can conceptualize them are as follows:

(a) Lack of comprehensive law governing the investment behaviour of credit institutions. That is there is no comprehensive commercial banking legislation in Lesotho. The banks are only governed by what they consider to be sound banking principle (excessively conservative) and the RSA foreign exchange regulation.

(b) Lack of banking lagislative, requiring these banks to maintain equality between local assets and liabilities also encourage exports of capital funds.

(c) The use of foreign currency as a medium of exchange.

(d) Lack of investment opportunity acceptable to the bank and higher interest rates in RSA.

All the reasons advanced by both B.C. Muzorewa and J Gray as well as many other studies (see bibliography) explain one important point, that commercial banks have successfully managed to effectively channelled access cash reserves out of the country for many years. The alternative solution to this problem is government lagislation which will gain the local authority control over these institutes and more importantly, Muzorewa goes further to suggest that "indegenous credit instituions are more likely to be tools of development than foreign owned and managed concerned". This latter point, certainly reinforce government officials perception of the problem and the fact that Lesotho bank will provide an alternative

mainly because it does not suggest an outright nationalization of foreign owned banks. The main question which remain unanswered in this context is how will both lagislation and local commercial banks achieve the expected objectives within the existing structure of monopolistic competition in the financial market? The effectiveness of any policy instrument, be it legal or institutional relying heavily on moral section, is measured by its approximation to the ideal solution. Then what is the institutional or market transmission mechanisms through which policy instruments such as establishing Lesotho bank and instituting control lagislation would be channelled towards redirecting the flow of funds back into Lesotho economy?

However, it is now over ten years since Lesotho bank has been established precisely to perform functions which foreign expatrate banks are alleged to have delibarately avoided. This period is long enough for us to assess the extent to which this bank has lived up to the expectations, namely:

(a) To maximize mobilization of domestic savings and to employ these savings in Lesotho.

(b) To facilitate the implementation of Five Years Development Plans by concentrating funds on officially identified priority economic areas.

(c) To finance the service sector particularly the marketing of crop, livestock and industrial products.

(d) To reduce the outflow of funds into the Republic of South Africa.

As for the lagislative control of financial institutions, a matter which is beyond the activities of Lesotho bank, it will be interesting to examine the impact of the Financial Institution Act 1973 and the influence or the role played by The Central Bank of Lesotho since its establishment in 1978 in controlling the flow

of funds. In particular, it will certainly be interesting to examine how the central bank facilitate the functions of Lesotho bank in its attempt to achieve the above mentioned objectives. Thirdly, the establishment of a domestic currency should be seen as yet one step toward the desired objective as some studies have suggested and, therefore, it would be interesting to investigate the extent to which the use of a local currency within the present financial market structures of the Rand Monetary Area has reduced the intensity of the outflow of savings and deposits generated by financial institutions. Although this paper will not attempt to analyse the three questions raised in this paragraph, it is important to note in passing, the view of the author that the impact of these factors would be minimum within the present structures and financial arrangements between Lesotho and Republic of South Africa. That the local currency today only serve the functions of a "national flack" under the current dual currency system where the printing and supply of domestic money is backed or rather conditioned by the availability of South African rands. However, this point needs to be investigated further in order to suggest concerete alternative policy issues. For the purpose of this paper we wish to concentrate on the question of whether Lesotho bank has been able to live up to its expectations. Whether the opportunities exist whereby similar indegenous financial institutions such as Lesotho bank will emerge in the near future to replace the foreign owned banks.

From the foregoing section there are at least three main points emerging from the discussion. First, it is quite instructive to conclude that Lesotho National Development Bank is the state bank which was established with the sole purpose of creating financial institutions necessary to finance developmental activities inside the country. As a state bank it enjoys certain advantages such as being assured of an adequate initial and running capital allocated from the government annual budget. Being under strick control of the government it is operating behind the protection of the state

and would therefore avoid the risk of being subjected to an unfair competition against the foreign owned commercial banks. However, the opportunity cost of being a state bank is the foregone capital revenue which would have been contributed by the public shareholders. It runs the cost of loosing local expertise which would otherwise have provided their services if appointment is being done on merit rather than on political considerations and affiliations. Lastly, as a state bank it runs the risk of general acceptability because it will always be associated with the rolling political party and to the extent that the party is unpopular, the bank will suffer as well. This later point will become more evident in the subsequent sections when we examine the degree to which Lesotho Bank has competed with other commercial banks.

The second point emerging from our discussion so far is the fact that Lesotho government officials and the public in general are in no doubt as to the fact that foreign own commercial banks are not actively participating in the process of financing economic activities in the country. That foreign owned commercial banks have consistently drained funds out of a capital scarce country into a relatively capital endowed Republic of South Africa. That this perculiar behaviour, while on tne one hand may be due to economic and investment opportunities deferentials between the two integrated countries, they were assisted by extra-economic factors such as South Africa's Building Societies lagislation which prohibited these banks from investing funds in Lesotho. It is in recognition of this fact that Lesotho government officials become scaptical about the ability and willingness of the Han existing foreign owned financial institutions to provide adequate financial resources for the implimentation of the approved Five Year Development Plans.

> It was further hoped that the success of Lesotho Bank will provide credit facilities to agriculture, commercial activities and industry. It was expected to restructure the financial system in the country and therefore reduce the outflow of funds.

The Third point which clearly comes out as a logical policy matter, necessary to facilitate the effective performance of Lesotho Bank to achieve the expected goals and objectives, the choice between two alternative options open to the government; first an outright nationalization of foreign owned financial institutions operating in Lesotho accompanied by a comprehensive lagislative structure that will prohibite financial out flows. This alternative would have implications for the present common currency area. The second option would be to assess the financial market conditions and, if they are favourable, subject Lesotho bank to a free market competition as has presently happened. The immediate implication of this option is that the current commercial banking activites are far below the potential capacity of this economy. That the actual banks mobilization of resources is lower than the potential ability of the communities to save and invest. In that regard, the newly established Lesotho Bank would successfully pursue its dual function; commercial and development banking by simply tapping the under mobilized resources. However, even under such extremely restrictive assumptions, Lesotho bank would not possibly reduce the outflow of funds by other foreign owned banks. In fact it can be argued that Lesotho Bank can perform the function of introducing and stimulating banking altitudes and behaviours to the non-banking rural communiting through its aggressive bank-branches approach only to loose these customers to other commercial banks.[15]

The analysis of the operations of Lesotho bank over the past decade cannot be properly mdade in isolation of the entire commercial banking system mainly because of the interelationships between the three banks. In fact, it is important at this stage to examine ways in which the expatrate banks have continued to drain funds out of Lesotho irrespective of the competition brought about by the emergence of Lesotho bank. The mechanism through which expatration of funds has continued to be channelled out of Lesotho are mainly the under utilization of excess liquidity and secondly the relationship between holding of foreign assets and liabilities.

SECTION III

COMMERCIAL BANKS MOBILIZATION OF FINANICAL RESOURCES AND THEIR EXCESS LIQUIDITY

Until 1973 when Lesotho Bank begins to operate, the two Commercial Banks, Barclays bank and Standard bank had been eminently successful in mobilizing funds in Lesotho. Now again the complete privacy whereby data concerning the activities of these bank is not available for public consumption, it is not possible to illustrate with emperical evidence the amounts of savings and deposits made by these banks. However, one can savely assume that since they are not charitable organizations, their continued existence is a living evidence of the fact that they are mobilizing successfully large amounts of savings and deposits with high levels of profits. That is they could not have been expatrating funds out of the country as pointed out in the above sections if they are not enjoying the monopoly of mobilizing these funds. It should also be pointed out that even though there is no legal minimum required cash ratio set by the government of Lesotho, it can be assumed that these banks are using the South African stipulated cash ratio as their own in the country. Alternatively, given the fact that financial conditions and degree of risks deffer in the two countries with Lesotho exhibiting a higher level of risk, bank managers would presumeably set a high cash reserve ratio considered to be a prudent financial management. These two ideal conditions not withstanding, it should be noted with emphasis that the question of prodence and the problem of running out of cash are not necessarily the major binding constraints to the domestic allocation of credit by commercial banks as they could very easily obtain the required cash from RSA Central banks whenever necessary. Table 3 below shows the excess liquidity of commercial bans in the country. The table shows that the average liquidity ranges between 58 and 96.5 percent in 1983. The main

TABLE 3

COMMERCIAL BANKS' LIQUIDITY RATIOS

million rands

Years	Deposits[1]	loans and Advances	Credit deposit ratio	liquid assets	liquidity ratio	long-term time deposits	ratio of long term deposit to total
1976	-	-	-	-	-	-	-
1977	-	-	-	-	-	-	-
1978	67.48	39.44	58.5	34.28	50.8	7.6	11.3
1979	85.32	49.96	58.6	47.06	55.2	7.94	9.3
1980	101.14	69.09	68.3	60.21	59.5	7.28	7.2
1981	111.99	90.25	80.6	82.85	74.0	5.58	5.0
1982	122.90	117.17	95.3	97.45	79.3	11.00	9.0
1983	148.67	121.87	82.0	143.44	96.5	9.04	6.1
1984	176.46	167.43				-	-
1985	237.16	185.85				-	-
1986	246.26	200.83				-	-

difficulty in the analysis of these important perfovance indicators is that there is no data for the period proceeding the emergence of Lesotho bank in 1973 and also that there is no disaggregated data for individual banks. Therefore the present liquidity ratios are inflated by the inclusion of Lesoth Bank which, as a development aand state bank is certainly operating at very high liquidity ratio in attempting to provide credit to locals. However, the data as presented shows that commercial banks are actively loaning out their funds and excess liquidity appears to be very low. Caution should also be exercised regarding the table in that it does not show who are the recipsants of loans and advances. However, the problem is partially solved when we examine table 4 and 5 which are presently the assets and liabilities of commercial banks. That is the performance of commercial banks can be assessed on the basis of the allocative functions which in turn depend very much upon overseas assets holidays. Evidently, the fact that Barclays bank and Standard bank are subsidieries of foreign international commercial banks proves beyond any reasonable doubt that their foreign assets will certainly exceed local assets. The question is whether these assets are the major determining factor to their credit allocative performance and profit repatration? It is therefore important to examine the growth of commercial banks' assets and compare with the liabilities.

TABLE 4

COMMERCIAL BANKS ASSETS

Years	Cash Balances	Balances with CBL	Foreign Assets	Loans & Advances Private Sector	Government Security	Loans & Avances Statutory Bodies	Other Assets	Total
1976								
1977								
1978	4.72		42.11	18.45	10.79	10.20	11.86	98.13
1979	6.67		51.17	23.85	17.55	8.55	19.32	127.11
1980	5.74	27.53	33.70	21.45	38.40	9.24	16.49	152.14
1981	5.81	22.79	35.71	33.31	42.66	10.44	26.52	177.24
1982	4.22	24.25	54.92	43.13	54.50	10.92	33.38	225.52
1983	6.12	42.73	72.03	42.66	68.41	10.80	51.75	294.50
1984	8.37	45.65	88.91	59.19	62.28	13.39	59.10	336.89
1985	8.91	69.02	112.13	79.63	73.27	11.26	52.68	406.91
1986	7.12	95.12	68.01	89.34	94.42	11.42	48.87	414.30

SOURCES: Central Bank of Lesotho Quarterly Review September 1982 Vol.1, No.2 Maseru

. In the absence of disaggregated data for individual banks, it may not be possible to explain which of the three banks holds the largest amount of foreign assets and/or liabilities. We can only assume that Barclays Bank and Standard bank are responsible for the large overseas assets. Furthermore, it is rather difficult to distinguish between foreign assets originating from the Republic of South African and those of the overseas origin. However, it is quite evident from tables (4) and (5) that net foreign assets held by commercial banks are very large both in absolute and relative terms. The most interesting feature of foreign assets is that they are growing overtime from 42.11 million rands in 1978 to 112.13 million rands in 1985 Table 4 thereby indicating the growing foreign demand for local financial assets. Table (5), last column further proves this point in that Lesotho is actually a net exporter of financial resources. That is net foreign assets is positive, very large and actually growing from 71.15 millions rands in 1980 to 211.24 million rands in 1986. This shows that foreigners are borrowing from the banking system of Lesotho more than the invest as the liability are very small. There is thus, through the banking system, a consistent drainage of funds from a capital scarce economy into the relatively more capital abundants countries of the Republic of South Africa and overseas. This situation would, at least on the surface, appear to be rather abnormal as economic theory would suggest that capital should move from a region of high concentration in the face of declining prices, profits and investment opportunities into regions of low concentration in search of new investment and greener pastures. However, the reasons for this abnormal behaviour of capital outflows in the form of assets holdings are many; first it can be argued that the high volume of foreign assets is a reflection of the scarcity of domestic liquid earning assets. The fact of the matter is that over a long period up until now, Lesotho government has been largely financed through the loans, grants, aid from overseas as well as through customs union revenue. As such commercial banks do not have opportunities for short terms investment in the local assets markets. The choice of liquid

TABLE 5

NET FOREIGN ASSETS OF THE BANKING SYSTEM

Year	Foreign Assets				Foreing Liabilities			
	Central Bank of Lesotho	Commercial Bank		Total	Central Bank of Lesotho	Commercial Banks	Total	Net Foreign Assets
		Total	which Rand Notes and coins					
1975								
1976								
1977								
1978								
1979								
1980	38.40	37.43	3.73	75.83	0.06	4.62	4.68	71.15
1981	40.15	39.77	4.07	79.92	0.25	5.63	5.63	74.04
1982	51.03	56.50	1.58	107.53	1.92	3.48	5.40	102.12
1983	81.34	73.97	1.94	155.31	2.75	23.20	25.20	129.36
1984	96.64	92.71	3.80	189.35	2.83	7.51	10.34	179.01
1985	109.63	116.89	4.75	226.52	2.03	7.91	9.94	216.58
1986	148.99	91.46	3.46	220.45	2.06	7.15	9.21	211.24

Source: Central Bank of Lesotho Quarterly reveiw Vol. V No.1 March 1986.

assets is between cash, non-income generating assets and foreign assets. The question that seems inevitable in this case is whether the high level of net foreign asset holding is a reflection of a viable domestic capital market?

The second reason for this high excess foreign asset holdings could be fluctuating sources of funds for commercial bank as to whether these sources are seasonal or contineous. That is if the sources of funds for banks is basically stable industrial activities or even in the case of Lesotho, stable migrant remmittences, bank assets would be contineously stable. However, in the case of an agricultural economy such as that of Lesotho, bank liquidity could be the functions of seasonal sale of agricultural produce and, given the limited range of form products produced for commercial purpose as well as the unpredictable weather conditions, banks liquidity would be highly volotile and fluctuating. Under such conditions, the high level of net foreign assets would be justified on the grounds that during the slack season or drought periods, banks cash inflow would be tightened and they would have to reduce their holdings of local assets. In the case of Lesotho, the two mentioned conditions are quite permisable except that they both are not binding constraints to the commercial liquidity positions. Thus, a disaproportionate net foreign assets as shown by tables 4 and 5 cannot be justified on the basis of fluctuating and unpredictable bank cash inflows.

The thrid reason, which can be more acceptable is that commercial banks' high levels of foreign assets is the direct result of International trade between Lesotho and RSA as ell as other overseas countries. To the extent that foreign trade is the dominant influencing factor, one can conclude that foreigners, are holding local assets against exports made into these country. This point, while it seems to be the main explanatory factor, is also debatable in the sense that Lesotho and RSA are using a single currency and as such, there would be no need for excess foreign exchange reserves for trade particularly with RSA.

Whatever the reason for the observed excess net foreign assets of banking system , the main important point to note and emphasis, is that Lesotho is the net exportor of financial resources.

Commercial bank liabilities is regarded as the main source of banking funds with the view to channel these funds into viable economic activities. In fact deposit laibilities are the single most important comparent of commercial banks' liabilitie . Table 6 therefore gives the distribution of commercial bank liabilities in their three principal forms; demand deposit, time deposit and saving deposit. The most clearing feature of commercial banking from this table is that the private sector seem to be the dominant source of funds for banks accross the three forms of liabilities. For instance, the private sector has the largest contribution in the demand deposit and the growth rate seems to be fairly high; from 18.05 millions rands in 1978 to 59.52 millions rands in 1986. The immediate implications of this growing form of bank liability is that the commercial banks liquidity is raising, their capacity to create money in the form of loans is expanding particularly if one assumes that their cash reserve requirements are not rising. The question is which of the two markets RSA and Lesotho is the beneficiency of loans created by these banks?

It is quite evident from the table that the pattern of distribution is that the private sector is the leading sector in all three forms of liabilities to be followed by the government and then the statutory bodies. The interesting point to not particularly in terms of time and savings deposits is that the large proportion of these liabilities come from the rural community which is basically surplus spenders. That is rural communities, as can also be observed from the deferred pay fund are largely isolated from the commercial economy so that their propensity to spend cash income is relatively low while on the otherhand, their source of cash income, whose function is only to suppliment agricultural subsistence output, is very high and consistent. While the rural communities'

demand for bank loans advances is indeterminate, one can safely assume that the posibility of aquiring bank loans is very limited due to rigide bank requirements such as securities. It is therefore instructive to conclude that rural communities are subsidicing urban bank customers through the provision of bank liabilities without enjoying investment benefits created thereof.

However, it is necessary to explain the observed significant growth of commercial bank liabilities in Lesotho. This growth can be explained interms of natural tendencies and economic conditions in that over a period of time, the economy of Lesotho has experienced a fairly high growth of income and automatically bank deposits should grow. Secondly, with the emergence of Lesotho National Development Bank and its aggresive banking approach, particularly with regard to rural penetration (See table 1) a lot of people have become enlightened with respect to the profitability of purchasing of income generating financial assets in banking. Thus LNDB would seem to have stimulated banking habits by providing banking services to the rural communities. This point is also backed by the observed growing banks liabilities in the face of increasing commercial banks. That is if the first two banks had efficiently exhausted the potential banking capacity of the country over the years of their operation prior to Lesotho bank, one would expect commercial liabilities to decline when Lesotho bank is established and takes its market share since 1973.

Table 6 also has implications for the degree of monetization and banking behaviour of Lesotho banking community as a whole. That is in a situation where the economy is completely monetized the process of portfolio holding structural change would be for the saving deposite to decline over time while time deposit and demand deposits grow. There should be a substantial shift in the distribution of the structure of deposit in favour of time and demand deposits. However, in the case of Lesotho this stage have being reached as saving deposits seem to be growing at a higher raten than than time deposit while demand deposit is growing at a

TABLE 6

COMMERCIAL BANKS LIABILITIES

Years	Demand Deposit			TIME DEPOSIT			SAVING DEPOSIT						
	Private Sector	Government	Statutory Bodies	Private Sector	Government	Statutory Bodies	Private Sector	Statutory Bodies	Deferred Pay fund	Capital & Reserves	Foreign Liabilities.	Others	Total
1976													
1977													
1978	18.05	4.80	5.46	10.74	2.28	0.06	23.46	0.07	18.28	5.47	2.62	6.84	98.13
1979	26.52	7.14	6.49	13.89	2.21	0.27	27.11	0.05	21.59	7.44	1.72	12.68	127.11
1980	34.87	13.35	2.09	12.48	2.21	0.66	34.12	0.08	25.90	9.32	4.62	12.44	152.14
1981	38.66	11.51	5.71	10.27	0.90	1.50	41.75	0.16	[illegible].23	9.25	5.63	15.67	177.24
1982	37.26	11.56	17.11	14.17	0.90	0.33	48.34	0.09	50.35	10.53	3.48	31.20	255.32
1983	36.88	12.44	19.61	15.74	0.90	0.53	63.57	-	58.37	26.01	23.20	38.25	294.50
1984	44.63	12.42	28.72	16.37	-	0.49	73.77	0.06	62.61	30.01	7.51	60.23	336.89
1985	65.46	20.62	35.59	21.75	-	1.99	92.10	0.01	63.91	26.63	7.91	70.89	406.91
1986	59.52	21.17	37.88	23.32	-	2.35	102.00	0.01	71.75	31.17	7.15	57.98	414.30

higher rate than savings and time deposits. The main reason for this low growth of savings is not so much the portfolio holding structural changes but rather, a shift of funds by the expatrate business people from locally based commercial banks into banks located in the Republic of South Africa either for purpose of conviniently financing foreign trade or for security reasons.

The credit allocative performance of commercial banks in Lesotho can be assessed on the basis of their active participation in financing viable major economic activities. Given the dual nature of the economy (agriculture co-existing with the service sector rather than the industrial section[(15)] it should be expected that the two sectors commanding the bulk of credit are agriculture, the distribution sectors and building construction together with transport which service all sectors of the economy.

Both theory and the experience of other developed countries have shown that as the economy is developing the process of structural transformation is such that agriculture declines in importance while the service and the industrial sectors become more dominant with the result that agriculture becomes more mechanized and commercial as opposed to labour-intensive subsistence production. It is therefore logically consistent to suggest and expect that in the process of economic structural transformation, agricultural share of credit will grow in an attempt to acquire mechanical impliments and other improved inputs such as fertilizers, seeds, insecticides etc.

On the other hand it can also be argued that in the process of structural transformation from a predominantly agrarian economy to an industrialized economy, the agricultural share of GNP, labour employment and aggregate growth rates are falling and, in the same manner, it should be expected that total share of labour should decline and be shifted to the emerging more competitive sectors. Infact agricultural contribution to the process of development should be such that savings generated from that sector are

channelled into the more profitable sectors.

Table 7 gives the distribution of commercial banks' loan and advances according to major economic activities and it is quite evident that the service sector (wholesale hotel , resturants, transportation, storage and communication) is the largest receipient of credit. The construction seems to be the second largest beneficiary of bank resources to be followed by manufacturing industries while agriculture is the lowest. When this table is cross examined with table 6, especially in conjuction with columns of private sector saving deposit, deferred pay fund and private sector time deposit, one can conclude that the distribution sector is employing household savings. That agriculture is contributing largely to the growth of the service sector.

The most pertinent question is why has there been an emphasis and shift of credit from agriculture into the service sector when in actual fact the agricultural sector has not necessarily developed to the stage where it could be financing other sectors? Is the high growth of the service sector a direct result of the demands made upon it by otehr domestic economic activites? The observed rather abnormal distribution of loans between sectors could be the function of a number of factors such as the concentration of ownership of business activities between local and foreign entrepreneurs. The service and industrial sectors are completely dominated by the foreign owners of South African origin and a few overseas businessmen. On ther other hand, the agricultural sector is owned by local farmers who are largely peasant in character and have very little commercial cash crop production. This difference in ownership and the character has implications for credit worthiness and attitudes towards risk particularly from the point of view of foreign owned commercial banks. That is when banks consider loan applications, the most important requirements are adequate collateral, guarantees and sound credit records. More oftens banks require that loan applicants should pleage as collateral, mortagages

TABLE 7

COMMERCIAL BANKS' LOANS AND ADVANCES TO BUSINESS ENTERPRISES AND STATUTORY BODIES.

Years	Agric Hunting & Fishing Forestry	Mining Quarrying	Manufacturing	Electricity Gas & Water	Construction	Wholesale Hotel & Rest.	Transport Storage & Communication	Non-Bank Financial Inst., Real Estate.	Community Social & Personal Services
1975									
1976									
1977									
1978	0.23	0.09	0.56	0.72	4.59	11.60	1.53	0.12	1.16
1979	0.10	0.01	0.45	0.57	4.26	13.43	1.43	0.88	1.17
1980	0.29	0.04	1.08	0.61	4.09	10.37	1.32	1.23	1.36
1981	0.88	2.56	2.95	0.46	5.05	18.61	1.56	1.72	1.31
1982	0.31	4.98	4.08	2.10	2.68	23.89	2.41	1.86	1.77
1983	0.32	0.39	4.67	2.27	3.55	23.64	2.14	1.73	1.54
1984	0.35	–	4.88	5.67	5.97	29.22	2.26	2.18	4.61
1985	0.52	–	5.20	7.06	6.48	30.66	3.20	3.24	1.93.
1986.									

on urban property, insurance policies, fixed deposit etc. As a result, propertyless customers, whose savings are both short-term and small in volume, find it more difficult to obtain a loan than big businessmen who also enjoy the monopoly of credit guarantee provided by local institutions such as LNDC[16]. Therefore mechandise trade and manufacturing have credit advantage over the agriculrtural sector.

Now given the initial objective of Lesotho Bank, one would expect agricultural credit to be rising since 1973 yet the growth of credit to this sector is very low. However, on the basis of available aggregated data is not possible to explain the degree to which Lesotho bank has participated in the agricultural finance.

SECTION IV

MONOPOLISTIC CONDITIONS OF STANDARD AND BARCLAYS BANK

This section attempts to illustrate the fact that Lesotho Bank has not made any impact on the operations of the expatrates banks in terms of reducing the volume of their generated savings. That is Lesotho bank was subjected to an unfair competition which, while on the one hand encouraged to be more aggressive and innovative with the aim to catch-up, has effectively diverted the local bank from its original conception of being a development bank into commercial orientation. To this end, it will be appropriate to examine the advantages which barclays bank and standards banks have over Lesotho Bank.

The monopolistic conditions of these two banks is largely determined by three main factors, peoples' attitudes towards them as against the local state bank. Secondly their international position as multinational banks and thirdly because they offer a variety of financial assets. In order to illustrate these points on the theoretical level, ir ia important to briefly review conditions of imperfect competition in a financial market. That is what do we understand by a monopoly bank and in what way are the three commercial banks operating in Lesotho enjoying monopolistic conditions?

Theoretically, a free competition economic model depicts an economic system in which consumer are free to buy the goods they want and they seek the products they want in the market of their choice. Workers can sell their services in the most advantageous market . Producers are free to buy their raw materials where they will and, though not possibly as free as consumers, are reltively free to hire the needed workers in the most advantageous markets. The price structure performs an economic service of great importance in that the decisions to produce what and how much are based largely

on the ultimate income derived therefore. The model therefore suggest that market prices and market popularity (free flow of information) quide production. By quiding production, market prices determine the use made of economic resources. Market prices also have a bearing on the way in which income is distributed.

Imperfect competition, model (monopoly) though not a complete contrast of the perfect competition, pre-supposes the existence of a single or few sellers sharing a large market with relatively elastic, (not perfectly elastic) demand. Monopolistic conditions can be a number of factors such as direct government interference through lagislation and protection regulations, restrictions or moral suation; it can be a result of excessive advertisement (popularity), amalgamations or patent rights; it can also be the result of fragmented market structures created by imperfect physical and social infrastructure, technological advantage and institutional structures such as that exist in the Southern African Rand Monetary Area. That is the use of a single South African currency in the region is an institutional factor which gives the South African banks a monopoly over the indigeneous banks of the peripheral countries such as Lesotho bank. Lastly, monopolistic condition can also be created by the marketing ability and accessibility to foreign market of certain businesses. Marketing ability and international pupularity lend themselves to credit worthiness in the international market, a factor which potential infact competitors cannot affort, hence monopoly.

Financial markets are following precisely the same model. Individuals are free to save or spend their incomes as they choose. If they spend their incomes, the proceeds flow through commodity market. If they save, they may put the funds to work directly in some form of real productive capital. Most savers, however, do not have the means for doing so, as a result a large fraction of individual savings is channelled through financial markets. The parallel aspect is that individuals and groups formed into business

cooperations are free to operate productive economic enterprises from which they hope to realize a profit. Eoth individuals and business frequently need to find outside sources of financial capital to aid them in their enterprises.

The price in financial markets is rather special: It is a money price on the use of money (interest rate). This price is the cost to the borrower and income to the lender.

Commercial banking, in Lesotho, particularly the two foreign owned banks (Barclays bank and Standard bank) exhibit monopoly characteristics of financial markets. The four most important charracterisitcs of monopoly enjoyed by these banks are informational secrecy, international popularity and local good will, the variety of financial scurities and international branch system which make it conviniant for expatrates as well as foreign companies to undertake their transactions at different places and countries.

Informational secrecy. It has always been difficult for researchers and policy makers to acquire the necesary information regarding the operation of the two foreign banks. Most studies, (Musorewa, Gray, Monado and A. Porteri) consistently make the excuse of inavilability of adequate published data. The annual reports of these two banks simply publish their international operations and are never specific on any single country. Even the aggregate figures about the banks activities are protected by this secrecy which we believe is necessitated by the desire to prevent others from knowing their rival's precise situation and market shares. This banks are presently required by law to submit their financial position (The law does not require them to publish their accounts) and if this condition is observed, it would appear that the Lesotho government is also unwilling to divuige this information, thereby perpetuating monopoly conditions of commercial banks. However, we strongly believe that the commercial banks' private interest should be sub-ordinated to the general public interest of having full information about their complex activities.

International Reputation both Barclays bank and Standard bank have international network operations with offices and branches in a number of countries. This international recognition gives them a greater publicity with the result that their world market shares far out-weighs that of any single countries' indegeneous banks. Their marketing techniques and the range of banking services are much wider and more sophisticated so much that no single country banks can affort to compite with them even at the local level.

Financial Securities. Commercial banks are interested in attracting deposits, and to do so they employ a varity of techniques and sell different financial securities. The two foreign banks operating, in Lesotho accept money on the following types of accounts within a monopolistic market structures: A large proportion of depositors comes from the business and cooperative communities and these prefere current accounts securities because of their convinience.

There are a number of reasons why these banks enjoy monopolitic condition in the sale of current accounts securities. In the first instance, these banks have an international network and are largely operating in RSA. This has resulted in a growing confidence for the market to accept their cheques as money. Thus the business communities who have to undertake their transactions mostly in RSA and in other countries, find it convinient and necessary to keep current account deposit with these banks. It should be noted that the business communities such as traders, cooperatives, wholesalers, building and construction and manufacturers control a large proportion of bankable financial national income and as such the market share controlled by this banks in Lesotho, on the basis of confidence, strategic location and international networks is very large. The second monopoly area of financial securities is the saving deposit which is concentrated largely in the household sector. Again the basis of monopoly in this financial security is the popularity of these banks which are largely regarded as traditional rather than foreign banks. The household sector has grown used to

this banks overtime and have developed confidence in them as opposed to newly established commercial bank such as Lesotho bank. Secondly, cash income acruing to the household sector is generated by the migrants and civil servants in Lesotho. As regard migrants, it can be argued that a migrant worker would have learned the use of banking facilities in RSA and that determines his choice of banks as a bank consumer. Secondly it is quite convinient for the Basotho miners or factory workers in RSA to deposit their savings in South African banks becuse they are very near to their working place. The consumer choice between South African banks would be bias towards Barclays banks and Standard bank because they operate both in Lesotho and RSA. In the case of civil servants, the major influencing factor is the cheque system of paying salaries by the government. That is since Lesotho government pay its employees by cheques and in the past the only two commercial banks were these foreign owned, it follows that civil sevants would have saving accounts with the two banks. Now through the multiplier process, civil servant businesses, their employees and other complimentary activities would need to have some banking relationships with these two banks. Thus saving deposit, whether by the household sector or business community would be made with both Barclays bank and Standard bank because of this monopoly condition. The popularity of these banks with the household sector is clearly shown by the minimum required balance for any savings book held. For example as early as 1972 when Lesotho bank emerge, these two banks had already set a minimum limit for savings deposit at ten rand (R10) for Standard Bank and twenty rand (R20) for Barclays. Yet this did not discourage household customers nor did they loose them when Lesotho bank emerged. Today, these two banks require a minimum balance of hundred rands (R100) for any savings book.

Fixed deposit Securities. The two main sectors which supply fixed deposit to commercial banks are business community and cooperatives as well as other financial institutions such as insurance companies. The household sector plays an insignifican role in fixed deposit

securities with the exception of the foreign or expatrate community which is mostly motivated by the need to expatrate income abroad for purposes of purchasing a house, meeting education expenses at home or buying shares. However, the important point to note here is that these two banks are enjoing monopolitic conditions in mobilizing fixed deposit securities mainly because of the nature of the sector which participates in this financial asset.

Lastly, the monopoly condition is further created by the strong backing which these two banks enjoy from their individual mother companies abroad. These banks do not have to survive by their own competitive activities of mobilizing funds in isolation. For instance, Barclays bank is vertically connected with the "Barclays Development Corporation" in London while Standard bank is connected to "Standard Bank Finance and Development Corporation" in London too. However, for administrative purposes, the Lesotho branches are controlled by headquarters, located in the Republic of South Africa. As such they are completely integrated in South African banking system so much that they look toward RSA central bank as a "lender of last resort" while they receive their instruction directly from London.

The above analysis should not be interpreted to mean that Lesotho National Development Bank (LNDB) is a perfect competitor in an environment characterized by imperfect competition. It is important to show that Lesotho Bank is not an exception to this rule of monopolistic financial market structure. That is it also enjoys certain previlages available only to a single state bank. The five most eminant factor which determine monopoly conditions of Lesotho bank are: the local government preferential treatment, migrants deffered pay remittances, custom Union Revenue, foreign aid and grants and compulsory savings including pension funds.

As a state bank, Lesotho bank is guaranteed a study flow of government budget which account for part of its working and fixed capital. This means that the bank does not have to market its shares to the general public in order to raise the initial and expansion capital. It does not have to convince the public or shareholders whenever part of the profits have to be ploughed back and most importantly, the government capital grant is almost interest free. Secondly, with the government acting as a guarantee for loans of both businesses and personal (car advances) the bank can affort to increase its coverage of the loan market. It can also manage to provide these loan facilities even at the interest rates for as long as the government perceive the investment as essential. In this regard, Lesotho bank has the monopoly of stimulating banking activities in communities and places where such opportunities are not known. Thirdly, as a government institution it has the advantage of being generally accepted by the community who feels that the government is the gardian of its interests. The government can therefore use the process of moral suation and its communication and news media to pupularize the state bank. People's choice between foreign banks and the local state bank would be more on the basis of political and social attitudes rather than the services provided by these banks. In this regard, a proposition emerge that the higher the popularity of the government, the more acceptable is the state bank. That is in a free choice society, state bank acceptability is positively related to the government legitimacy.

Migrants deffered pay remittances. The growth of Lesotho bank household saving deposits has been greatly enhenced by the establishment of deffered pay Act of 1974. By the provision of this Act, migrants are requested to remit about sixty percent (60%) of their monthly salaries to Lesotho bank for period of two years. This people can withdraw all or part of their savings including interest at the end of their contracts in RSA mines. The importance of this arrangement to Lesotho bank market share of saving deposit securities is that migrants households are not free to choose between commercial banks.

They are compelled by the condition of convinience to open an account with Lesotho bank because of the special service provided. Now assuming that migrant remittances form a large proportion of rural household cash income it is conclusive to assert that Lesotho bank monopolies the rural banking community particularly with important aspect of the deffered pay provision to Lesotho bank is the period of time it takes for the migrant to withdraw. The period ranges from the minimum of six months to twenty four months (two years). This implies that Lesotho bank is assured of a pool of funds which remains stable for at least two years. This pool can grow for a variety of reasons; for instance when migrant earnings increase overtime, when migrant employment opportunities increase and when migrant extent their period of staying in the mines beyond the period of two years. This latter case seem to be more operative in recent years because of the new mine system of allowing for weeked visits and cutting on leave periods. However, the single important point to note about migrant deffered pay arrangement is that Lesotho bank enjoys a previlage which other banks don't have.

Customs Union Revenue Deposit. The 1969 custom union agreement between Lesotho and RSA provides that Lesotho should get customs revenue for goods imported into the region. This revenue, which form a substantial part of the government income is usually deposited into Lesotho bank most probably, interest free. This will certainly provide Lesotho bank with a large amount of liquid assets thereby marketing it possible for it to expand its loan supply beyond the minimum deposited in current accounts. This condition is certainly comperable to the two foreign banks who may never face the problem of liquidity shortage as they can always get funds either from South African central bank or from the mother companies in London. Therefore, in term of liquid assets, which determine the commercial banks ability to supply loans, is not completely worn off though its minimum cilling is constraint by the amount deposited by the government.

In fact this excess capacity is highly dependent on the extent to which Lesotho government uses this customs revenue income for recurrent expenditure and if so, it depends largely on the average residual held by the bank during the receipt intervals.

Foreign aid and grants. The foregoing analysis of Lesotho bank's excess capacity to extent loans beyond current account deposit is also augmented by the inflow of foreign and grants which are mostly in foreign currencies. Since Lesotho bank will not necessarily keep these foreign exchange reserves but will deposit them with either the Central Bank of Lesotho or abroad, it follows that its liquid assets reserves will be higher thereby giving it the opportunity to attract the business community, particularly those engaged in foreign trade sector of the economy. However the extent to which Lesotho bank can use this favourable condition to its advantage and succeed to increase its market share of the business communities depend largely on a number of factors. It depends on foreign exchange control regulations and also on the rate at which Lesotho government recurrent expenditure runs down both the custom union revenue and the foreign aid and grants income. However, these are the two main monetary instruments which Lesotho government can use to support the state bank against the imperfect competition offered by foreign commercial banks.

The last but not least monopoly condition which is open to Lesotho bank is the preferential treatment which the government can provide. In this regard the government can allow the bank to create loans for below the ten percent reserve requirement. It can make it a rule that all the cooperatives,credit union, credit societies and other specialized credit institutions which are mobilizing savings at the gross roots level should deposit their funds with Lesotho bank. This extra economic factor does not only gives the indegenous bank monopoly over foreign owned banks but also guarantees that rural funds are used to finance the development process of the rural economic sector.

In condlusion therefore, it can be asserted that commercial banking in Lesotho is characterized by monopolitic competition based on market segmentation, institutional structures and international facilities. The process of banking product differentiation is not so much based on advertised, salesmanship and other usual business techniques instead it is based on profit accumulation, international reputation and institutional support from either parent companies or government. It is clear then that the establishment of Lesotho bank cannot be understood without or oppreciation of the nature and functioning of the foreign owned commercial banking system. It is therefore important at this stage to examine in section III, ways in which these banks drained funds out of the Lesotho economy. For this purpose, we will first begin by discussion the process of mobilizing funds and the under utilization of excess liquidity. Secondly, we analyse the problem of repatrating funds through holding of overseas asserts and the interest rate regime.

FOOTNOTES

1. H.T. Patrick 1966

2. Carla Barnett (Commercial Banking in Beliza) argues that bank branches almost invariably move towards emerging & dynamic industry.

3. Barclays Bank report 1973 : Economic conditions in Lesotho

4. See Basil Mozorewa 1976 and H.T. Patrick 1966.

5. See A. Seidman 1982.

6. Lesotho Bank is actually a Commercial Bank using similar interest rates as others.

7. A paper of the aspects of marketing financial assets is forthcoming. The main focus of the study is to analysis the major contributing factors to the success of Lesotho.

8. The emphasis is mine.

9. There is a controversy over the issue of majority voting permitted by shareholding and active decission making which is usually done by the managers. The Lesotho Example of contract management and LNDC majority shareholding in most companies shows 'that 51% majority shareholding does not give Lesotho government an absolute control over the companies.

10. First Five Year Development Plan 1980-1985.

11. First Five Year Development Plan 1980-1985

12. Series of Prime Minister's speaches on the justification of the Second Development Plan 1971.

13. Moeletsi oa Basotho Vol. 29 No.1820 27 March 197

14. Muzorewa

15. See P.M. Senaoana forthcoming paper on the rural banking approach by Lesotho. The paper argues that Lesotho bank has successfully penetrated the inaccessible regions of Lesotho to introduce banking concept and behaviour yet because of the migrant labour system, rural customers have found it conviient to open savings accounts with South African banks.

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