

## The World Economic Crisis: Implications for Lesotho NGOS

### Introductory Background

Southern Development Non-Governmental Organizations (SDNGOs) rely heavily on funding from northern donors inclusive of foundations, governments, corporations and NGO Partners. The last two years however, have witnessed interesting phenomenon whereby local and international media have been preoccupied by analysis of the scope and implications of the global financial crisis. The meltdown followed a 'housing bubble' that burst in the United States in 2008, which itself was attributed to a rise in credit risk between 2007 and 2008. This resulted in a liquidity crisis that prompted a substantial injection of capital into financial markets by the central banks of advanced economies. The United States Federal Reserve, the Bank of England and the European Central Bank swiftly responded with massive liquidity injections and the mobilization of public resources meant to recapitalize banks; insure deposits; guarantee money market transactions; and buy back troubled assets<sup>1</sup>.

Sources of SDNGOs funding saw their assets decline by almost 22 percent due to the economic meltdown. Consequently, there was a substantial drop in NGO funding as respective donors began to cut down their contributions (IRIN 2009)<sup>2</sup>. In response, NGOs were forced to scale down both programmes and staff as their income streams flattened<sup>3</sup>. Fundraising experts of some of the world's top NGOs focused a slowdown in 2009 programming growth because of the squeeze. Predictions made by some of the major SNGO programme funders (Oxfam GB, Save the Children UK and World Vision USA) which between them account for an annual income of US\$3.1 billion, were not very rosy at all. According to these giants, the usual goodwill and generosity by Financial Services and Investment Banking sector was expected to decline going into 2009.

Other innovative NGOs however, were reported to have resorted to finding and attracting new alternative sources of funding especially from Corporations and Governments, albeit with some risk or at a cost. The concern was that NGOs that accept and rely on government funding are more secure, but at a cost. It is suggested that if major NGOs let governments and corporations dominate their funding, the sector could face problems of independence and credibility, which is even more serious than financial problems. So the above crisis in the end affected the developing countries, in particular their NGO sector, but to varying degrees.

### The Global Financial Crisis and Sub-Saharan Africa

The Bretton Woods Institutions (World Bank and the IMF) have consistently argued that growth is essential for much-needed poverty reduction in Africa. The African sub-continent south of the

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<sup>1</sup> International Monetary Fund (2009) *Regional Economic Outlook: Sub-Saharan Africa*, in World Economic and Financial Surveys, 0258-7440.

<sup>2</sup> Integrated Regional Information Networks

<sup>3</sup> <http://allafrica.com/africa>

Sahara had over a decade prior to the 2007/2008 US Credit Crunch made remarkable gains in promoting growth and achieving economic stability<sup>4</sup>. Sub-Saharan growth over the period had been estimated to have averaged more than 6 percent between 2005 and 2009; inflation had fallen to single-digit levels before the fuel and food price shocks of 2008; while reserves were built up. The Fund regarded these as positive developments which had relied on strong economic policies; a favourable external environment with rising commodity prices; debt relief and aid from the international community. In the case of Lesotho however, records show that the country's economy had been in decline since 2000, albeit a marginal recovery in 2005<sup>5</sup>. This was a clear challenge on the country's prospect to keep up with the pace of human development, made even more acute by the global recession that the IMF disclosed had taken toll on the economy.

### **Impact of the Global Financial Crisis on Sub-Saharan Africa**

The implication of the crisis on the sub-continent, according to the IMF, is that hard-won economic gains are now at risk. It in fact went as far as pointing out that Africa was beginning to feel the impact of the global financial crisis. Media began to flag NGO specific warning messages inclusive of:

*'Mixed Picture on Private Donations as Financial Crisis Bites'* - where it was argued that the effects of the global financial crisis are variable and that it was still too early to foresee the long term impact; *'NGOs Pare Down in Face of Financial Crisis'* - argued that donors, especially corporate donors in the financial sector, have reduced their donations to NGOs due to the global financial crisis (<http://allafrica.com/africa> (2008); *'Why Fundraising May Flourish While Business Flounders'* - which argued that fundraising for charities and NGOs continued to do well despite economic downturns, but donations from individuals increased in a slower pace (*Canadian Fundraiser*, 2008); *'Less Money for More Work - the NGO Double Whammy'* (IRIN, 2009); *'Is the Economic Mess Going to Kill 100, 000 Non-Profits?'* - which predicted that 100,000 US non-profits would go under due to the economic crisis (AlterNet March 13, 2009)); *'Tight Belts, Tough Choices for Charities'* which informed that the global financial crisis affects the income of humanitarian NGOs who now deal with decreased funding by trying to make their operations more efficient (IRIN, 2008); *'Credit Crisis Rattle Civil Society'* - argued that donors in rich countries were cutting back on their aid funding because of the international financial crisis; *'Charity Coffers Face Credit Crunch'* - argued that NGOs worry that the Wall Street crisis would tempt governments to reduce international aid and make investors more cautious about supporting development projects (IRIN, 2008); *'NGOs in aid-recipient countries now have to compete for less money'* (*Phnom Penh Post*, 2008).

Special workshops were convened (*'Workshop series for NGOs "Opportunities in Challenging Times"'*), and web based surveys were conducted where respective experiences were sought - *'South African NGOs and the Financial Crisis - What is your experience?'*<sup>6</sup>. To cut down costs, a

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<sup>4</sup> International Monetary Fund (2009) Regional Economic Outlook: Sub-Saharan Africa, in World Economic and Financial Surveys, 0258-7440.

<sup>5</sup> CBL (2009) October Economic Review, No. 111

<sup>6</sup> <http://ngopulse.org/>

large number of NGOs revised down their programs and retrenched staff. Funding from governments, institutions and other individuals now play an increasingly important role in preventing the crisis from affecting the poorest (IRIN October 27, 2008).

The major impact of the world financial and economic crisis on sub-Saharan Africa overall includes fallen demand for African exports; declined commodity prices; and, weakened remittance flows. There is now tighter global credit and investor risk aversion, which in turn have led to portfolio flows. Consequently, deterred foreign direct investment (FDI) has been reversing. In the process, finance has been made more costly. There are also fears that the economic slowdown is also likely to increase credit risk and nonperforming assets, thus weakening the balance sheets of financial institutions and corporations.

Lesotho's Finance Minister, in this year's (2010-2011) Budget Speech summed up the global situation succinctly. He cited the IMF according to which the U.S. economy contracted by 5.5 percent and 1 percent in the first and second quarters of 2009. In the same year, unemployment was recorded at 10.2 percent, the highest level since 1983. For Lesotho, he disclosed, this means Americans have less disposable income to buy our exports and underscores the need and urgency to diversify our markets and export products. On the Euro-zone, he disclosed, economic developments there followed a similar pattern to the U.S. as output declined by 4.9 percent and 4.8 percent in the first and second quarters of 2009, while unemployment was recorded at 9.4 percent and 9.6 percent over the same quarters. He indicated that although Lesotho does not export much to the Euro-Zone, it is a target market that beckons to Lesotho and which has granted it duty-free and quota-free access to its market under the Interim Economic Partnership with the EU.

He also addressed South Africa, Lesotho's main trading partner employing over 50,000 Basotho in its mines and industries, excluding those in services and other tertiary sectors. In relation thereto, the economy had in 2009, contracted by 6 percent and 3 percent in the first and second quarters respectively. Unemployment on the other hand, is estimated at 24.5 percent with some further lay-offs still possible if commodity exports do not pick up strongly. This economic contraction has caused a retrenchment of Basotho migrant workers with consequent declines in remittances yet to be assessed. This is in turn expected to affect the living standards in the rural areas where most of the workers come from.

The biggest greatest impact of economic contraction of South Africa however, remains SACU revenue shares, as they have historically been an anchor for expenditure policy planning in Lesotho. An added danger is that the method used to calculate shares to member states is also unpredictable. According to the Minister, SACU revenue had increased from M1,422 million in 2003/4 to M4,900 million in 2008/9 and 2009/10, respectively. In 2010/11 it is projected to decline by 60 percent to M2, 162 million and to M1, 695 million in 2011/12 before recovering to M3, 725 million in 2012/13.

## **Proposed Responses**

Analysts suggest that appropriate policy response depends on country-specific circumstances. However, the IMF maintains that priority for all sub-Saharan African countries must be to contain the adverse impact of the crisis on economic growth and poverty, while preserving the hard-won gains mentioned earlier, inclusive of macroeconomic stability and debt sustainability. It goes on to caution that temptations to respond to weakening balance of payments positions with protectionist measures or by reverting to administrative controls need to be avoided. Economic policy through these difficult times, the Fund suggests, should be guided by the following principles:

- a) *Use of available fiscal space to finance increase in fiscal deficit.* The countries that achieved macroeconomic stability without binding debt sustainability constraints to let automatic stabilizers work as they adjust to the new external environment.
- b) *Where possible, ease monetary policy and let the exchange rate adjust to the external environment.*
- c) *Closely monitor financial vulnerabilities and be prepared to act promptly.* Determined risk-based bank supervision will be essential for identifying and addressing banking system vulnerabilities at an early stage.
- d) *Keep medium-term goals in sight.* Fiscal measures in particular need to consider debt sustainability issues and support development strategies.

## Policy Options for Lesotho

Lesotho participates in three regional economic blocs, namely, Southern African Customs Union (SACU), Common Monetary Area (CMA) and Southern African Development Community (SADC)<sup>7</sup>. Reviews indicated that SACU has benefited its members tremendously and that Lesotho depends heavily on trade with South Africa and the United States that respectively account for 69 and 19 percent of total trade. Intra-SACU trade is high, allowing small members to enjoy high quality imports. In addition, SACU revenue from the common external tariff form a large part of government revenue, usually more than 50 percent of total revenue in the LNS (Lesotho, Namibia and Swaziland) countries. The CMA comprises all the SACU members excluding Botswana. The currencies of the LNS countries are pegged one-for-one with the South African currency, the rand. The other regional economic bloc is SADC, which comprises Angola, Botswana, Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Swaziland, South Africa, Tanzania, Zambia and Zimbabwe.

Analysts suggest that like her peers, Lesotho faces a serious challenge to avert the situation. Membership in CMA and SACU limits her policy options. The CMA membership has ceded the use of monetary policy to respond to any shock. Likewise, SACU membership also restricts the use of fiscal policy. There is also a serious limit on tax cuts since SACU members have resolved to unify their tax policies and laws. It must be highlighted that Lesotho's main source of revenue is SACU, with a share of over 50 per cent. Furthermore, SADC has put in place the benchmarks for macroeconomic convergence. The two benchmarks relevant to fiscal policy are; a fiscal deficit range of 3 to 5 per cent of GDP, and debt to GDP ratio of not more than 60 per cent. This, according to experts, means the country has leverage on increasing spending. It is

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<sup>7</sup> SACU, the oldest customs union in the world, comprises Botswana, Lesotho, Namibia, Swaziland and South Africa.

imperative at this stage they suggest, to determine the items whose spending can easily be reversed with minimum market distortions. As mentioned earlier, investment spending would be desirable to use as a fiscal stimulus. This has potential to lubricate private sector demand and achieve growth within a short period. For the country, boosting the economy could mean a more aggressive stance on capital expenditure. The capital budget was under spent in the recent years due to limited capacity to implement projects. However, it is important to identify specific sectors of the economy whose response to stimulus is high and desirable. This implies, it is suggested, that social spending may not qualify for fiscal stimulus.

### **Impact on Southern Africa**

The questions that arise then relate to the extent to which the region was affected by the crisis. If it was, whether it has affected NGO funding and where this leaves southern NGOs, particularly those in Lesotho. The Central Bank of Lesotho (CBL) talks of two rounds. In the first round, the extent to which the crisis had affected the Southern African region by end of 2008 did not compare with the rest of the world<sup>8</sup>. As an illustration, it was disclosed that out of the four big banks operating in the region, only one that had a merger with a British bank was slightly affected. Otherwise, the crisis in the entire region then, appeared to be well muted. This was partly attributed to the regional banks' conservatism adopted over the years, as well as relatively stringent exchange controls.

Experts had expected that since the crisis did not adversely affect the financial sector in Southern Africa, then second round effects would be minimal, if any at all (CBL). To their dismay, it is disclosed, the region appears to have been affected significantly by second round effects. The economic structure of the least developed countries, as well as that of the emerging markets, dictates that these countries are affected by the developments in the markets of developed countries. For instance, it is established that Lesotho's exports of clothing and textiles is largely dependent on the level of economic activity in the US markets. This is the case for the entire region's exports, regardless of the level of development. Thus as a result of the impact of financial crisis on economies of developed countries, demand for regional products has plummeted, forcing manufacturing industry, especially the export sector, to retrench workers.

Consequent to the above, argues CBL, the purchasing power of the retrenched workforce drops, leading to the overall decrease in domestic demand. This process manifests itself through cyclical effect, resulting in the overall slowdown in production. If not adequately addressed by the policy makers, this slowdown in turn could lead into a recession with adverse domino effect. The impact can be severe on Lesotho's small economy given that the majority already lives on handouts. The crisis has also made the region vulnerable to inflation which could be caused by depreciation of regional currencies against those of their major trading partners. Among diverse economic predictions made over the slowdown, include a fear that if not attended to urgently, it potentially could match the recession experienced in the 1930s.

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<sup>8</sup> CBL (2008) December Economic Review

These predictions have led to a situation where world leaders have taken different policy actions to avert the situation.

### **Impact on Lesotho's Economy**

It is too soon to conclusively predict, let alone assess the exact impact the crisis have had on Lesotho's Economy generally, and more specifically on the NGO sector. We are yet to access whatever studies or empirical evidence have or are being undertaken or collected on this subject. However, available evidence to date suggests that the local NGO sector has not been immune to the fall-out of the crisis. All NGOs, big and small; urban and rural; local and international; without exception have been affected. For some, it is disclosed, the impact has been immediate, while for others the real impact will only be known in months to come.

A rapid survey and literature review that informs this article reveals that sources of NGO funding are under increasing pressure. SANGONeT, authenticated by anecdotal evidence, discloses that respective regular supporters and international donors have less deposable income; corporate bottom lines have shrunk; and international grant flows have slowed<sup>9</sup>. In order to cope, many parents postpone their children's education just to keep their families fed. They put off health care needs to pay for basic utilities. They postpone dreams or stop saving money — because there's nothing extra to save. And some even choose which days of the week they eat — or who in the family can eat on a given day — because there's just not enough to go around.

The biggest impact manifested itself in the laying off of workers employed in the manufacturing of textile and clothing and the mining industry. This, it was disclosed, had sent shock waves through other sectors of the economy like retail, transport and telecommunications. The meltdown was also blamed for reduction of the SACU revenue which accounts for 60 per cent of total revenue to the Government of Lesotho. Large transfers from SACU, together with workers' remittances and exports of textiles and diamonds, contributed to a sizable build-up of international reserves equivalent to 6.7 months of imports at end-2007. Inflation surged from 6.4 percent at end-2006 to 11.8 percent at end-November 2008 owing mainly to the rise in food and fuel prices. Growth in broad monetary aggregates remains high, reflecting the continued accumulation of net foreign assets.

Nonetheless, in February 2009, the Executive Board of the IMF concluded that Lesotho had made significant progress in macroeconomic performance except that the pace of implementation of key structural reforms had been slow. It noted that economic activity surged above historic trends, averaging 6.6 percent during 2006-07 following a decade of low growth. The surge was driven by the mining, textile and construction sectors. The only unfortunate thing was that poverty had then seen only a modest decline. HIV/AIDS epidemic has also continued to impact negatively on the economy, public service delivery and social development, and is threatening the achievement of the Millennium Development Goals (MDGs).

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<sup>9</sup> <http://www.ngopulse.org/group/community>

On his part, in his presentation of the 2010-2011 Budget Speech, Lesotho's Finance Minister was upbeat. He disclosed that although the meltdown had ravaged the world economy, Lesotho had for its part remained focused on the economic fundamentals. It pursued *high, shared and sustainable growth, reducing poverty, creating jobs and protecting the poor, orphans and vulnerable children and old citizens*. It remained focused on fighting HIV and AIDS; extending the care and treatment of Children with HIV and AIDS; on building satellite clinics in all the ten districts of Lesotho. It has partnered with the Christian Health Association of Lesotho (CHAL) and other development partners to deliver coverage over a wider area and to include more people.

The country's strong economic performance was attributed to the Government's prudent macroeconomic management, and a continued build-up of international reserves. It was noted however, that the country continues to face the challenges of sustaining economic growth, tackling widespread poverty and the high incidence of HIV/AIDS, and achieving the MDGs. The on-going global economic and financial crisis further complicates efforts aimed at addressing these challenges.

### **The Main Transmission Channels of the Crisis**

The IMF spells out the main transmission channels, which include SACU revenues; textiles; diamonds, and workers' remittances<sup>10</sup>:

#### **1) SACU Revenues**

Slower growth in South Africa's economy reduces import demand, and thus customs duty, excise taxes and the amount of revenues transferred to Lesotho. Following the recent downward revision in South Africa's growth prospects, the projected SACU common revenue pool (CRP) was reduced by 6 percent in 2009, and by 15 percent in 2010–11. This has led to a significant revision of Lesotho's medium-term fiscal framework;

#### **2) Textiles**

With the slow-down in the U.S. economy, export volumes from Lesotho have declined. In addition, as most of the garment factories are owned by firms in Asia, some of them are facing difficulties obtaining trade credit for input financing from their Asian banks, which have been affected by the global credit crunch.

#### **3) Diamonds**

Weak prices for diamonds and the global credit crunch have resulted in reduced production and exports of diamonds. Already one mining company, Liqhobong, has suspended production and is reassessing its operations. Another, Kao, which is just beginning production, is looking for potential investors—a task that is difficult in the current environment.

#### **4) Worker remittances**

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<sup>10</sup> IMF (2010) Lesotho Country Report No. 10/5

Remittances from migrant workers, mainly from South Africa, account for about 20 percent of GDP. Already retrenchments in South Africa's mining industry in response to the global credit crunch may put over 9,000 jobs at risk, thus potentially affecting some 50,000 Basotho who work in South Africa's mines. A decline in remittances reduces private consumption, lowers growth and increases poverty.

The above situation is a direct threat to the livelihoods of Basotho. The Government has been cautioned and seriously urged by both the CBL and Civil Society to ensure that in dealing with these challenges, it should ensure that all programmes currently in place to improve livelihoods remain intact. Programmes that are untouchable include:

- 1) Provision of basic health care services, in particular free access to health services and drugs, including the fight against HIV/AIDS pandemic;
- 2) Continued strengthening of critical efforts to provide education at all levels, in particular free primary;
- 3) To maintain provision of Old Age Pension.

Happily for civil society, the Minister in his Budget Speech, has to a large extent lived to their expectation. The only challenge is that Government has continued the long tradition of marginalizing and discriminating them in its allocation of the budget. This is despite the fact that NGOs are contributing a relatively large amount of money into the Tax Collector's bag.

### **Conclusions**

If there had been expectations by NGO activists that the recent budget speech was going to shed a light into whether and how the budget was going to cushion them against the crisis, they must have been seriously disappointed. While the reality is that global resources which have historically been the life-line for DNGOs have shrunk, there does not seem to be any respite offered by their own tax dollars. Not even a mere reference to NGOs has been made. Only Public Private Partnership (PPP) is envisaged. So this implies that organized civil society should resolve to be resolute and aggressive in its hunt for alternative resource mobilization and partnership building if it is going to survive. How exactly this will be realized, is yet to be seen as the year unfolds.