PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA1286

Project Name	Second Private Sector Competitiveness and Economic Diversification Prj (P144933)
Region	AFRICA
Country	Lesotho
Sector(s)	General industry and trade sector (50%), Other industry (40%), SME Finance (10%)
Theme(s)	Micro, Small and Medium Enterprise support (50%), Export development and competitiveness (30%), Other Private Sector Development (20 %)
Lending Instrument	Investment Project Financing
Project ID	P144933
Borrower(s)	Ministry of Finance and Development Planning
Implementing Agency	Ministry of Trade and Industry, Cooperatives and Marketing
Environmental Category	B-Partial Assessment
Date PID Prepared/Updated	05-Sep-2013
Date PID Approved/Disclosed	06-Sep-2013
Estimated Date of Appraisal Completion	06-Sep-2013
Estimated Date of Board Approval	31-Oct-2013
Decision	The Management has granted approval to appraise and to negotiate.

I. Project Context

Country Context

1. Lesotho is a lower middle-income country with per capita gross national income of US $1,210. The economy has grown at an annual rate of 3 percent in per capita terms—modest for its income level but comparable to the rest of the SACU region, the African continent, and small states. The accompanying structural changes have involved shifts from subsistence agriculture and remittances toward natural resources, manufacturing exports, and services.

2. The main growth engine before 2007 was manufacturing exports, mostly from the textile and apparel industry. Since then, public investment has taken over as the main driver. The manufacturing sector's contribution to GDP declined from about 20 percent in 2006 to 11 percent in 2011—the result of stagnation in the textile and apparel sector after the global economic crisis, increased competition from low-cost Asian producers, and the rapid growth in other sectors, notably mining.

3.The country now finds itself at a crossroads– requiring new engines of growth, a more streamlined role of the state and the emergence of a dynamic private sector. Lesotho's economic growth has been predominantly export led. Unemployment in Lesotho stood at 24 percent in 2008, among the highest in the world. Only 230,000 of the 608,000 employed people engage in formal wage employment. The manufacturing sector, was until recently a growing source of employment, and thus holds a key role in creating jobs. While FDI in the textile and apparel industry has created jobs, the expected backward linkages to the local economy have been limited, with practically no spin-offs or subcontracting activities. The challenge facing Lesotho's private sector is twofold: (i) the need to diversify into other sectors by attracting FDI into new sectors and (ii) establishing stronger linkages between FDI and the local SMEs.

4. Economic growth has not been adequately inclusive, resulting in high concentration of poverty in rural areas, persistent high levels of inequality, and widespread unemployment. Unemployment stood at 24 percent in 2008, among the highest in the world. Only 230,000 of the 608,000 employed people engage in formal wage employment. The rest are in informal activities, and they are often paid in-kind. Poverty is concentrated in rural areas that, despite poor soil quality and rainfall, remain home to about three quarters of the population, indicating underutilization and mis-allocation of labor resources. The critical challenges of inclusive growth, a sustainable and effective public sector, and access to quality service delivery define Lesotho's core development agenda. A necessary condition to achieve inclusive growth is job creation, particularly in low-skilled sectors.

5. The National Strategic Development Plan (NSDP) seeks to establish the pre-conditions for high, sustainable, and private sector-led economic growth and faster job creation. The plan's targets include long-term GDP growth of 5 percent per year and creation of 50,000 private-sector jobs. The plan also recognizes that the most effective way out of poverty is through high, sustainable and private sector-led economic growth coupled with faster job creation. It recognizes that the sustainable engines of growth are agriculture, manufacturing and tourism. In addition, it mentions that Lesotho needs to exploit better its comparative advantages such as: a) its location within South Africa, which provides access to its markets and advanced infrastructure that creates links with the rest of the world; b) trade preferences; and c) a relatively large, young, competitive and literate human resource base.

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6. The proposed Second Private Sector Competitiveness and Economic Diversification Project (PSCED) aims at supporting the Government's strategy by (i) improving business environment; (ii) increasing access to finance; (iii) supporting investment promotion in new sectors with increased backward linkages to the local economy and (iv) targeted support to new growth sectors such as horticulture and tourism that have tremendous potential for job creation and poverty alleviation.

Sectoral and institutional Context

7. Lesotho's private sector growth is hindered by a number of factors. Improving the overall business environment will be essential to attracting new Foreign Direct Investments (FDI) as well as fostering a vibrant domestic private sector. The NSDP acknowledges an "uncompetitive business environment" as one of the most binding constraints to the growth of private enterprises, adversely affecting both foreign investment and the growth of local small and medium-sized enterprises (SMEs). All quantitative measures (Global Trade Reports, Doing Business Indicators, and

Enterprise Surveys) suggest that business regulations are a serious constraint to growth. Lesotho's Ease of Doing Business rank was 136 out of 185 countries in 2013 . While Lesotho has made important reforms, notably in streamlining the process of starting a business, reflected in its improved overall ranking – by 17 places – in the 2013 Doing Business rankings it still lags behind many of its competitors. There remain a number of factors that hinder private sector growth, at almost every business stage – from accessing land to obtaining construction permits, engaging in cross-border trade with South Africa, and accessing finance. The country is losing ground to be competitive as several reform-minded African governments have implemented policies to cut high transaction costs. Productivity enhancements are essential to support the growth of real wages, and, therefore incomes and living standards.

8. The manufacturing sector was until recently a growing source of employment, and remains critical for job creation. While FDI in the textile and apparel industry has delivered employment, the expected backward linkages to the local economy have been limited, with practically no spin-offs or subcontracting activities. The challenge facing Lesotho's private sector today is twofold: (i) the need to diversify into other sectors by attracting FDI into new sectors and (ii) establishing stronger linkages between FDI and the local SMEs.

9. Lesotho is faced with an unemployment rate of 24 percent, with nearly two thirds of its labor force in the informal sector principally engaged in subsistence agriculture. In this context, focusing on commercial horticulture could be an important source of employment. The sector is a critical route to employment for the unemployed and those engaged in subsistence agriculture and could be particularly important in creating job opportunities for women. This is particularly important in light of the fact that despite efforts made by GoL to assist farmers through subsidies on agricultural inputs, productivity has not responded positively which to a large extent is due to poor farm management practices . This project aims at transforming strategic areas in Lesotho into major producers and exporters of early variety tree crops. Supporting the commercial horticulture sector will be a vital source of job creation and poverty alleviation bringing smallholder farmers out of subsistence farming into commercial farming. In addition, the project will also help facilitate targeted product development and productivity improvements in the tourism sector that can in turn lead to increased job creation and foreign exchange.

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10. Private sector growth is dependent on businesses being able to access credit at an affordable price. The level of financing to the private sector in Lesotho is low. Domestic credit to the private sector (as a % of GDP), that is measured by loans and trade credit that establish a claim for repayment is low in Lesotho, compared to other countries in the region.

11. Several important further reforms remain to be undertaken in order to improve credit extension. These include the establishment of a credit bureau, the introduction of a legal framework and national registry for security over moveable property, and the enactment of a new insolvency statute . The lack of these elements has resulted in a tight credit environment, whereby banks' exposure is high and there is no effective way of tracking a borrower's credit history. The proposed Second PSCED Project aims to address some of these issues to enable greater access to credit especially to the local SMEs by increasing the available financing instruments available to them.

II. Proposed Development Objectives

The development objective of the proposed project is to contribute to the development of non-textile sectors resulting in increased private sector investment, firm growth and job creation. This will be

achieved by (i) improving business environment; (ii) increasing access to finance; (iii) supporting investment promotion in new sectors with increased backward linkages to the local economy and (iv) targeted support to new growth sectors such as horticulture and tourism.

III. Project Description

Component Name

Improving the Business Environment

Comments (optional)

Component Name

Supporting Economic Diversification

Comments (optional)

Component Name

Project Implementation

Comments (optional)

IV. Financing *(in USD Million)*

Total Project Cost:	15.00	Total Bank Financing:	13.10
Total Cofinancing:		Financing Gap:	0.00
For Loans/Credits/Others			**Amount**
BORROWER/RECIPIENT			1.90
International Development Association (IDA)			13.10
Total			15.00

V. Implementation

12. Reflecting the multi-sector nature of the project, implementation arrangements are intended to offer a balance between the effective overall supervision and monitoring of the activities at the project level, as well as reinforcing the management and institutional responsibilities of individual sub-components. The institutional and implementation arrangements of the project have been fine-tuned during the implementation of the PSCED Project and aim at mainstreaming the operational responsibility to the public institutions/agencies that are in charge of implementing the policy agenda and outsourcing specialized knowledge and management expertise from the private sector where possible.

13. Project Steering Committee (PSC): The PSC will consist of members representing the agencies responsible for the project implementation i.e. the principal secretaries from the MTICM, MTEC, MAFS, MFLS, MoF, MDP, Deputy Governor of the Central Bank, Town Clerk of the MCC, the Parliamentary Counsel, Master of High Court and the CEOs from LNDC and LTDC. The committee shall meet every month to review implementation progress in the first year and later can meet every quarter to monitor the implementation progress of the project and help to resolve technical and implementation problems affecting project progress. The meetings will be chaired by

the Principal Secretary of MTICM.

14. Project Management Unit (PMU): The day-to-day operations of the project will be overseen by a Project Management Unit that will be headed by a qualified Project Manager. In addition, the PMU will include a Financial Manager and a Procurement Manager who will oversee the Financial Management and Procurement issues respectively and a Horticulture Manager to oversee the day-to-day activities in the horticulture component. The PMU will provide for overall fiduciary management, monitoring and evaluation, project oversight, and coordination. The role and functions of the PMU have been detailed in the Project Implementation Manual (PIM). The Project Manager will be responsible for: (i) overall day-to-day management of the project, including coordination of procurement, financial management and M&E; (ii) coordination with all the implementing agencies responsible for the implementation of the various sub-components; and (iii) coordination with other donors and relevant programs/projects. The Project Manager will report to the Project Steering Committee chaired by the Principal Secretary, MTICM. The project will cover the operating costs of the PMU, necessary equipment purchase, training of staff and the costs of annual audits of project accounts.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	×	
Natural Habitats OP/BP 4.04		×
Forests OP/BP 4.36		×
Pest Management OP 4.09	×	
Physical Cultural Resources OP/BP 4.11		×
Indigenous Peoples OP/BP 4.10		×
Involuntary Resettlement OP/BP 4.12		×
Safety of Dams OP/BP 4.37		×
Projects on International Waterways OP/BP 7.50		×
Projects in Disputed Areas OP/BP 7.60		×

Comments (optional)

VII. Contact point

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