THE POLITICAL ECONOMY OF LESOTHO FISCAL POLICY AND FISCAL REACTION FUNCTIONS

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Abstract

The paper seeks to determine the economic and political factors that have shaped the choice of Lesotho’s fiscal policy during both the pre-colonial and post-colonial era. This is essential given that fiscal policy is the linchpin for macroeconomic management in Lesotho, especially in the context of the fixed exchange rate regime. It is important to trace back this evolution as far back as the colonial era since some researchers have argued that institutional divergences that took place during colonization, had lasting implications on the present day institutions. Analytical Narratives are used to understand the institutional context within which events occurred in order to assess the factors that shaped the evolution and constrained the effectiveness of fiscal policy in Lesotho over diverse regimes. The findings show a series of political and institutional features at the roots of the country’s underdevelopment since the colonial era to the end of the review period given that political elites used it as an apparatus to advance their personal and political quests. The post-colonial elites deepened despotism traits of the colonists. The era of coalition governments has exacerbated the fiscal position. Since debt is an integral part of fiscal policy, the fiscal reaction functions for Lesotho are estimated using VAR and ARDL models to evaluate how the government has been reacting to its debt position in the past and to also determine the sustainability of fiscal policy. The results depict that the government has not been reacting to the level of its debt burden and that the path of government fiscal policy is not sustainable.

JEL Codes:
E62 - Fiscal Policy
E69 - Macroeconomic Policy, Macroeconomic Aspects of Public Finance, and General Outlook: Other
F54 - Colonialism; Imperialism; Postcolonialism
Keywords:
Political economy; Fiscal policy; Fiscal reaction functions

1. INTRODUCTION

"Countries such as Great Britain and the United States became rich because their citizens overthrew the elites who controlled power and created a society where political rights were much more broadly distributed, where the government was accountable and responsive to citizens, and where the great mass of people could take advantage of economic opportunities" (Acemoglu, 2012).

Why do nations fail? In their recent renowned book, Acemoglu and Robinson (2012) assert that nations fail because of "politics" or because of their political institutions that determine economic institutions which do not support the processes of development. They further argue that it is not necessarily economic policies or geography as earlier authors had suggested that lead to the failure of nations rather it is institutions. The authors theorize that extractive political institutions in which a "small" elite group of individuals' exploit - in the sense of Marx - the rest of the population are the main causes of development failures in many developing countries while developed countries have progressed because they enacted "inclusive" political institutions in which "many" people are included in the governance process hence the exploitation process is either attenuated or absent.

While these assertions seem plausible, they remain subject to empirical debates. In line with the arguments raised by Acemoglu and Robinson (2012), this study seeks to examine the factors that have underpinned Lesotho's development failure with a focus on political economy of fiscal policy during both the pre-colonial and post-independence era. This is particularly important because the country has adopted fixed exchange rate regime with South Africa since the 1980s and surrendered its monetary policy to South African Reserve Bank (SARB) leaving fiscal policy as the only macroeconomic management tool. Given that fiscal policy is determined by political players, we explore its evolution over different regimes and establish the extent to which it has been framed by political incentives in the context of Lesotho. This helps us compare the behavior of diverse political players and how they have used fiscal policy to achieve their ends during both the pre-colonial and post-colonial eras.

The initiatives of diverse regimes to develop various national development frameworks[1] in the quest to advance economic growth and development assert that the country's political elites are

[1] These frameworks include the National Development Plans, National Budget Speeches, different programmes embarked with International Organizations like IMF and World Bank, and other commitment devices to buttress the fiscal position and foster development with the most recent tool being the 2012/13 - 2016/17 National Strategic Development Plan.

not ignorant of fiscal policy measures that can reverse the economic challenges. The puzzle though is that neither the knowledge nor the adopted frameworks have been transmuted into economic equivalence. The failure to steer fiscal policy towards favourable development outcomes has led Lesotho to remain a least developed country and lacking behind other Southern African Customs Union (SACU) Member States in terms of economic development.

There is emphatically an urgent need for profound introspection of the evolution of fiscal policy and its interaction with political institutions in order to determine the impediments to its effectiveness if the country is to achieve the desired economic transformation. The rationale for exploring evolution of fiscal policy as far back as the colonial era is conjectured on the fact that authors such as Acemoglu and Robinson (2012) have argued that institutional divergences that took place during colonization, had lasting implications on the present day institutions particularly political institutions in developing countries and as such continue to affect development outcomes. Eslava (2006) corroborates this conjecture by indicating that a series of political and institutional features were key determinants of the fiscal balance during the early colonial period. Alesina et al. (1998) and other researchers like Alesina and Tabellini (1990) and Alesina and Passalacqua (2015), support the above findings by stipulating that deficit and debt reduction policies are almost always associated with politically charged issues.

The recent fiscal imbalances have instigated a need for fiscal consolidation measures. On the hand, the country has entered into an era of coalition governments which has implications on the fiscal account and public debt. Yet no attempt has been made to explore how fiscal policy behaves under coalition political institutions and under one party majority political institutions. This essay is an attempt to fill this gap.

The study differs from the past empirical research in the country in that it relates the role of politics on the economy; the study does not only analyze trends in the country's fiscal policy, but also attempts to put into perspective, the political incentives underlying such policy measures thereby contributing to the literature on fiscal policy and government behavior. The study is novel in that it also covers an extensive period, both the pre-colonial and post-colonial periods which gives a comprehensive viewpoint on the evolution of Lesotho fiscal policy. Furthermore, given that debt is the integral part of fiscal policy, the study estimates fiscal policy reaction functions to determine how the government has been reacting to changes in its debt level as both the economic and political dynamics do have an impact on debt thus further contributing to the literature on debt and fiscal policy in developing countries. In addition, the study assesses the sustainability of Lesotho fiscal policy. Based on the foregoing discussion, the main objective of this study is to determine the political and economic factors that have shaped the choice of fiscal policy during the colonial and post-independence era as well as to investigate how the government has been responding to changes in its public debt in the past and to determine the sustainability of fiscal policy.

2. OVERVIEW OF LESOTHO's GOVERNANCE STRUCTURES AND SYSTEMS

2.1 Political System during the Colonial Era

Lesotho was placed under British rule on the 12th March 1868 becoming the British protectorate and was later annexed to the Cape colony in 1871 (Basutoland Report, 1938). Following a series of wars with the Cape Government as Basotho refused to comply with some of the terms provided by the Cape Colony, the Imperial Government took over again the administration of Lesotho in 1884[2]. Since 1884 until the first democratic government of 1965, the country was governed by the resident commissioner under the direction of the high commissioner[3] with the later possessing legislative powers (Basutoland Report, 1938). The government was constituted by the colonists alongside the native rulers (chiefs) and in 1903, a native National Council consisting of 100 members was formed as an advisory body to the Resident Commissioner on domestic affairs of the country[4].

The constitution of governance was such that the chiefs were used to implement colonial policies by participating in the colonial administration (Gay et al., 1995). As entailed in Sir Alan Pim report (1935), the two systems of government worked practically independently of each other as they were not amalgamated into one system of government. The aforesaid is corroborated by

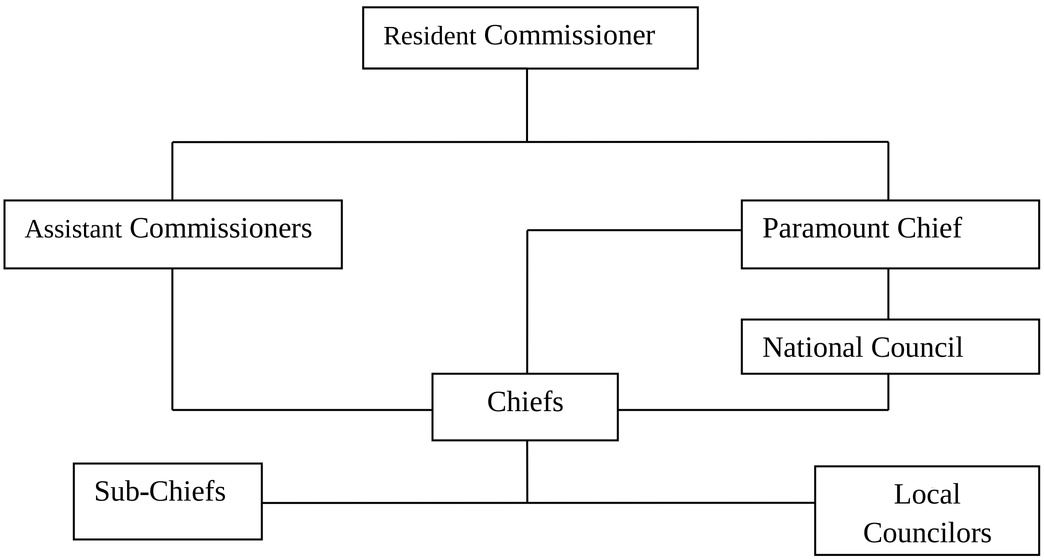
[2] Basutoland Annual Report, 1938

[3] Before 1931, the resident commissioner was under the direction of the high commissioner for South Africa. After then, the resident commissioner became under the direction of the high commissioner of Basutoland, Bechuanaland Protectorate and Swaziland.

[4] Basutoland Annual Report 1910

Gay et al. (1995) who allege that the administrative structure that existed during the Imperial rule points to the laissez faire system of British administration: The principle that the Europeans used to administer the colonies and protectorates metropolis.

Figure 2.1: The Colonial Governance Structure



Source: Author's illustration

2.2 Post-Independence Governance Structure and system

The country has a bicameral parliament consisting of a 120 seat member Parliament and a 33 seat Senate of which 22 are permanently held by principal chiefs and 11 other senators who are appointed to represent the wider interests of society[5]. At the national level, there are 3 arms of Government: the executive, the legislature and the judiciary. At the sub-national level, the country is divided into 10 administrative districts (sub-divided into 129 community councils) each administered by District Administrators under the Ministry of Local Government and Chieftaincy.

The first democratic government of 1965 ushered the country into independence in 1966. Following the 1970 elections, the country entered into authoritarian government as the incumbent Prime Minister suspended the constitution. The authoritarian Government faced a lot

[5] Government web-portal

of pressure from both external and domestic spheres and eventually the military intervened and seized power in January 1986 (Matlosa, 1997).

The country entered again into democratic government in 1993 that lasted until 2012. The democratic government of 1993-2012 was followed by a new dispensation of coalition governments. The first coalition government assumed power in 2012 to 2015. The second coalition government collapsed after two years in power following the break-up in one of the major coalition partners. Lesotho coalition governments have been marked by a very short time tenure which poses uncertainty in policy decision making.

2.3 Lesotho's past debt trajectory

With regard to public debt, the country has been relying on foreign funds by Multilateral, and Bilateral Financial Institutions[6]. The government policy has been to borrow at concessional terms against hard loans, which implies borrowing with at least 35 percent grant element, longer grace period and longer maturity terms. The policy stance augurs well for Lesotho as the chunk of its projects is infrastructural in nature and the economic benefits can ensue with a substantial time lag. The Multilateral loans have traditionally constituted a higher share of external debt.

Figure 2.2 illustrates Lesotho Debt-GDP (Gross Domestic Product) ratio from 1980/81 – 2016/17. In the late 1980s, the high ratio of Debt-GDP stemmed from amongst others: the implementation of Lesotho Highlands Water Project, sharp depreciation of Loti and the post-colonial structural and fiscal imbalances[7]. During this period, the government increased borrowing from the banking system with part of this being met by a reduction in net foreign assets which was an unsustainable policy direction. This route of intense borrowing from the banking system was reversed in 1990 resultant from the SAPs leading to assuage of Debt-GDP ratio as the government imbibed the policy of contracting debt on concessional terms[8]. The spike in Debt-GDP ratio of 116 percent in 2001/02 emanated from amongst others, a tax refund

[6] Ministry of Finance, Debt Management Unit
[7] Budget Speech, 1988
[8] Lesotho Fourth Five Year Development Plan

settlement to South Africa in connection with Lesotho Highlands Development Authority (LHDA) activities (Budget Speech, 2001).

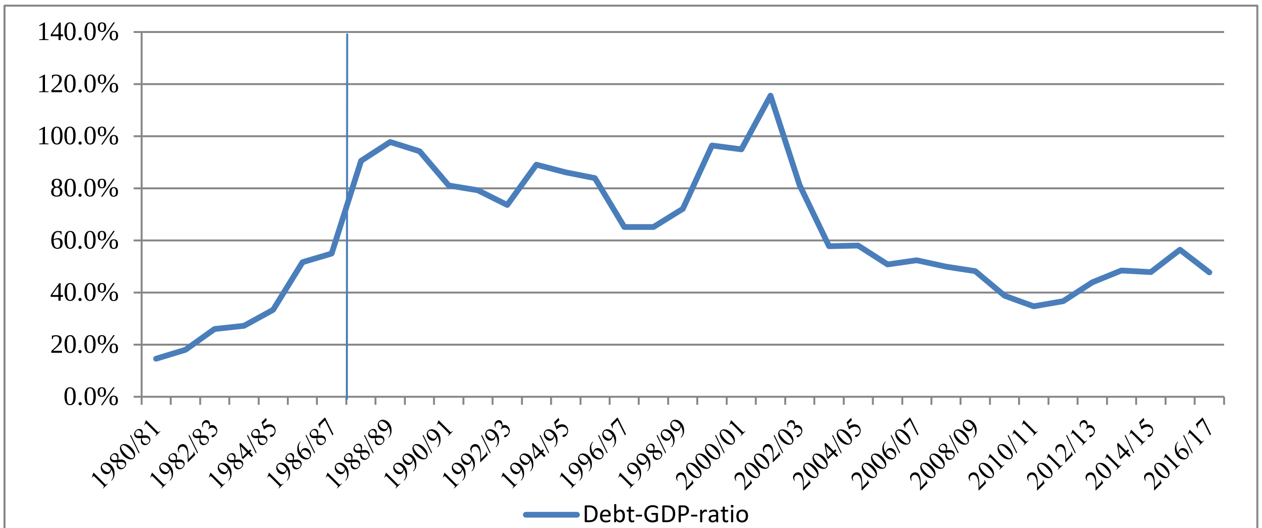


Figure2.2: Lesotho Debt-GDP ratio from 1980/81 – 2016/17[9]
Source: Central Bank of Lesotho and Ministry of Finance

3. LITERATURE REVIEW

The reviewed literature postulates that fiscal outcomes, in particular budget deficits and debt are orchestrated by political underpinnings such as: political opportunism in fiscal decision making, distributive conflicts, budget institutions, uncertainty of expectations, composition of fiscal adjustment, government type and political orientation, as well as endogeneity of institutions in the determination of fiscal policy.

Political opportunism in fiscal decision making

Eslava (2006) argued that fiscal policy is decided by opportunistic policymakers whose choices are intended to maximize voters' support. Voters value public spending and oust incumbents who are fiscally conservative thereby generating incentives for fiscal irresponsibility. This theory is corroborated by Rogoff (1990), Rogoff and Sibert (1988), Alesina and Passalacqua (2015). Moraga and Vidal (2004) argued that these political biases where politicians choose fiscal policy

[9] Data prior 1987/88 is on external debt alone due to unavailability of data on domestic debt.

that suit their political interest at the expense of social welfare have a negative bearing on debt. Notwithstanding, Eslava (2006) consents that the above theory of fiscal policy based on opportunistic politicians has been criticized on the ground that the notion of fiscal illusion implies not only that voters cannot fully understand the government budget, but also that they are repeatedly fooled by politicians.

Distributive conflicts

Under this line of literature, fiscal deficits are determined by two factors: conflicts of interests between different politicians with heterogeneous preferences which result in strategic deficits and distributive conflicts between groups of voters with conflicting interests for a common pool of government revenues (Enslava 2006).

These findings are corroborated by Moraga and Vidal (2004). On the contrary, some experimental studies[10] do not support any of the models of strategic deficits. Authors like Sutter 2003, believe that while it is a fact that deficits are strategic, it is hard to identify the phenomenon in the data if other sources of heterogeneity are not appropriately controlled for.

Budget Institutions

Another branch of theoretical literature relates the determination of fiscal policy to budget institutions. The ability of voters to understand the government's budget depends on the sophistication of voters and is key to avoiding fiscal excesses (Eslava, 2006). These results are supported by Alesina et al. (1998) where they used the index of budget institutions to examine the relationship between debt accumulation and budget institutions. They found that countries that rank higher in terms of the index of budget institutions have also lower deficits and debt. Other researchers like Von Hagen (1992) support these findings,

The composition of fiscal adjustment

Alesina et al. (1998) indicate that the composition of fiscal adjustment is paramount in the determination of fiscal policy because there are inherently both economic and political consequences to the government. This line of research posits that significant cuts in social expenditure and in government employment are a prerequisite for a lasting adjustment (Alesina

[10] Lambertini (2003),is one of the researcher who examined U.S. states and did not find consistent evidence in favor of either model of strategic use of deficits.

et al., 1998). This is conjectured by Alesina and Perotti (1995). The findings of Alesina et al. (1998) also allude to this findings by discovering that when deficits are reduced, governments that follow a tight fiscal policy approach and focus on spending cuts may be rewarded at the ballot box. They further discovered that cabinets that are willing to cut transfers and the government wage bill, are not punished by the voters and are likely to survive longer.

Uncertainty of expectations

Another factor that derives in explaining the government's deviation from the optimal level of debt is when political power alternates randomly between competing political parties as postulated by Alesina and Tabellini (1990). Each government will be tempted to leave a legacy of high debt for its successor (strategic debt). Strategic debts therefore increase with more political polarization and with higher uncertainty of the electoral outcome. Alesina and Tabellini (1990) conjectured the above research by stating that, if a party is unsure of being reappointed, it will issue debt. The study of Roubini and Sachs (1989) confirm this theory by discovering that governments with large coalitions and/or short tenures are characterized by particularly large average deficits.

Government Type and Political Orientation

Government fragmentation increases public expenditures. According to Baskaran (2013), in countries with parliamentary regimes, fragmentation hypothesis refers to coalition governments and cabinet size. The indication of the fragmentation hypothesis is that, overall demand for public expenditure will increase with the number of parties represented in the government and the size of the cabinet. May (1952) on the other hand showed that, simple majority rule is the only social choice process which can reach a decision for all possible citizen preference ordering as it is unrestricted and is simple to administer. This theory is supported by Roubini and Sachs (1989) who postulate that multi party coalition governments especially with a short expected tenure are poor at reducing budget deficits. On the contrary, Alesina et al. (1998) indicated that the ideological orientation of government does not seem to have much influence on the frequency of loose and tight episodes. They however conjectured that a coalition government is much less likely to succeed in consolidating the budget than a single party government

Endogeneity of Institutions in the determination of fiscal policy

Alesina and Passalacqua (2015) allege that political institutions are endogenous in the determination of fiscal policy and in debt level. The authors allege that the same historical, sociological and cultural variables which may have led to the choice of certain institutions may also be correlated with fiscal policies. Aghion et al (2005) lends credence to these findings.

4. METHODOLOGY

Data sources and description

To assess the evolution of Lesotho fiscal policy, the pre-colonial data was extracted from various pre-colonial/Basutoland reports (1910, 1921/22, 1923, 1926, 1934, 1938, 1946 and 1968). The *First to Fourth five-year-national development plans* were used to extract fiscal data from 1968/69 to 1990/91. Medium Term Fiscal Framework (MTFF) for the period 1991/92 to 2016/17 was obtained from the Ministry of Finance. Data on public debt was obtained from the Ministry of Finance, CBL Annual reports and IMF database for 1991/92-2016/17, 1987/88-1990/91 and 1980/81-1986/87 respectively. The data is analyzed through the use of analytic narratives which involve the use of case study essays to assess how fiscal policy has evolved during different political regimes. All the data is given in fiscal years.

To estimate fiscal reaction functions and determine the sustainability of fiscal policy, the study uses fiscal data on debt, primary balance, GDP, real economic growth rate, output gap and interest rates[11]. Due to the fact that some of fiscal variables like public debt have a relatively short time series available, fiscal policy reaction functions are estimated over the period 1987/88 to 2016/17. The VAR and ARDL models are used to estimate fiscal reaction functions. The two approaches are used to come up with concrete results and to generate medium term forecasts to test the credibility of our models against the debt targets as stated in 2017/18 national budget speech.

[11] Personal computation of primary balance was done as it is not captured under fiscal indicators from the Ministry of Finance.

Model Specification

Analytical Narratives

Short case study essays coupled with descriptive statistics are used to analytically narrate political and economic factors that underlined the fiscal choices over different regimes from the colonial era to the post -colonial period. The use of historical and comparative research offers institutional context within which events occurred (Asquer, 2013) and therefore makes it possible to derive explanations from the seemingly descriptive material. Fiscal policy during diverse regimes is analysed considering both the components of revenue and expenditure. Debt as an integral part of fiscal policy is included in cases although we will not delve much on it on this study. Government Finance Statistics is used as a framework to analyse revenue and expenditure developments.

Fiscal reaction functions

The model derives from the budget constraint of government which is given as follows[12]:

$$D_t = D_{t-1} + iD_{t-1} - B_t \quad (1)$$

$$D_t = (1 + i)D_{t-1} - B_t$$

Where D: Public debt

i: Nominal interest rate

B: Primary balance

Using this equation to measure the change in the level of indebtedness, measured against GDP yields the following equation:

$$\Delta (D/Y)_t = ((r - g)/(1 + g))(D/Y)_{t-1} - (B/Y)_t \quad (2)$$

Where r: Real interest rate

g: Real economic growth rate

Y: Nominal GDP

The dynamics of public debt are analyzed in terms of nominal GDP ratio. The primary balance that ensures that debt/GDP level remains unchanged ($\Delta d_{t=0}$) is derived from equation (2) as follows:

$$(B/Y)_t = ((r - g)/(1 + g))(D/Y)_{t-1} \quad (3)$$

[12] Debt Sustainability online course by International Monetary Fund

Equation (3) can be interpreted as a fiscal rule that defines the primary balance/GDP ratio required to keep to such a debt/GDP target.

The fiscal reaction function is to be estimated in this analogous form to establish the actual behavior of government:

$$\left(\frac{B}{Y}\right)_t^{Act} = \beta^*(D/Y)_{t-1}^{Act} + \varepsilon_t \tag{4}$$

Where subscript Act indicates the actual time series, as opposed to the required primary balance/GDP ratio or the target debt/GDP ratio and $\beta^* = (r-g)/(1+g)$. To allow inertia in government behavior, a lag of the primary balance, $\left(\frac{B}{Y}\right)_{t-1}^{Act}$, can be added to the right-hand side of Equation (4). The output gap (OG) is also added to the right-hand side as a control variable to allow for the possibility that government pursues short run demand stabilisation. The basic fiscal reaction function is therefore specified as:

$$\left(\frac{B}{Y}\right)_t^{Act} = \beta_1 + \beta_2\left(\frac{B}{Y}\right)_{t-1}^{Act} + \beta_3\left(\frac{D}{Y}\right)_{t-1}^{Act} + \beta_4\,(OG)_t + \varepsilon_t \tag{5}$$

Equation 5 is used to estimate fiscal policy reaction functions for Lesotho. If the change that the Government brings about in the primary balance in reaction to changes in the level of debt, $\beta_3/(1-\beta_2)$ is close to β^* in equation (4), it would mean that government is attempting to stabilize its debt ratio at the realised level in the previous period (Burger et al., 2011).

Equation (2) estimated earlier can also be written as:

$$(D/Y)_t = ((1+r)/(1+g))(D/Y)_{t-1} - (B/Y)_t \tag{6}$$

Equation (6) implies that the debt/GDP ratio depends on its own lag, the interest rate, the economic growth rate and the primary balance.

To derive the ARDL equation, the long run relationship between primary balance/GDP and public debt/GDP from equation (5) is given as:

$$\left(\frac{B}{Y}\right)_t^{Act} = \beta^*(D/Y)_{t-1}^{Act} \quad \text{where, } \beta^* = (r-g)/(1+g) \tag{7}$$

From equation 7, the following ARDL equation which captures time lags is derived:

$$\Delta\left(\frac{B}{Y}\right) = \beta_1(B/Y)_{t-1} + \beta_2(D/Y)_{t-1} + \beta_3\Delta(\frac{D}{Y}) + \beta_4\Delta(\frac{D}{Y})_{t-1} + \beta_5\Delta(\frac{D}{Y})_{t-2} + \beta_6\Delta(B/Y_{t-1}) + \beta_7\Delta(B/Y)_{t-2} + \beta_8(OG)_{t-1} \tag{8}$$

$$\left(\frac{B}{Y}\right) - (B/Y)_{t-1} = \beta_1(B/Y)_{t-1} + \beta_2(D/Y)_{t-1} + \beta_3(D/Y - D/Y_{t-1}) + \beta_4(D/Y_{t-1} - D/Y_{t-2}) + \beta_5(D/Y_{t-2} - D/Y_{t-3}) + \beta_6(B/Y_{t-1} - B/Y_{t-2}) + \beta_7(B/Y_{t-2} - B/Y_{t-3}) + \beta_8(OG)_{t-1} \tag{9}$$

5. RESULTS

Was fiscal policy for revenue maximization and effective spending or was it for advancing the colonial empire during the Colonial Era: 1904/05 – 1964/65?

Throughout the colonial period, 1904/05-1964/65, the administration of the territory was presided over by the Imperial Government as indicated by various Basutoland report. Immediately after taking over the territory, the British government imposed the hut tax which was later replaced by native tax. One incentive for this imposition was to raise revenue to meet the administrative expenses of the protectorate so that the country would not rely exclusively on grants from Britain, Lye and Murray (1980, 1982). The chiefs and headmen collected the tax on behalf of district Assistant Commissioners who were the Europeans and were in return paid out of the proceeds from their collection (Basutoland Report, 1921/22). This was however demeaning to the chieftaincy institution and was a bone of contention between the chiefs and the public as the later were used as agents to explore funds from their subjects to sustain the colonial government.

Another incentive for the imposition of the hut/native tax was to draw Basotho laborers into the South African mining industry which was exclusively owned by British white neighbor (Maliehe, 2014). The third incentive associated with the imposition of hut/native tax was to monetarize the Lesotho economy and convert it into a cash economy that would support the fast growing South African goods markets.

Income-tax was introduced in 1921/22 on the lines of that levied in the Union of South Africa due to the need for increased revenue during that period (Basutoland Report, 1921/22). In addition, a Poll tax of £2 per annum was imposed on all adult males in Basutoland not liable to Native Tax in 1933 (Basutoland Report, 1933). It is alleged that with the onset of the great depression, additional poll and health taxes were levied on the black population throughout South Africa. This by extension explains why the tax was levied on Basutoland in May 1933.

The imposition Coincided with the great drought of 1932/33 in which the country was going through a dire famine (Basutoland Report, 1933) and economic depress. These socio-economic predicaments notwithstanding, the government went ahead and introduced the poll tax. Fiscal discretionary policy was thus used to extract resources from the deprived Basotho to relieve the imperialists.

License fees were required for trade purposes, (Maliehe, 2014) and the Resident Commissioner had the jurisdiction rights to issue renew or refuse licenses at his disposition. According to Pim report (1935), only three trading licenses out of the 194 in operation in 1935 were owned by Basotho traders. When the barriers were lifted, Basotho were constrained to trade in the rural areas (Maliehe, 2014) pointing to the autocratic nature of the Imperial system.

Under proclamation No. 14 of 1923, Wool and mohair fund was established (Basutoland Report, 1938). The European traders were key players and beneficiaries in the exports of this product as they engaged in trading practices that effectively eliminated competition (Hunter and Mokitimi, 1989). These practices included provision of credit against commodity sales and payment with script or chits and employment of tout to encourage producers to deal with a particular trader (Hunter and Mokitimi, 1989).

The Colonial Development & Welfare (C.D &W) grants were first introduced in 1934/35. Constantine (1940) alleges that in the edge to advance the Colonial Empire, the Imperial government aided for the building of economic infrastructures in the colonies without which private enterprise in colonial production and marketing faced high risks and excessive costs. Therefore, the introduction of C.D & W grants was not only going to give a political mileage to the colonies but would also ensure a benign environment for their markets. Furthermore, the belated introduction of C.D & W grants lends credence to the assertion that Britain did not show interest in the affairs of Basotho during the early colonization period but only started investing in some of the capital and development schemes upon the realization that the country's annexation to South Africa was not tenable (Hunter and Mokitimi, 1989).

As a means to quell the natives' aggression over the lost land, the Imperialist Government invested a lot of resources in maintaining order and justice as demonstrated in Table 5.1. The *Police and Prisons* accounted for the highest share of the administrative costs (Basutoland Report, 1938). This lends support to the assertion that "the focus of the Resident Commissioner was on taxation, Basutoland's foreign affairs, the settling of disputes overland between chiefs and high level justice administration; little investments in infrastructure or education were made" (Lesotho Government Undated; Eldredge 1980, 167). Furthermore, to garner more influence in the administration of justice the colonists were at the apex of the government administration while the natives only occupied inferior positions.

Contrary to some findings that the colonists spend fewer resources on economic sectors of their colonies, the study divulges that a substantial amount of resources was invested on this sector in Basutoland. The main incentive for prioritizing this productive sector was to ultimately boost the exports sector which was driven mainly by agriculture where European investors were the main players. To this effect, *Agriculture & Veterinary services* received a higher share of total expense.

Table 5. 1: Components of the Administration Sector from 1904/05-1965/66 (in thousands of Pounds)

	1904/05	**1912/13**	**1920/21**	**1928/29**	**1936/37**	**1944/45**	**1952/53**	**1960/61**	**1964/65**
TOTAL	**32.85**	**48.46**	**90.69**	**91.66**	**93.59**	**140.85**	**305.00**	**1106.09**	**1366.76**
Resident Commissioner	10.02	15.11	28.90	13.10	13.93	22.57	6.09	21.16	14.37
Paramount	5.43	6.90	11.46	12.56	12.99	12.14	0.00	69.08	23.35
National Council	0.04	1.31	2.11	1.76	1.72	0.00	0.00	41.87	0.00
Central Administration	0.00	0.00	0.00	0.00	0.00	2.96	0.00	231.22	0.00
District Administation	0.00	0.00	0.00	14.12	18.45	43.24	56.26	123.64	0.00
Basuto Admin/courts (jails)	2.20	4.09	7.80	11.76	13.69	0.00	106.07	105.54	17.13
Police & Prisons	15.16	21.06	40.43	38.36	32.80	59.94	136.58	513.58	947.61

Source: Basutoland Annual Reports (various)

On education, European children were accorded different education from the natives given that they attended different schools (Basutoland Report, 1938) which advocated for unequal and segregated society. Mats'ela (1982) indicates that only a few children from chiefs and Basotho clergies were sent to more up-to-date schools in the Cape Province. Motaba (1998) reiterates that the interest was in educating a few Basotho in order to produce interpreters in courts and translators of English to facilitate communication with colonial population. Indeed, the education system in the country lends its credence to the colonial time and subsequent education policies and strategies have not yet been able to decimate this legacy.

With regard to Labour legislation, the High Commissioner was given the jurisdiction to regulate the level of wages paid to natives in any occupation or in any area within the territory (Basutoland report, 1938). According to the Basutoland Report (1938), there was a salary mismatch between the Europeans and natives with the Europeans earning by far, higher salaries than the natives thereby failing to promote a society where wealth was much more broadly distributed and many people had access to economic opportunities.

Revenue during this era was used as an apparatus to exploit the native's resources, to promote unequal society through uneven distribution of economic opportunities and to ease the Imperialists burden of providing resources. Spending on the other hand was curtailed mainly towards maintenance of order and justice to safeguard the security of the Imperialists and in boosting the export sector.

From Embryonic Democracy to De Facto One Party Rule (1965 –1986) How did Fiscal Policy Respond?

> "The present crisis in Africa is largely an institutional crisis. In particular, it is a crisis of the state. The dilemma facing the African state is that because it was inherited, in many instances just like an empty shell from the colonial powers, ……In this situation, it is not surprising that short-term considerations have taken precedence over long-term ones, power over welfare, personal over institutional considerations, and security over development" (Mupanduki,2007).

The first democratic government assumed power in 1965 and ushered the country into independence in 1966. After independence, the country adopted the Westminster system of government which was the institutional legacy of the former Imperial rulers (Matlosa, 1997).

At its inception, the Government received a massive injection in C, D &W grants worth M25.8 million and M27.8 million in 1966/67 and 1967/68 respectfully from M1.5 million in 1965. As the grants subsided in 1968/69, the fiscal position deteriorated. The British aid was suspended after 1970 national elections where the incumbent Prime Minister rejected the election outcome; declared the state of emergency; suspended the constitution; and dissolved the parliament (Matlosa, 1997). As the Government was grappling with financial crises following the 1970 state of emergency, it imposed a maize levy on imported maize and maize products as it[13]. Basotho business owners of which the majority was deemed to be affiliated with the opposition defied this policy and were found guilty by the high court ensuing into the auctioning of all their property due to their failure to raise the amount charged by the High Court (Maliehe, 2016).

Table 5. 2: Components of the Fiscal Policy during Embryonic Democracy

	1965/66	1966/67	1967/68	1968/69	1969/70
Revenue excluding grants	4,07	4,84	6,28	5,65	7,42
Total revenue	12,75	39,43	42,72	5,65	9,01
1. Tax revenue	1,39	1,52	1,74	1,90	2,21
3. Grants	8,68	34,60	36,44	0,00	1,59
4. Other revenue	1,28	1,75	2,61	1,83	1,81
5.Current transfers/SACU	1,40	1,57	1,93	1,92	3,40
Total Expenditure	11,14	12,41	15,16	11,22	11,42
Non Financial Assets	1,09	1,84	2,31	0,82	1,24
Total Expense	9,59	9,56	11,20	9,69	9,78
Economic services	2,58	1,99	1,93	1,90	1,80
Social Services	2,51	2,80	3,37	3,39	3,24
General Government services	2,12	2,31	2,59	2,58	2,60
Administration	1,20	1,28	1,35	1,53	1,66
Statutary	0,30	0,30	0,29	0,13	0,36
Legislation,Executive & Judiciary	0,17	0,18	0,18	0,17	0,13
Other expense	0,71	0,70	1,50	0,01	0,00
Overall Fiscal Balance	2,08	28,03	29,21	-4,86	-2,00
Overall Balance exluding Grants	-6,60	-6,57	-7,23	-4,86	-3,60

[13]The South African Government had abolished the maize levy towards the end of 1969 and the Basotho business owners did not comply with this regulation and continued selling maize at a lower price than European traders thereby outcompeting them as shown by Maliehe, 2016.

There were however some revenue enhancing measures introduced during this era. These include imposition of hotel accommodation levy and a gaming levy on the profits of casinos which were first collected during the *First development plan*[14]. Furthermore, the Government introduced a five per cent retail sales tax in December 1982 which moved in line with that of South Africa in order to strengthen its fiscal position amid increasing deficit and unreliable aid (World Bank, 1988). The country also benefitted from the new SACU agreement which was operationalized in 1969/70 following the 1910 SACU Agreement,

During the embryonic rule, the share of revenue (excluding grants) to GDP was 13 percent, the share of recurrent expenditure to GDP was 25 percent while the development budget share to GDP amounted to 5 percent only. The *Social services*, *Administration and General Government services* were almost always on the upward trajectory (Table 5.2). On the contrary, *Economic services* were always on the declining path lending credence to assertion that the sector was initially prioritised to boost the European exports. It can be seen that the fiscal institutions were still not financially independent and the structural pattern of spending modelled by the imperialists still haunted the country even after independence.

One of the debacles of the immediate postcolonial elites was their compromise towards the District Councils. Instead of increasing the powers of the District Councils which are central to the development of communities in the grassroots, the government abolished them in 1969 as some were dominated by the main opposition party (Maleleka, 2009) and were replaced by Village Development Councils (VDCs) These structures were nominated such that to a large extent they could serve the interests of the ruling party. Indiana University Press (1972) lends credence to the above assertions by stating that Government concentrated a number of economic projects in the areas where the ruling party had narrowly escaped defeat to win over the votes. This deferment of democracy spilled over into being a development impediment as the government prioritised its political significance at the expense of institutional considerations.

[14] First Five Year Development Plan, 1970

Reminiscent of the colonial government, the elites paid more focus on the area of law and order. The modern army was established during the de facto one party rule Matlosa (2006), transformed into a paramilitary force styled Lesotho Paramilitary Force (LPF) in 1980 and subsequently elevated to a defense force proper later in the 1980s when it assumed the status of the Royal Defense Force (Matlosa, 1997). The political tensions of the 1980s let to a massive increase in military expenditure (World Bank, 1988) which worsened the fiscal deficit. This deficit was further exacerbated by an across-the-board salaries increase of 40 percent in 1985 (World Bank, 1988) where a larger size of civil servants is alleged to have been politically motivated and promotion was not on the basis of merit but rather on political affiliation (Blomstrom and Lundahi, 2002).

There were however some strides in health as the country adopted the Primary Health Care Strategy (PHC) in 1970. It is reported in the Second Five Year Development Plan that the programme led to the significant improvement in the health survival indicators related to life expectancy at birth, child and maternal mortalities through to early 1990s. There were also some reforms aimed at boosting the agricultural sector which included restricting the number of licenses issued on purchasing of wool and mohair to private traders (Hunter and Mokitimi, 1989), the establishment of the Livestock Marketing Corporation and Livestock products Marketing Services the establishment of Co-op Lesotho in 1981. Regrettably, due to financial challenges, lack of expertise and poor management, some of these initiative halted Hunter and Mokitimi, 1989. Some infrastructure projects were also implemented during this era.

Fiscal Policy Developments during the Military Rule, 1986 –1993

The military regime assumed office in January 1986 after toppling the preceding regime (Matlosa, 1997). However, Matlosa (1997) postulates that during its term in office, the military regime deepened the authoritarian character of the state and its institutional crisis became much more pronounced as the Military Council suspended all formal political activity.

It was during this era that the country adopted the World Bank’s neo-liberal economic policies, the Structural Adjustment Programmes (SAPs) from 1988 to 1995 that came in three packages: i) The SAP of 1988/89-1990/91;ii) The Enhanced Structural Adjustment Facility (ESAF) of

1991/92 to 1994/95; and iii) the Privatization and Private Sector Development Project of 1995 to 2000 which was implemented during the subsequent era (Maliehe, 2014).

The economic situation at this period had deteriorated conspicuously. The fiscal deficits as a percent of GDP averaged 14.1 percent between 1985/86 and 1988/89 with the record high of 16.4 in 1987/88. The underlying factors for these macroeconomic crises were the insufficient structural transformations and diversifications required to move away from the inherited colonial type of economic structures[15]. Nonetheless, some of the country's challenges were internally inherent as elaborated in the previous section.

By the end of 1980s, some tax reforms in the SAP were introduced with the objective of simplifying the tax system due to administration weaknesses (Blomstrom and Lundahi, 2002). The Structural Adjustment Progamme initiated the negotiations between Lesotho and South Africa on the revision of the 1973 labour agreement between the two countries to ensure that employers deducted relevant taxes from migrants' wages on behalf of the Lesotho government to which South African government was not corporative. Lesotho therefore resorted to the introduction of a levy of M100 per contract from Basotho miners but the accruing revenues were minimal.

During this era, the level of military expenditures was high compared to the levels recorded in the previous regimes (World Bank, 1988). Part of this increase reflected the Military Council's new responsibility for food aid program, (World Bank, 1988). On parallel, wages and salaries of civil servants were increased drastically in 1988 versus the preceding review of 1985. The review was implemented in line with the SAPs in the quest to retain skilled professionals. In the late 1988's, public employment comprised almost 45 percent of the total formal sector work force, having grown substantially since the early 1980s to levels which government accepted to be too high (World Bank, 1988).

The highlands water treaty between Lesotho & South Africa that ensued unprecedented water project was signed in October 1986 (Gill, 1972). Gill (1972) argues that this long discussed

[15] Lesotho-fourth five-year development plan 1986/87-90/91 Ministry of planning, economic and manpower development.

project was initiated without any attempt by the government to allow the public to debate its merits in order to have ownership of the project. This can be explained by the nature of the government which did not have people's representation to foster feedback processes in decision making. The preceding regime could not enter into agreement with the South African government on this project which was initiated even before independence as the elites then could not agree with the stipulated terms (Gill, 1972).

Fiscal Policy under One Party Majority Democratic Rule (1993-2012)

Following the transition from the military rule (1986-1993), the country moved into a democratic government after the elections of 1993. The new government benefited from Enhanced Structural Adjustment Facility (ESAF) of 1991/92-1994/95 as the programme laid the foundation for economic stability (Maliehe, 2016). The fiscal position was therefore robust when the new regime assumed power, with fiscal surplus recorded at 8.8 percent of GDP in 1993/94 as demonstrated in Table 5.3. The fiscal surpluses persisted until 1997/98 albeit at the declining rate (they were registered at 6.6, 5.9, 2.4 and 0.3 per cent of GDP in 1994/95, 1995/96, 1996/97 and 1997/98 respectively).

In 1994, the privatization and private sector development project which was the integral part of SAPs was launched with the aim of easing the financial burden on the budget, improving efficiency in production, encouraging and improving domestic investment by local residents and attracting foreign investment into the economy (Maliehe, 2016). The purpose of the privatization programme notwithstanding, its demerits which include difficulty in regulating private monopoly stick out. The Government has encountered complexities monitoring state owned enterprises due to a lot of hidden information ensuing into non declaration of dividends. The summary of fiscal account is presented in Table 5.3.

Table 5.3: Summary of Fiscal Account from 1993/94-2011/12 (millions of Maloti)

	1993/94	1996/97	1999/00	2002/03	2005/06	2008/09	2011/12
TOTAL REVENUE	1262.1	1864.7	2054.5	3228.7	4653.3	9094.0	9627.2
Revenue excluding grants	1218.3	1760.9	2018.3	3051.4	4489.7	8599.2	8190.4
Tax revenue	361.9	521.4	668.9	1140.3	1755.0	2858.0	4282.8
Social Contributions	0.2	0.3	0.3	0.3	0.0	0.0	0.0
Grants	43.8	103.7	36.2	177.3	163.6	494.8	1436.8
Other revenue	109.0	233.2	166.0	440.9	428.7	840.6	1154.9
SACU	747.1	1006.0	1183.1	1470.0	2306.0	4900.6	2752.6
EXPENSE	885.4	1434.1	2663.3	3108.1	3940.7	6517.0	8519.1
Compensation of Employees	414.9	708.9	883.1	1210.8	1495.9	2329.7	3640.2
Use of goods and services	290.3	528.9	697.8	1092.1	1242.2	2287.5	2042.1
Interest Payments	62.0	29.1	92.5	209.5	216.8	129.2	137.1
Subsidies	23.0	36.1	605.5	0.0	0.0	204.0	238.8
Grants	63.0	113.5	255.9	278.8	528.1	778.4	894.4
Social Benefits	0.5	0.0	0.4	9.2	148.6	226.9	586.1
Other expense	31.6	17.7	128.0	307.7	309.1	561.3	980.4
OTHER ANALYTIC MEASURES							
Capital expenditure	284.2	577.9	1096.1	667.8	681.5	947.8	4162.9
Non financial assets	157.8	339.9	276.9	318.1	322.1	1392.9	2978.6
Total expenditure	1043.1	1774.0	2940.2	3426.1	4262.8	7909.9	11497.6
Public debt	2230.5	2409.2	4833.1	5702.8	4546.4	7044.8	6843.7
Fiscal balance	220.7	89.4	-884.6	-163.2	396.9	582.3	-1870.4
Nominal GDP	2505.9	3699.3	5010.8	7024.8	8945.2	14620.7	18660.0
Debt-GDP ratio	89.0%	65.1%	96.5%	81.2%	50.8%	48.2%	36.7%
Fiscal balance (% of GDP)	8.8%	2.4%	-17.7%	-2.3%	4.4%	4.0%	-10.0%

Source: Ministry of Finance

After more than a decade of consecutive growth, *total revenue* realized a decline in 1998/99 and 1999/00 in the aftermath of the 1998 political turmoil that saw part of the country in flames. The impressive fiscal position realized since the impact of the ESAF programme of the 1990s was thus reversed. The roots of the 1998 conflict are traceable to the country's structural crisis and institutional paralysis as conjectured by researchers like Matlosa (2006). Weak institutions pose an unfavorable environment for the rule of law and respect for property rights which are deemed enabling mechanisms for a thriving fiscal policy.

Notwithstanding, a number of fiscal reforms with respect to revenue were initiated during this tenure. These include the institutionalization of Lesotho Revenue Authority in 2002/03 which was intended to increase efficiency in tax collection and was mandated with the management of government revenue policy[16]. VAT was legislated and operationalized in 2003/04 as an effective mechanism for tax management and was replacing the sales tax of 1982 (Budget Speech, 2003/04).

A number of expansionary measures were exhibited during this regime. These included downward revision of company tax rate brackets from 35 percent to 25 percent in 2006/07[17] as a means of encouraging private sector led growth. The manufacturing and farming sectors had the preferential rate of 15 percent. This preferential rate was further lowered to 10 percent in support of manufacturing industry to make it more attractive to new and existing investors with the manufacturing industries that exported outside SACU region being completely exempted from corporate tax. The manufacturing sector has been hailed as the second largest employer after the government. Nonetheless, apart from employment benefits, not much economic benefits accrue from this sector as it is renowned for expatriating profits.

In July 2007, the country benefitted from a gigantic grant worth over M 2.5 billion from Millennium Challenge Corporation on the ground of ruling justly, investing in people and economic freedom as shown in the 2008/09 Budget Speech. In parallel, because of being recognized for good governance, the European Commission increased its Indicative Aid allocation under European Development Fund (EDF) by 25% in 2008/09 (Budget Speech, 2008/09). Lesotho also benefitted from Budget support grants.

SACU revenue remained the mainstay of revenue throughout the regime followed by tax revenue. Towards the end of the regime, revenue was affected by the aftermath of the recent

[16] 2001/02 Budget Speech to the Parliament of Lesotho
[17] 2006/07 Budget Speech to the Parliament of the Kingdom of Lesotho

global financial and economic crises, impacting negatively on SACU revenues. The fiscal deficit of 5.8 percent of GDP was registered in 2009/10 and culminated to 10.0 percent of GDP in 2011/12. To redress the impact of the crises, the Government entered into a three-Year Extended Credit Facility (ECF) Program with the International Monetary Fund (IMF) in 2010, to help in fiscal consolidation implementation[18].

Right on its onset, the new democratic government tailored spending on the expansionary path by increasing wages and salaries of the armed force by 25 percent in 1994/95 following their internal fighting of 1994 (Gay et al., 1995). The Amnesty Report (1995) shows that the Government stepped in this direction as it feared that most members of the security forces remained loyal to Lesotho's former military rulers. The Government further increased the wages and salaries for civil servants by 34 percent in 1995/96 and the increase was further extended to police and prison officers (Gay et al., 1995). In 1994, as the government bowed to police strike that demanded a salary increase, they were given a 50 percent salary hike in 1995 (Gay et al., 1995). Notwithstanding these increases in compensation of employees, the fiscal position remained sound attributable to ESAF programme and the underlying surpluses persisted until 1997/98 as seen in Table 5.3.

Subsequent reforms on wages and salaries continued during this tenure and were composed of; salary reviews; salary regrading; salary merging with the most popular being the review of statutory positions in 2005/06 and the review normalization of Principal Secretaries and Government Secretary positions in 2007/08. Massive increases in compensation of employees by 20, 22 and 35 percent were realized in 2007/08, 2008/09 and 2009/10 respectively.

A number of social safety net programs were introduced in the early 2000s[19]. These include: Free Primary Education, Old Age Pension (OAP), African Pioneer Corps Pension (APC), Lesotho Liberation Army Pension (LLA), School Feeding Programme, Child support grant and Workers Compensation. Pelham (2007) conjectures that Lesotho OAP was an ex-post response to an absence of support and the demographic impact of the AIDS epidemic. However, we argue that

[18] Budget Speech to Parliament for the 2011/2012 Fiscal Year
[19] Ministry of Finance

Lesotho Pension also portrayed ex-ante response because the political parties used the old age pension in their elections manifestos to win the electorates. It is a general believe that the introduction of the pension and other social safety net programmes gave the ruling party the political milestone in the 2007 elections. Another drastic reform on the pension system during this tenure relates to the switching from Unfunded Defined Benefit Scheme to Pre-Funded Defined Contribution Scheme in 2008/09 (Budget Speech, 2008/09).

In terms of governance instituions, the government established independent institutions like the Office of the Ombudsman in 1993 and the Independent Electoral Commission (IEC) in 1997. The establishment of IEC was necessary to mitigate the election syndrome of post electoral disputates hence setting a benign environment for consolidating democracy (Matlosa, 2006).

In 2002, the First-Past-The-Post (FPTP) electoral system was replaced by the Mixed Member Proportional (MMP) system leading to the increase in parliament size from 80 seats to 120 (Matlosa, 2006). While the motive for broadening the political ground might be construed as a quest for more public representation, the costs born by the government was evinced by the increase in gratuities to statutory positions from M35m in 2002/03 to M60m in 2003/04. Another unprecedented move in governance was the holding of first local government elections in 2005/06.

Government subsidies during the regime were extended chiefly to the textile and agricultural sectors. The subsidy to the textile sector was in the form of Duty Credit Certificate scheme (DCCs) as stated in 2006/07 Budget Speech. With regard to agriculture, the government launched a once off programme of assisting farmers with payment of 50% of the cost of inputs and ploughing and also placed a 20% subsidy on unsifted maize meal in 2003/04 (Budget Speech, 2003/04). Block farming was introduced in 2006/07 with the intention to intensify household food production and food security (Budget Speech 2007/08). These preferential measures to the sector have however not resulted in corresponding impact especially in rural areas where agriculture still defines the livelihoods of the majority as high poverty levels are still prevalent.

On financing, the government adopted a new financing model of the use of Public Private Partnerships (PPP) which was piloted with the construction of the main referral hospital in the country. However, the ensuing skyrocket expenses has heavily consumed the country's resources leading to the health care services related to the hospital taking a greater chunk of the sector budget allocation and pointing to lack of value for money. Health care services related to the hospital ballooned to M338.3 million in 2011/12 from M118.1 million recorded in 2010/11.

The era of Coalition Governments 2012/13-2016/17

The new tripartite coalition government marked a new era in the country's politics following the national elections of May 2012. The first coalition government brought a lot of optimism after many years of a single party majority rule. However, the theory that shows the shortcomings inherent in this type of government and the consequential effects on fiscal policy were sooner proved irrefutable by the developments that unfolded, impacting on the fiscal policy. The inherent complexities in this nature of government include office seeking tendencies; ideological divergences; resource conflicts and difficulty in implementing fiscal adjustments (Roubini and Sachs, 1987). Table 5.4 presents revenue and expenditure during the First Coalition Government.

The first coalition government benefited from positive structural changes that were ongoing at the time it assumed office. These included the Lesotho compact with MCC that was signed during the preceding regime which was then at its climax. The regime also benefited from the ECF program with IMF that was also entered into during the previous regime in 2010. The fiscal consolidation exercise of the program in 2012/13 yielded positive results as the fiscal balance turned from the deficit of 10 percent of GDP registered in 2011/12 to the surplus of 4.5 percent of GDP in 2012/13.

Table 5.4: Fiscal Indicators during the First Two Coalition Governments

	2012/13	2013/14	2014/15	2015/16	2016/17
Total revenue	13144,9	13274,5	14582,5	15301,1	14050,0
1. Tax revenue	4596,3	5147,6	5785,4	6578,1	7008,6
3. Grants	1703,5	1047,5	495,7	966,1	866,5
4. Other revenue	878,8	1024,8	1267,3	1358,3	1656,0
5.Current transfers/SACU	5966,3	6054,6	7034,1	6398,6	4519,0
				-	-
Expense	-8794,5	-10468,9	-10744,7	12031,0	13388,0
1. Compensation of Employees	-3748,8	-4588,7	-4984,5	-5538,4	-6096,0
2. Use of goods and services	-2385,0	-3026,3	-2829,6	-3085,9	-3819,3
4. Interest Payments	-165,9	-188,6	-177,2	-274,1	-254,6
5. Subsidies	-252,9	-232,2	-201,4	-250,7	-415,1
6. Grants	-881,8	-898,8	-1037,0	-1105,9	-1258,1
7. Social Benefits	-613,0	-762,5	-779,1	-897,9	-893,1
8. Other expense	-747,0	-771,7	-735,9	-877,8	-651,9
Analytic Measures					
				-	
Total expenditure	-12190,4	-13878,7	-13731,6	15715,8	-16757
Debt-GDP ratio	43,9%	48,5%	47,9%	56,4%	47,7%
Fiscal balance as % of GDP	4,5%	-3,2%	3,4%	-2,0%	-8,0%
Nominal GDP	20074,27	22370,56	24944,62	26424	29374

Source: Ministry of Finance

In 2014/15, the government implemented an expansionary fiscal policy by revising downwards the lower and upper personal income tax rates from 22 to 20 and 35 to 30 percent respectively (Budget Speech, 2014/15). This was on the grounds that Lesotho's effective tax rate on personal incomes had remained one of the highest in Sub-Saharan Africa as shown in the speech. To that end, the reduction was intended to reduce the tax burden and encourage tax compliance

The government continued to receive foreign capital and recurrent grants from bilateral and multilateral organizations during the first coalition government. Regrettably, the European Union withdrew its General Budget Support resulting from slippages in the achievement of the agreed performance benchmarks, particularly with respect to Public Financial Management and the health sector reforms[20]. This led to the decline in recurrent grants from foreign and international organizations to M4.2 million in 2014/15 from M149.1 million in 2013/14.

A number of ministries were regrouped after the establishment of the first coalition government leading to the upward trajectory of government ministries[21] as a result of three newly created ministries. Efficiency was cited as one of the factors behind this, but the increased number of parties represented in the government also necessitated the measure. The outright impact of increased ministries was fragmentation in government policies as the coordination of the activities of various ministries had not been very systematic.

Policy intervention measures aimed at supporting and boosting both the farmers and SMME were sustained during the tenure. These included the subsidy for summer cropping in 2012/13. An SMME capacity building programme that entailed implementing reforms aimed at easing investment procedures and assisting potential SMMEs was developed in 2013/14 (Budget Speech, 2013/14). The government also signed a Memorandum of Understanding with the four commercial banks on Partial Credit Guarantee Fund (PCGF) as indicated in 2013/14 Budget Speech.

In 2013/14 the government effected an across the board salary review (Budget Speech, 2013/14). The intent was given as to increase the morale, productivity, reduce the disparities between the low and highly paid Public Officers and retain the employees with scarce and critical skills with the intent to improve service delivery[22]. The review was undertaken at the period when the wage bill was already signaling a red flag as the public sector remained the largest formal employer. This expansionary fiscal policy increased *Wages and salaries* by around M600 million. This policy measure is well enunciated by the theory of fragmentation in decision making by Baskaram (2013) which alleges that coalition governments are not good for expenditure control as the Government went ahead with salary review despite the fact that Lesotho wage bill was already very high.

[20] 2013/14 Budget Speech of the Kingdom of Lesotho.
[21] The ministry of social development was regrouped from the ministry of health. The ministry of finance and development planning were split into the two separate ministries. Mining ministry was newly created
[22] 2013/14 Budget Speech for the Parliament of Lesotho

Both the restructuring and salary review attest to the "fragmentation hypothesis" which refers to coalition governments and cabinet size and asserts that overall public expenditure is higher, the larger the number of parties represented in the government and the bigger the size of the cabinet (Baskaram, 2013). The literature has suggested that electoral systems with more proportionality and a larger number of parties, as well as those with less government power over the legislature, produce larger governments, larger deficits, and more procyclical fiscal policies (Enslava, 2006).

The execution rate capital expenditure was the lowest in six years amounting to only 75 percent, as reflected in 2014/15 capital budget performance. Given fragmentations between the coalition partners, the government seemed unstable and created a lot of uncertainty on its continuity. This is substantiated by the literature that governments where rulers have short time horizons spend too little on productive public goods, while strong states where rulers have too much security are able to pay attention to productive investment (Alesina and Tabellini, 1990). As spending on public goods increases future tax revenues, coalition governments are likely to deter increase in future tax base because of the short time horizon associated with them.

The collapse of the first coalition government is not a puzzle given the theoretical and empirical evidences that reveal the political economy of coalition governments and fiscal policy. Disagreements are renowned for this type of government as there is no single uniform objective function for the various political parties in the government unlike single majority government (Roubini and Sachs, 1989). As a result of the fragmentation problem which was evidenced in disagreements in decision making by the players in the coalition government, the parliament which is key for the legislative framework, was prorogated. Analysts like 'Nyane (2015) allege that the prorogation of Parliament plunged the country into a security and political crises. These institutional hiccups were a deterrent to a vibrant fiscal policy in many respects. The failure of the first coalition government resulted in the elections being brought forward by two years. The conducting of elections within a short space of time shows no value for money and is an opportunity cost to other developments that could transform the economy and enhance the lives of the vulnerable.

The second coalition government assumed office in 2015 after the collapse of its predecessor. The fiscal position was weak during this era partly as a result of dwindled SACU revenue for two consecutive fiscal years, 2015/16 and 2016/17. The ensuing fiscal deficits were recorded at 1.3 percent of GDP in 2015/16 and at around 9 percent of GDP in 2016/17. This warranted fiscal measures geared towards fiscal sustainability which would also translate into an improved external position that had been in deficit since the aftermath of the recent financial and economic crises. Contrariwise, as shall be seen in the analysis, the government embarked on expansionary fiscal policies demonstrating time inconsistency in government behavior. Table 5.8 below presents the summary of fiscal account during this regime.

The regime was constraint by limited availability of resources as illustrated in Table 5.4. This emanated from overdependence on SACU which was a scourge on revenue due to its volatility coupled with government's lack of control over it. The increase in non - tax revenue components which is driven mainly by water royalties and dividends from Financial Public Corporations (FPCs) could not compensate this decline. The government had limited avenue in terms of tax revenue and the only scope that could be exploited was on non-tax revenue especially dividends payments by FPCs as they are renowned for either non declaration or under declaration of dividends.

The weak fiscal performance along with the worsened external position propelled the government to undertake expenditure control measures to curtail the budgetary imbalance. These involved freezing of some items of use of goods and services to curb recurrent spending[23]. Alongside this, the government implemented the full launch of second phase of the PFM reform programme that focused on eight specified components[24] aimed at promoting efficacy, accountability and transparency in the administration of public resources (Budget Speech, 2016/17). As a result of constraint government envelope, development budget realized a decline in the second year of the second coalition government (Budget Speech, 2016/17) which was a deterrent to development needs of the country.

[23] Ministry of Finance

[24] The PFM reform has eight components: 1) regulatory framework, 2) Budget, 3) Cash Management 4) internal audit and control 5) accounting and fiscal reporting 6) Public procurement/anti-corruption, 7) Oversight and external audit, 8) governance and institutional management.

Paradoxically, despite the abovementioned macroeconomic challenges, the structure of expenditure in other line items continued to reflect fiscal profligacy. The new government created five additional ministries as each of the minor parties was awarded with a full ministry. In addition, the Government guaranteed interest free loans to members of parliament which became a liability to the nation and was eventually paid by the subsequent government. This expansionary expenditure was carried on despite the conspicuous increasing fiscal pressure as the government was not able to sustain high expenditure through increased revenue.

Further to this, there were high recurrent expenses associated with the fleet service. The dynamics in this fleet service are believed to have contributed to the collapse of the second coalition government as some of the members of the main coalition partner accused other members of corruption concerning the fleet tendering process. This resource conflict is renowned for coalition governments where access over scanty resources is made possible by having more power over the state resources (Matlosa, 1997). Following this collapse, the snap elections were called. These results are well supported by Matlosa (1997) who explains that contestation over state power, resource conflicts, and personality cult syndrome, have characterized the country's political elites.

FISCAL REACTION FUNCTIONS

The analysis of the evolution of fiscal policy through diverse regimes has portrayed time inconsistency in Government behavior which has often resulted in fiscal deficits. Against this backdrop, it suffices that we assess how the Government has in the past reacted to its debt burden by estimating fiscal reaction functions as the two fiscal components (deficits and debt) are intertwined. The government's commitment to its debt burden is deduced by its reduction of primary deficit or increasing the surplus in response to rising debt (Burger et al. 2011). We also seek to establish whether fiscal policy has followed a sustainability path.

Table 5. 5 Debt-GDP and Primary-Balance-GDP ratios results for stationarity tests (ADF, PP and KPSS tests in levels)

	ADF Test Statistics	PP Test Statistics	KPSS Test Statistics
Intercept specification			
Debt-GDP-ratio	-1.5216	-1.3562	0.5620
Primary-balance-GDP ratio	-3.1369	-3.1369	0.0724
No trend no intercept specification			
Debt-GDP-ratio	-1.1128	-1.3453	
Primary-balance-GDP ratio	-3.1464	-3.1354	
Intercept and trend specification			
Debt-GDP-ratio	-3.2154	-2.3263	0.0806
Primary-balance-GDP ratio	-2.9875	-2.9875	0.0636

(ADF, PP and KPSS tests in first difference for Debt-GDP ratio)

	ADF Test Statistics	PP Test Statistics	KPSS Test Statistics
Intercept	-4.8950	-5.7258	0.1949
No trend no intercept	-4.8893	-4.9680	
Intercept and Trend	-4.8193	-5.5123	0.1891

Critical values at 1%, 5% and 10% levels are ***, **, and * respectfully.

ADF and PP critical values for Debt-to-GDP in levels: Intercept: -3.6793***, -2.9678** and -2.6230*. No Intercept no Trend: -2.6471*, -1.9529**, -1.6100***. Intercept and trend: -4.3400***, -3.5875** and -3.2300*.

ADF and PP critical values for Primary Balance-to-GDP in levels: Intercept -3.6793***, -2.9678** and -2.6230*. No intercept and no trend: -2.6471***, -1.9529** and -16100* Intercept and trend -4.3098***, -3.5742** and -3.2217*.

KPSS critical values for intercept are 0.7390***, 0.4630** and 0.3470*. Intercept and trend specification yields 0.2160***, 0.1460** and 0.1190*.

Fiscal Reaction Functions Estimation

In analyzing the data, the first step is to determine whether Debt-GDP and Primary-Balance-GDP ratios are stationary based on equation 5 of chapter four. Augmented Dickey Fuller (ADF) and Philips-Perron tests of unit root are used while the stationarity test of Kwiatkowski-Philips-Shin (KPSS) is also used. Output gap on the other hand is stationary by definition as can be seen in Appendix I. Table 5.9 presents the summary of the unit root test results for the three tests. The results portray the presence of a unit root in Debt-GDP ratio but the series becomes stationary upon first differencing. Primary-balance-GDP on the other hand seem to be stationary.

VAR Model

Given that Debt-GDP ratio is I(I) series while Primary-Balance-GDP is I(0), fiscal reaction functions derived in chapter four are estimated using a VAR model and an ARDL model for robustness check. The VAR entails determining the suitable number of lags and testing for stationarity of the VAR. Using lag order selection criterion, most of the criterions select lag 1 as the optimal lag of the VAR. Also, the estimated VAR is stationary given that all the inverse roots of the characteristic AR polynomial lie within the unit imaginary circle as shown in Appendix I.

Table 5. 6: Vector Autoregression Estimates[25]

	B_Y	D_Y	OG
B_Y(-1)	0.5457	-0.3280	-0.0066
	(0.0007)	(0.2190)	(0.8971)
	[3.5182]	[-1.2391]	[-0.1297]
D_Y(-1)	0.0074	0.9703	-0.0029
	(0.6785)	(0.0000)	(0.6237)
	[0.4150]	[32.0575]	[-0.4926]
OG(-1)	1.2835	-1.1912	0.0701
	(0.0270)	(0.2240)	(0.7086)
	[2.2536]	[-1.2256]	[0.3752]

Robustness Checks: Estimation of ARDL model

To ascertain the robustness of the results from the estimated VAR model, the ARDL model is also used to estimate the Lesotho fiscal reaction function. The advantage of this model is that no stationarity or cointegration tests are required for it to be used. This model takes into account the long run relationship between primary balance/GDP and public debt/GDP. The output gap is

[25] The first, second and third rows of the variables represent the coefficients, the P-values and the t-statistics respectively.

added as a control variable to allow for the possibility that government pursues short run demand stabilization.

Table 5.7 ARDL (1, 1) Estimation equation

	Coefficient	Std. Error	t-Statistic	Prob.
B_Y(-1)	-0.493882	0.159290	-3.100515	0.0049
D_Y(-1)	0.017264	0.019067	0.905459	0.3742
OG(-1)	1.592580	0.636883	2.500583	0.0196

Lesotho fiscal reaction functions:

Table 5. 8: Lesotho Fiscal Reaction functions table[26]

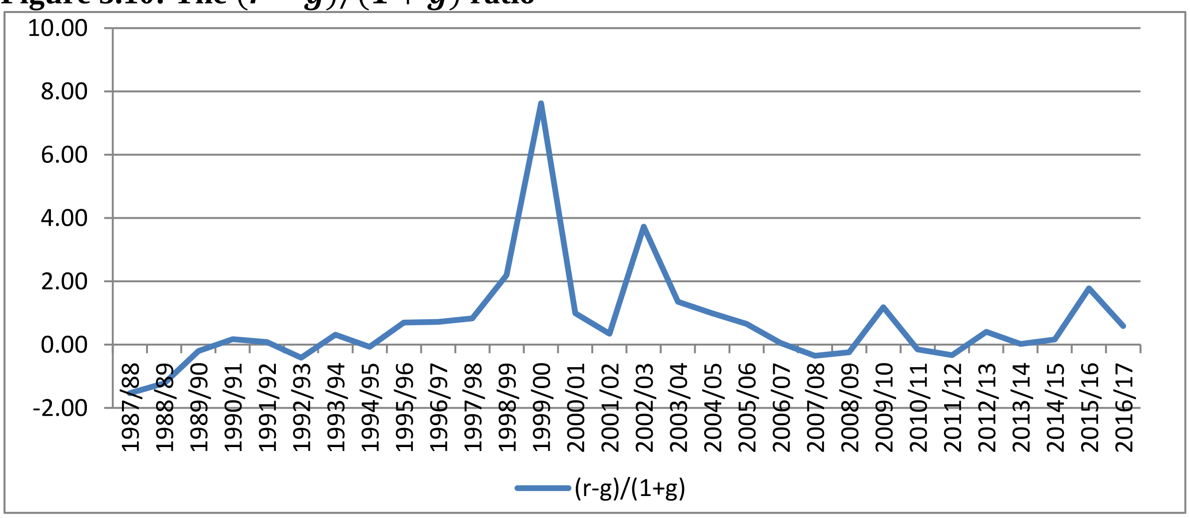
Variable	VAR	ARDL
$B\_Y_{(t-1)}$	0.5457	-0.4939
	(0.0007)	(0.0049)
	[3.5182]	-3.1005
$D\_Y_{(t-1)}$	0.0074	0.0172
	(0.6785)	(0.3742)
	[0.4150]	0.9055
$\hat{y}_{(t-1)}$	1.2835	1.5926
	(0.0270)	(0.0196)
	[2.2536]	[2.5006]

Both models offer consistent results regarding the reaction of the Government to its debt level. This is on the ground that the coefficient of the lag of Debt-GDP (β_3) is not statistically significant in both models, implying that the change in Government debt does not explain developments in primary balance which by extension indicates that the Government has not been reacting in changes to its debt burden. The parameter for output gap is statistically significant in all the methods pointing to countercyclical behavior of the government. In parallel, the parameter for the ratio of Primary-Balance-GDP is statistically significant in both models indicating that Primary-balance-GDP is autocorrelated with its lag.

[26] The first rows of the variables represent the coefficients, the second represent the P-value while the t-statistics are shown in the third row.

In assessing fiscal sustainability, Burger (2011) stipulates that fiscal policy is sustainable if $\beta_3/(1-\beta_2) > \beta^*$ where $\beta^* = (r-g)/(1+g)$. Based on the estimation results from Table 5.14, $\beta_3/(1-\beta_2)$ = 0.015 and 0.011 for VAR and ARDL methods respectively. On the other hand, the average of $(r-g)/(1+g)$ = 0.70. As it is evitable from Figure 5.7, $(r-g)/(1+g)$ ratio has been positive most of the time or at least slightly below zero. The peak in 1999/00 is associated with the increase in interest rates in response to the Asian crises (Burger, 2011). Since $\beta_3/(1-\beta_2) < \beta^* = (r-g)/(1+g)$ in both models the implication could have been that fiscal policy in Lesotho is not sustainable if the coefficients were statistically significant. However, given that the estimated coefficients of Debt-GDP ratio are not statistically significant, the sustainability results can therefore be regarded as irrelevant implying that in the absence of fiscal reaction functions, it becomes difficult to estimate the sustainability of fiscal policy.

Figure 5.10: The $(r-g)/(1+g)$ ratio



The objective of using fiscal reaction function to estimate debt in the medium term is also annulled by the absence of the fiscal policy reaction functions.

6. CONCLUSION AND POLICY IMPLICATIONS

Lesotho inherited unfavorable development conditions from the colonial system. The institutional weaknesses in chieftainship that crippled pre-colonial institutions which provided the foundations for justice and feedback mechanism exacerbated the country’s ordeals. Additionally, imperialists never bordered to lay solid institutions such that even after decades of post-colonial era, the structural and fiscal imbalances still lingered on. While these crimes of colonization were responsible for the country's underdevelopment during the Imperial era staggering into the post-colonial period, the puzzle for the country's underdevelopment cannot be pinned altogether on the colonists.

The suspension of the constitution in 1970 and the consequent intervention of the military on governance in 1986 shows political leaders who have been entwined in the status quo thereby compromising the building of effective institutions that would ensue the rule of law, promotion of peace, democratic governance, accountability and transparency. The fiscal policy therefore being subjected to such post-independence political institutions could not effectively address the development needs of the country.

While neither the democratic government that succeeded the Military regime was able to transform this country notwithstanding its many years in government, the current era of coalition government seem to be plummeting a glimmer of hope. This stems from the conspicuously expansionary fiscal policy that is intrinsic to this type of government. Even more distressful is the short time horizon evidenced in the past two coalition governments which deter the continuity in development plans. The fragmentation episodes in the coalition governments that were largely precipitated by resource conflicts and fiscal opportunism have impacted on fiscal balance through manifold ramifications. These include the holding of elections within the short space of time; the effects on economic institutions resulting from uncertainty in continuity of policies and strategies; delayed allocation and appropriation of the national budget which has spillover effects to other sectors of the economy; deferred legislation of bills & laws and restraint business vibrancy due to uncertainty in the national security amongst others.

As the country finds itself on the crossroad, only firm political decisions that can orchestrate collective consciousness among the citizens can foster robust political and economic institutional reforms which can immunize this country from the socio economic woes that are long overdue. Given that our economy is perceived as a "small cake" such that it does not matter what size the cake is, it will always be finite and cause for strife and destructive conflicts, the country is in ardent need of political leaders who can relinquish the status quo of viewing the state resources as an apparatus of amassing wealth at the expense of the majority. As such, it is paramount that political leaders are illuminated on their own roles and the roles of their decision making capacities which impact on the performance of political institutions and state institutions that have an influence on economic outcomes. The coalition governments call to attention the need to consider collaborative capabilities of both the partner-political parties and the individuals within them.

With regard to fiscal reaction functions which give an indication of how a country has in the past reacted to changes in the level of its public debt as shown earlier, based on the VAR and ARDL estimates, the government does not seem to have been reacting to the level of its debt burden. Our results also depict that the path of Government fiscal policy is not sustainable. The country should consider implementing fiscal rules which can act as binding devices to restrain the policy makers from deviating from optimal fiscal decisions. The implementation of fiscal rules can aid the Government to advance a sustainable fiscal policy and curb the time inconsistency in Government behaviour which was seen in a number of expansionary fiscal policies. Part of Lesotho fiscal policy dilemmas has been to increase spending during periods of windfalls which sometimes become irreversible during periods of downturns.

The current PFM project that aims at amongst others governance and institutional management can help mitigate the implementation of fiscal rules by laying sound regulatory framework. The absence of fiscal policy reaction functions for Lesotho should caution the authorities who have taken comfort in that Lesotho is classified as a moderately indebted country.

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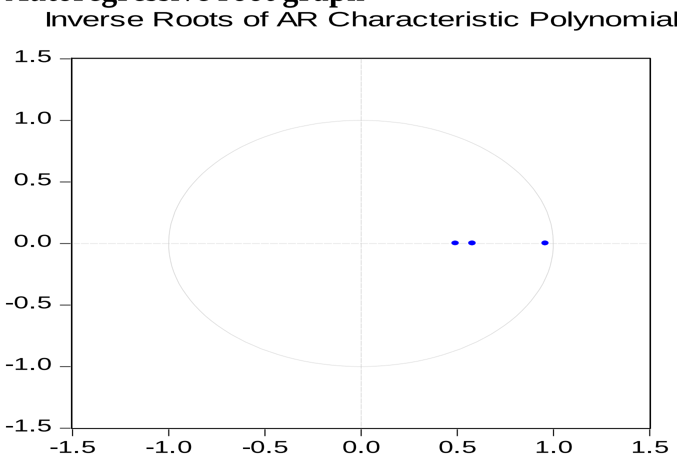
Appendix 1

VAR lag order selection criterion

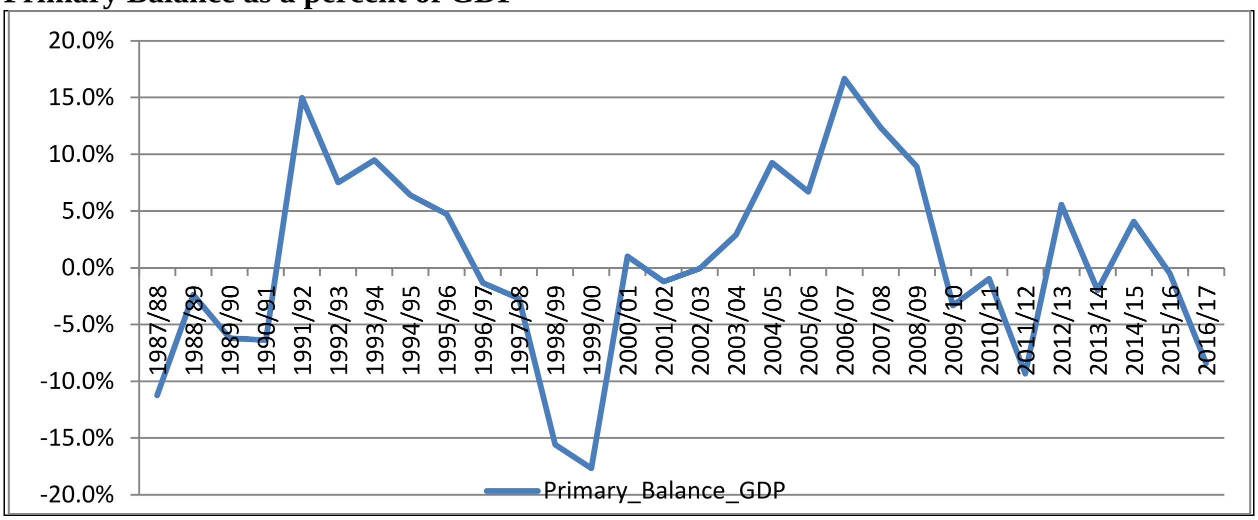
Lag	LogL	LR	FPE	AIC	SC	HQ
1	-259.7717	NA	43775.25 *	19.19798 *	19.62619 *	19.32889 *
2	-256.3773	5.333969	66502.23	19.59838	20.45480	19.86020

Autoregressive root graph

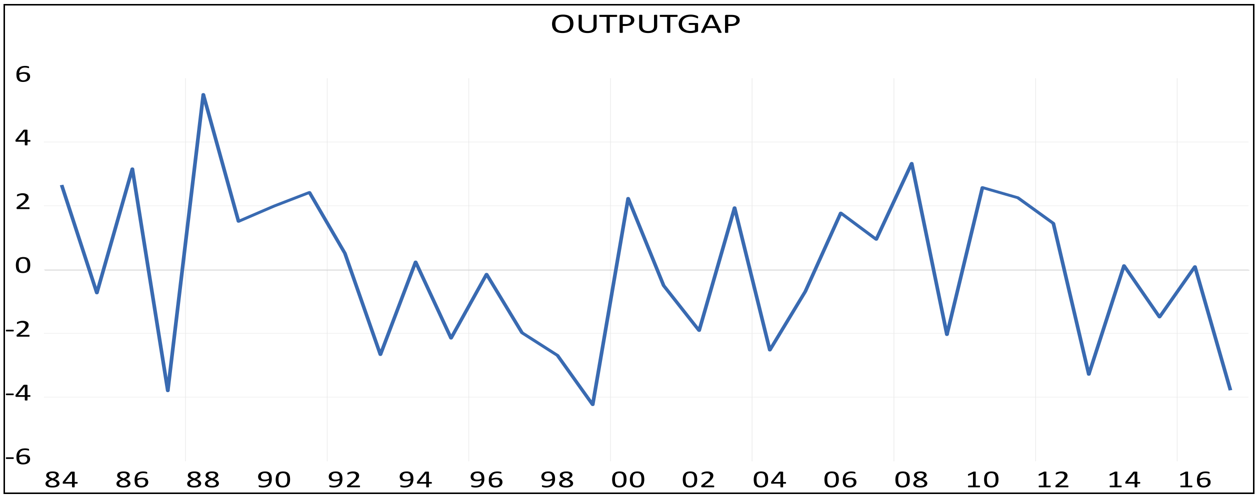


Since all the inverse roots of the characteristic AR polynomial lie within the unit imaginary circle, the VAR is stationary.

Primary Balance as a percent of GDP



Output-Gap


OUTPUTGAP
6
4
2
0
-2
-4
-6
84 86 88 90 92 94 96 98 00 02 04 06 08 10 12 14 16