AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE
DE DÉVELOPPEMENT

Country Focus Report 2025

Lesotho



Making Lesotho's Capital Work Better for its Development

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LIST OF ACRONYMS AND ABBREVIATIONS

AEO	African Economic Outlook
AfCFTA	African Continental Free Trade Agreement
AfDB	African Development Bank Group
AGOA	African Growth and Opportunity Act
CBL	Central Bank of Lesotho
CFR	Country Focus Report
CFRA	Country Fiduciary Risk Assessment
CPI	Corruption Perception Index
CMA	Common Monetary Area
DCEO	Directorate of Corruption and Economic Offenses
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
LHWP II	Lesotho Highland Water Project Phase II
LRA	Lesotho Revenue Authority
MCC II	Millenium Challenge Corporation Compact II
MSM	Maseru Securities Market
ODA	Official Development Assistance
PFM	Public Financial Management
RMC	Regional Member Countries
SACU	Southern Africa Customs Union
SADC	Southern Africa Development Community
SDGs	Sustainable Development Goals





EXECUTIVE SUMMARY

Lesotho's economy grew modestly at 2.4% in 2024 driven by infrastructure projects like the Lesotho Highland Water Project Phase II (LHWP-II) which boosted activity in the services sector. Inflation eased to 6.1% due to lower food and fuel prices, while the fiscal balance recorded a surplus of 8.4% of gross domestic product (GDP), driven by a strong Southern African Customs Union (SACU) receipts and water royalties. Despite these gains, the economy remains vulnerable. Growth is projected to slow to 1.1% in 2025 and 0.5% in 2026, with fiscal and external balances expected to weaken as SACU revenues decline, Official Development Assistance (ODA) shrinks, and capital spending rises. Key risks include climate vulnerabilities, sluggish growth in key trading partners, escalating trade tensions, ODA cuts, and the aftermath of the cancellation of the Millenium Challenge Corporation Compact II (MCC II). To mitigate these risks, Lesotho should prioritize economic diversification by shifting toward higher value-added sectors, while expanding trade partnerships to reduce reliance on a few key markets.

Rich in water, diamonds, a youthful population and a stable financial sector, the country faces challenges with regulatory inefficiency, poor infrastructure, high youth unemployment, and a weak business environment. Maximizing these resources requires strong state capacity to enforce the rule of law, uphold contracts, and create a stable regulatory environment for investment. Financing development efforts depends on improving domestic resource mobilization and ensuring efficient capital allocation. While tax revenues have increased, reaching 24.1 percent of GDP in FY2024/25, reliance on SACU revenues remains high. To achieve fiscal sustainability, reducing external dependency, strengthening tax systems, and prioritizing productive investments in infrastructure and governance will enhance capital utilization, driving sustainable growth.

Strengthening institutional quality and governance is key to improving capital mobilization and public spending efficiency. Reforms should enhance transparency, accountability and fiscal discipline by curbing illicit financial flows, corruption and informality. Encouraging private sector participation through regulatory reform will attract investment, foster innovation, improve service delivery, and reduce the fiscal burden on the government, driving sustainable economic growth.

GENERAL INTRODUCTION

The Kingdom of Lesotho is a small, mountainous, landlocked country surrounded by South Africa, on which it is economically dependent. South Africa supplies 79.5% of its imports and buys 53.3% of Lesotho's exports as of 2023.

Lesotho is a lower-middle-income country, with nominal gross national income per capita of USD 1,160 in 2023 and in 2024 a population of 2.3 million (32.2% living in urban areas with 34.5% under 15 years old). The country has promising opportunities across several sectors. It has abundant water resources with potential to be a key player in regional water security, an established textile and apparel industry, abundant mineral resources, significant hydropower and wind energy potential, and fertile land for agro-industrial production.

However, Lesotho's economic potential remains underutilized, with development largely reliant on government-led projects such as the Lesotho Highland Water Project Phase II (LHWP-II) - an approach that is not sustainable in the long term. The US Government's new "reciprocal trade" strategy, funding cuts impacting the health sector, cancellation of the Millenium Challenge Corporation Compact II (MCC II), and the uncertainty around the renewal of the Africa Growth Opportunity Act (AGOA) come September 2025 threaten economic stability and development prospects, highlighting the need for economic diversification and structural transformation.

The Country Focus Report (CFR) develops, at the country level, the theme and analyses carried out in the African Economic Outlook (AEO) 2025. The theme for the 2025 CFR is *Making Lesotho's Capital Work Better for Lesotho's Development.* It extends the 2023 and 2024 CFR focus and relevance by leveraging Lesotho's domestic capital to fast-track structural transformation and explores the role of institutions and governance in making Lesotho's capital work better for Lesotho's development. The report is divided into three chapters beginning with Lesotho's recent macroeconomic performance and outlook. Chapter II looks at the effectiveness of domestic capital mobilization in Lesotho based on the structural change financing gap identified in the CFR 2024 and provides an analysis of the financing landscape. Chapter III examines the catalytic role of the state to increase the wealth of Lesotho by valorizing its capital. The CFR involves rigorous analysis, desk review and interviews to bring new insights and provide evidence-based policy recommendations.



MACROECONOMIC PERFORMANCE AND OUTLOOK

1



Key Messages

- In 2024, Lesotho's economy grew modestly to 2.4 %, driven by mega-projects like the Lesotho Highlands Water Project Phase II which boosted the services sector, particularly finance, trade, and transport.
- External vulnerabilities persist, with a narrow export base and reliance on volatile remittances, Southern African Customs Union (SACU) revenues, and external aid. Risks include climate vulnerabilities, sluggish growth in key trading partners, rising trade tensions and shifting global priorities.
- Strengthening economic diversification, improving the business climate, and expanding trade partnerships are critical for sustained, inclusive growth.

1.1 Introduction

Lesotho's economy relies on government led projects, textiles and diamond exports, remittances, and SACU revenues. While macroeconomic management has been generally sound, growth remains vulnerable to external shocks and limited diversification. This chapter reviews recent economic performance and growth prospects for 2025–2026, analyzing macroeconomic trends, public finances, and financial flows such as remittances, Foreign Direct Investment (FDI), and Official Development Assistance (ODA). It also explores policy options to support resilient, inclusive growth and examines links between resource mobilization, development finance, and social outcomes.

1.2 Growth performance

Lesotho's economic growth remains weak and is insufficient to effectively address the country's development challenges. In 2024, Lesotho's economy grew modestly to2.4 %, up from 1.8% in 2023 (see Table 1), driven by mega projects like the LHWP-II which boosted the services sector, particularly finance, trade, and transport. The services sector has emerged as the dominant contributor to GDP (62.5%), while agriculture (6.5%) has seen modest growth. On the supply side, industry, particularly manufacturing, has declined significantly, with its share falling from 22.2% in 2007 to 13.6% in 2024, largely due to contractions in the textile sector. Mining has exhibited volatility, while construction, which peaked at 7.8% of GDP in 2012, declined to 2.5% in 2024. On the demand side, household consumption has been affected by inflation, while government consumption, particularly in public administration and defense, has provided stability. Investment trends have mirrored the decline in construction, and net exports have fluctuated due to shifts in the mining and manufacturing sectors.

1.3 Other recent macroeconomic and social developments

1.3.1 Monetary policy, inflation, exchange rate

At the core of Lesotho's monetary policy is the fixed exchange rate regime, with the Loti pegged one-to-one to the South African Rand under the Common Monetary Area (CMA). This significantly limits Lesotho's monetary policy independence. Inflation eased to 6.1% in 2024 from 6.3% in 2023, amid volatile food prices. To anchor inflation expectations, the Central Bank cut interest rates by a cumulative 50 basis points between November and February 2025 to 7.25%, aligning with domestic and regional conditions. The Loti, alongside the Rand, depreciated 2% against the US dollar in 2024 but outperformed many major currencies.

1.3.2 Financial sector

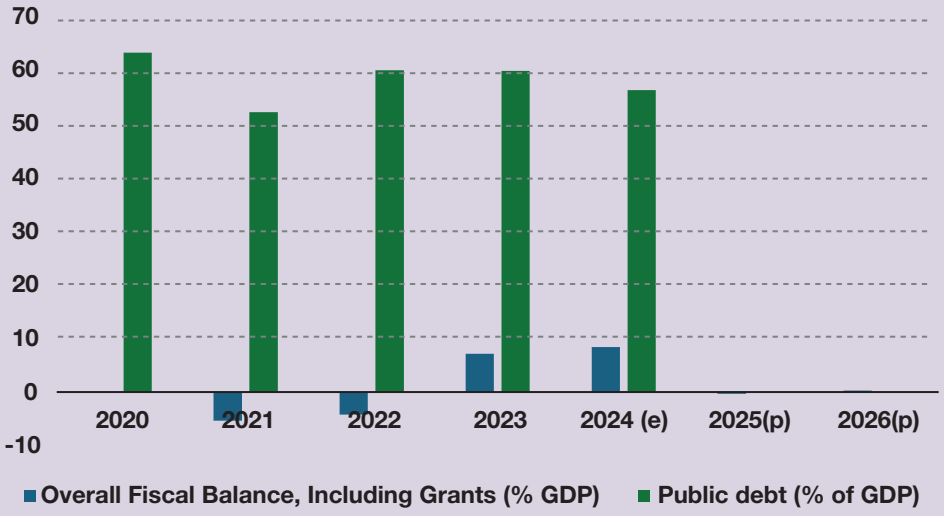
Lesotho's financial sector remains stable and plays a significant role in the economy, contributing 12.3% to GDP in 2023. As at end-2023, commercial banks dominated the financial system commanding 69.8% of total assets, followed by non-bank financial institutions (30.2%). On an annual basis, credit to the private sector grew by 10.4% in November 2024, driven by both household and business sector credit. In 2023, the commercial banks' capital adequacy ratios averaged 17.2%, above the 8% prudential requirement, indicating strong capital buffers for financial shocks. There was a slight deterioration in non-performing loans to 4.0% in November 2024, from a low of 3.3% in 2019. Meanwhile, digital financial inclusion has seen remarkable growth, especially amongst women, with financial inclusion reaching 91%. Additionally, Lesotho's national savings rate stood at 22.47% of GDP in 2024, highlighting a relatively strong capacity for domestic capital formation.

1.3.3 Fiscal policy and public debt

In 2024, Lesotho's fiscal balance recorded a surplus of 8.4% of GDP, up from 7.1% in 2023, reflecting a marked improvement supported by higher Southern African Customs Union receipts (27.8% of GDP) and increased water royalties (7.2% of GDP). However, Lesotho's ability to conduct independent fiscal policy remains constrained, as its budget heavily relies on SACU revenues. This surplus represents a notable shift from past deficits (Figure 1). However, the volatility of SACU revenues continues to pose a significant risk to fiscal stability, making medium-term budget planning and expenditure management more challenging. Looking ahead, the government aims to scale up public investment while addressing the rising wage bill, which consumes nearly 40% of total expenditures. To improve fiscal discipline and efficiency, the 2023 Public Procurement Act was enacted to strengthen expenditure controls.

Lesotho's public debt stood at 56.2% of GDP as of November 2024, remaining within a moderate risk of debt distress, according to the World Bank. Interest payments accounted for 3.3% of government revenue in 2022. To enhance fiscal sustainability, the government plans to introduce fiscal rules, including a Public Debt Rule to cap debt relative to GDP.

Figure 1: Trends in fiscal balance and public debt in Lesotho



Sources: AfDB statistics; Central Bank of Lesotho

1.3.4 External position – external financial flows

Lesotho's external position remains vulnerable with persistent current account deficits and reliance on external financial flows. In 2024, the current account deficit narrowed to 0.4% of GDP from 6.6% in 2023, driven by higher SACU revenues and water royalties. At 1.2% of GDP, net FDI remains modest, reflecting capital outflows exceeding inflows, with risks of further deterioration if ongoing business climate reforms stall. Remittances accounted for 22.9% of GDP in 2023, serving as a lifeline for households, though actual figures may be underreported. ODA remains vital for development but has become increasingly unpredictable due to shifting donor priorities. Lesotho's international reserves grew to 5.2 months of imports in 2024, up from 4.8 months in 2023, exceeding the three-month benchmark. However, external shocks, potential trade disruptions including the uncertainty of the AGOA renewal and SACU revenue fluctuations pose a risk to reserve adequacy.

1.3.5 Social developments

Lesotho faces high unemployment, which rose to 30.1% in 2024, from 22.5% in 2019, with youth (15-35 years) unemployment at 38.9%. Poverty has declined from 56.6% in 2002 to 49.7% in 2017, but rural poverty remains high at 60.7% compared to urban poverty at 28.5%. Life expectancy has improved, reaching 57.8 years in 2024. The Human Development Index fell marginally to 0.521 in 2022, from 0.524 in 2019, with an unchanged rank of 168 out of 193 countries. Despite progress, inequality remains high, with a Gini Index of 44.9 (2017). Government interventions, including the Cash for Work (Tsoha-U-iketsetse) program, aim to alleviate socio-economic disparities.

Box 1: Domestic resource mobilization efforts and development finance gap

Lesotho faces a significant development finance gap, worsened by a declining global funding climate and fluctuations in SACU revenues which make up 42% of revenues. Lesotho aims to reduce reliance on external aid and enhance domestic resource mobilization, which remains constrained by a large informal sector which narrows the tax base, and weak compliance. Additionally, a small private sector restricts non-tax revenue generation. Lesotho is developing a National Digital Transformation Strategy to accelerate digital growth and formalize informal activities and is working on increasing revenue collection capacities.

Table 1: Key Macroeconomic and Social Indicators

Indicators	2020	2021	2022	2023	2024(e)	2025(p)	2026(p)
Real GDP Growth (%)	-8.2	2.3	2.4	1.8	2.4	1.1	0.5
Real GDP Growth per Capita (%)	-9.3	1.1	1.2	0.7	1.3	0.0	-0.7
Inflation (%)	5.0	6.0	8.3	6.3	6.1	4.7	5.0
Overall Fiscal Balance, Including Grants (% GDP)	0.0	-5.3	-4.2	7.1	8.4	-0.3	0.3
Primary balance (% GDP)	1.6	-3.9	-2.3	9.1	10.8	2.2	2.8
Current Account (% GDP)	-1.5	-4.8	-8.2	-6.6	-0.4	-5.1	-6.5
Total Population (million)				2.3	2.3		
Life Expectancy at Birth - Total (years)				57.4	57.8		

Source: Data from national authorities, AfDB Statistics Department, October 2024, IMF, World Bank and UN; estimates (e) and prediction (p) based on AfDB data.

1.4 Macroeconomic outlook and risks

1.4.1 Outlook (economic growth – inflation - fiscal and external position)

Real GDP growth is projected to slow to 1.1% in 2025, declining to 0.5% in 2026, with the LHWP-II serving as the primary driver of economic activity, and without which the economy would stagnate. Inflation is expected to ease to 4.7% in 2025 and 5.0% in 2026 due to lower fuel prices. With lower SACU revenues, ODA cuts, and increased capital spending, the fiscal balance is expected to deteriorate to 0.3% of GDP deficit in 2025, rebounding to a 0.3% surplus in 2026. The current account deficit is projected to widen to 5.1% of GDP in 2025 and 6.5% in 2026.

1.4.2 Risks

Downside risks to Lesotho's economic outlook include climate vulnerabilities putting pressure on food prices, sluggish growth in key trading partners affecting both diamonds and textiles and clothing exports, escalating trade tensions, ODA cuts, and cancellation of the MCC II. Additionally, uncertainty surrounding the renewal of the AGOA threatens the textile sector which contributes 12.8% of GDP. To mitigate these risks, Lesotho needs to prioritize economic diversification by shifting toward higher value-added sectors, while expanding trade partnerships to reduce reliance on a few key markets.

Box 2: Impact of Current Shocks on Lesotho

Lesotho's economy has recently come under pressure from a combination of economic shocks including cuts in ODA, a 50% tariff on exports to the U.S. (temporarily reduced to 10% for a 90-day period starting April 9, 2025), and the cancellation of the MCC second five-year compact, a USD 300 million grant. These shocks are compounding existing structural challenges such as high unemployment and underscore the urgent need for targeted policy responses to build resilience and support inclusive recovery.

The suspension of key U.S. assistance, particularly the U.S. President's Emergency Plan for AIDS Relief (PEPFAR) and United States Agency for International Development (USAID) has severely disrupted the health sector, resulting in the loss of approximately 1,500 healthcare jobs and setbacks in HIV/AIDS prevention, treatment and outreach. Moreover, other donors have signaled potential funding cuts, adding to uncertainty in the global aid landscape.

The cancelled MCC compact, which aimed to improve Lesotho's rural economy through an irrigated high-value crops horticulture project, boost profits, strengthen primary healthcare, and support women- and youth-led enterprises, also halts critical infrastructure and institutional reforms. This cancellation has severely disrupted Lesotho's development prospects. With limited fiscal space and no clear plan to fill the funding gap, the situation underscores the urgency for Lesotho to explore alternative financing mechanisms and partnerships with other development partners to avert a broader crisis.

The U.S. tariff on Lesotho's exports, threatens to reduce the competitiveness of its textile and apparel exports that have benefitted greatly from duty-free access to U.S. markets under AGOA but is set to expire in September 2025. Textile exports to the U.S. accounted for about 47% of Lesotho's textile exports and amounted to over USD 200 million. The tariffs could potentially result in a 20–30% decline in orders, slashing export earnings by up to USD 60 million. This could push GDP growth below 1%, especially if factory closures or retrenchments accelerate. Medium-term impacts will depend on the speed at which Lesotho can diversify its markets or improve supply chain efficiency. If diversification efforts stall, Lesotho may face further declines in investment, factory relocations, and job losses in its already fragile manufacturing base, undermining tax revenue.

While Lesotho's own tariff could potentially have a devastating impact on the economy, the broader and more significant impact stems from tariff developments in South Africa which affects all SACU members. The 30% tariffs imposed on South Africa could have indirect, yet substantial effects on Lesotho. Most notably, the tariffs could lead to a slowdown in South Africa's economy, reducing employment opportunities for Basotho migrant workers and leading to a decline in remittance flows, an essential source of household income in Lesotho. Additionally, reduced trade volumes may lower SACU revenues, further straining Lesotho's public finances and social services, compounding economic pressures on the population. Long-term risks include deindustrialization, a further rise in unemployment, and social instability. Poverty levels could rise, particularly in urban centers which are heavily reliant on factory employment. Conversely, with appropriate investment and support, Lesotho could reorient its production towards regional markets and gradually reduce its exposure to U.S. policy shocks.

Navigating these overlapping shocks will require coordinated action to stabilize the economy, protect vulnerable populations and lay the groundwork for a more diversified economy. The uncertainty around the AGOA expiration, combined with trade tariffs on its exports, necessitates the exploration of new markets, including AfCFTA, and the enhancement of manufacturing efficiency and value-addition in the country's textile niche. Exploring bilateral agreements and upgrading logistics chains to reduce costs is equally essential. The government should invest in sector competitiveness—particularly in quality assurance, skills development, and logistics efficiency—to maintain apparel as a viable export even under less favorable trade terms. In parallel, policies to support entrepreneurship and SME development in non-textile sectors will help to reduce structural dependence on a single export industry.

1.5 Policy options to accelerate Lesotho's economic development

To accelerate growth, support economic transformation, and build resilience to shocks in Lesotho, monetary and fiscal policies should prioritize strengthening fiscal discipline by diversifying revenue sources beyond the volatile SACU receipts. Domestic resource mobilization efforts such as the ongoing development of a National Digital Transformation Strategy will expand the tax base by formalizing informal activity and improving revenue collection. The AfDB through the Tax Modernization Project aims to expand the tax base, modernize collection procedures, while the Institutional Support for Debt and Expenditure Management Project contributes to the strengthening of debt management and enhancement of public investment and the fiscal reporting process, with the aim of promoting fiscal consolidation and macroeconomic stability. This, coupled with stringent anti-corruption measures supported by a robust Directorate on Corruption and Economic Offenses (DCEO), would ensure suitable funding for development.

Given Lesotho's high public wage bill, containing it should be prioritized. A more targeted approach to wage bill management, such as eliminating inefficiencies, streamlining workforce structures, and continuing to ensure that salary adjustments align with fiscal sustainability, could help free up resources for essential social programs. Additionally, bold yet responsible fiscal planning is necessary to mitigate service delivery disruptions while effectively addressing wage bill pressures. Enhancing spending efficiency and prioritizing social investments will be critical to accelerating inclusive economic development.

Leveraging concessional loans and public-private partnerships can help finance critical infrastructure and drive inclusive growth through the development of a private sector strategy, streamlined regulations, and an improved business environment. It will also boost investor confidence. A national strategy for the private sector is currently under development with support from the United Nations Development Programme (UNDP) in collaboration with other development partners, which is expected to provide a strategic framework to guide private sector investments.

Developing climate-resilient infrastructure and adopting adaptive policies, guided by the Lesotho National Resilience Strategic Framework will mitigate environmental risks, while strengthening social protection systems, and will cushion vulnerable populations from economic shocks.

Finally, deepening regional trade integration, such as the African Continental Free Trade Area (AfCFTA) will reduce aid dependence and open new pathways for sustained growth

BOOSTING DOMESTIC CAPITAL MOBILIZATION AND EFFICIENT UTILIZATION

2



Key Messages

- Lesotho's financing needs to achieve its Sustainable Development Goals (SDGs) by 2030 amount to USD 0.812 billion, with a financing gap of USD 0.718 billion. Closing this gap requires increasing the tax-to-GDP ratio by 26.4%.

- In 2024/25, tax revenue accounted for 24.1% of GDP (37% of total revenue), mostly derived from taxes on goods and services and income tax. SACU revenues, which Lesotho is highly dependent on, accounted for 27.8% of GDP. Additionally, Lesotho has been able to leverage its abundant water resources through cross border water transfer agreements with South Africa, which generate substantial royalties (7.2% of GDP).

- Lesotho possesses valuable natural (both renewable and non-renewable) human, financial, and business resources valued at about 22 billion in 2020 (in constant 2019 USD). Of those resources, produced capital and renewable natural capital expanded by 221% and 13% respectively during 1995-2020, but human capital declined by 1% over the same period.

- Lesotho must focus on mobilizing domestic capital more effectively and utilizing it efficiently to drive sustainable development.

2.1 Introduction

Effective domestic resource mobilization in Lesotho is crucial for addressing the structural change financing gap of USD 0.718 billion identified in CFR 2024. Lesotho possesses valuable renewable and non-renewable, human, domestic, and business capital, although their potential remains untapped. Rich in water, diamonds, a youthful population and a stable financial sector, the country faces challenges with regulatory inefficiency, poor infrastructure, high unemployment, and a weak business environment. By harnessing these key sources of capital, Lesotho can tackle historical challenges and inefficiencies, driving future growth and sustainable development.

2.2 Fiscal resource mobilization

2.2.1 Lesotho's financing needs

Lesotho's financing needs to achieve the SDGs by 2030 amount to USD 0.812 billion, with a financing gap of USD 0.718 billion. Closing this gap requires increasing the tax-to-GDP ratio by 26.4% (CFR 2024). The fiscal balance has been in surplus since 2023, driven by strong SACU receipts and fiscal consolidation. This strong fiscal position allows Lesotho to invest in their development priorities while maintaining adequate fiscal buffers. However, the recent cuts in ODA are straining revenues and call for continued fiscal prudence.

2.2.2 Tax revenue

In 2024/25, tax revenue accounted for 37% of total revenue, with taxes on goods and services (19%) and income tax (17%) as key sources. SACU transfers accounted for 42% of total revenues, over and above the domestic tax revenue. Over 2014-2023, Lesotho recorded the highest cumulative tax-to-GDP ratio in Africa at 395.7%, well above the regional median of 138.5% and the Southern Africa Development Community's (SADC) average of 199.3%. To strengthen domestic resource mobilization and reduce reliance on SACU receipts, Lesotho is implementing reforms, such as digitalization, to improve revenue collection.

2.2.3 Non-tax revenues

Non-tax revenue in FY2024/25 was dominated by water royalties from the Lesotho Highlands Development Authority (11%), grants (6%) and property income (3%). The heavy reliance on SACU receipts and water royalties reflects Lesotho's economic dependence on South Africa and its water resources. This narrow tax base presents fiscal vulnerabilities and highlights the need to have a more diversified non-tax revenue stream. Strengthening the management of these key revenue sources is critical to ensuring a stable flow of funds to support essential public services and infrastructure development.

Box 3: Lesotho's Dependence on SACU Revenues

SACU revenues are a vital source of fiscal revenue for Lesotho, contributing 27.8% of GDP in FY24/25. Lesotho's share is drawn from a Common Revenue Pool (CRP), distributed via a predefined formula based on trade flows and excise collections, and is heavily influenced by South Africa's economic performance. While SACU revenues provide critical budgetary support, their volatility poses fiscal planning challenges. In recent years, SACU windfalls have supported fiscal surpluses in Lesotho, but as these transfers decline, critical budget lines face increasing pressure. This heavy reliance limits Lesotho's fiscal autonomy and exposes it to external shocks, such as the U.S. tariffs on South Africa which will negatively impact South Africa's economic performance and by extension overall SACU receipts. To enhance resilience and long-term sustainability, Lesotho is prioritizing domestic resource mobilization.

2.2.4 Mobilizing domestic fiscal resources and expenditure efficiency

Total expenditure increased after 2020 to support post-COVID-19 recovery. The elevated level of recurrent expenditure, particularly the wage bill (17.8% of GDP and highest in Sub-Saharan Africa), underscores the need for structural reforms to boost development spending while preserving fiscal sustainability. Capital expenditure for 2024/2025 stands at about 15% of GDP and is expected to increase, demonstrating Lesotho's commitment to infrastructure development and long-term economic growth. There are efforts to digitalize tax systems to expand the tax base and enhance revenue collection and improve public service delivery.

Figure 2: Trends in Domestic Resource Mobilization



Source: Central Bank of Lesotho

2.3 Lesotho's natural capital

2.3.1 Overview of Lesotho's natural capital

Lesotho possesses valuable natural, human, financial, and business resources valued at about 22 billion in 2020 (in constant 2019 USD, Table 2). Of these resources, produced capital and renewable natural capital expanded by 221% and 13% respectively during 1995-2020, but human capital declined by 1%. Lesotho has been able to leverage its abundant water resources through cross-border water transfer agreements which generates substantial royalties. Additionally, Lesotho holds untapped mineral resources which could play a key role in the just energy transition, though exploration remains costly.

Table 2: Decomposition of natural capital

Million, chained 2019 USD	1995	2000	2005	2010	2015	2020	Change, 1995-2020, (%)
National comprehensive wealth index	17590	19492	22510	22908	21445	21824	24
Produced capital	1106	1604	1794	2098	2813	3554	221
Human capital	14674	16382	18056	15963	14865	14493	-1
Renewable natural capital	3677	3691	4020	4189	4172	4149	13
Agriculture land	2238	2243	2236	2235	2136	2498	12
Hydropower energy	0	1283	1589	1739	1822	1466	…
Nonrenewable natural capital	0	0	0	0	0	0	…
Foreign assets	1308	1596	2825	4327	1822	1746	34
Foreign liabilities	1687	2872	2836	2763	2186	2138	27
Population	1.9	2.0	2.0	2.0	2.1	2.3	17

Source: AfDB Statistics Department

2.3.2 Economic contribution of Lesotho's natural capital

Lesotho's natural capital is vital for economic growth, contributing to GDP, employment, and fiscal revenues. The nonrenewable sector, particularly diamond mining, remains a cornerstone of the economy, with the mining sector's share of GDP standing at 7.3% in 2024. The renewable sector, especially water resources, plays an important role. Water exports to South Africa generate royalties equivalent to 7.2% of GDP. Governance and revenue management of both renewable and nonrenewable resources remain a concern underscoring the need to strengthen governance frameworks.

2.3.3 Estimates and dynamics of natural capital

Human capital constitutes the largest share of Lesotho's wealth, valued at approximately USD 14 billion, followed by renewable natural resources at USD 4 billion and produced capital at USD 3.5 billion. Notable growth has occurred in renewable natural capital, particularly in hydropower potential and cross-border water transfer initiatives. In contrast, the non-renewable sector, especially diamond mining, is facing increasing competition from lab-grown alternatives and remains vulnerable to commodity price fluctuations. Tourism, leveraging Lesotho's distinctive landscapes and rich cultural heritage, is also emerging as an important source of foreign exchange and job creation.

2.3.4 Challenges of leveraging Lesotho's natural capital

Lesotho faces challenges in leveraging its natural capital for sustainable development, as natural capital accounting, essential for tracking, management, and sustainably utilizing these resources, remains underdeveloped. The most recent GDP rebasing was completed in 2012, with the economic census data collection for a new rebasing underway, scheduled for 2027, supported by Development Partners. The Ministry of Natural Resources is in the early stages of this process, laying the groundwork for more effective integration of natural capital into economic planning.

2.4 Business capital

2.4.1 Setting the stage

Lesotho's private sector remains small and constrained by structural challenges and an uncertain regulatory environment. It is dominated by micro, small and medium enterprises, which face a weak business environment and limited access to finance. Lesotho's informal economy is sizeable, generating about 31% of GDP and employing over 50% of the labor force, mainly in subsistence agriculture. The sector is characterized by non-standard contracts of employment and poor regulation of working conditions, including exclusion from existing social security schemes. To improve the business environment, the government plans reforms and skills development to address informality and access to credit in order to improve productivity and value-addition.

2.4.2 Indicators of business capital

Lesotho's domestic private capital base remains underdeveloped with a firm density of just 25.5 per 1,000 people in 2020, well below Botswana's 146, indicating untapped investment potential. In 2020 the total number of firms stood at 35,385. The key business capital indicators underscore low private sector participation in the economy and competitiveness. According to the latest World Bank B-Ready report, Lesotho scores highest in Business Entry (76/100), Labor (63/100), and International Trade (61/100) supported by simplified business registration, efficient dispute resolution mechanisms and coordinated border management. However, it scored lowest in Market Competition (26/100) and Business Insolvency (37/100), reflecting weak procurement digitization and limited insolvency systems.

2.4.3 Challenges and opportunities for enhancing business capital in Lesotho

Challenges in Lesotho's business environment include high-startup costs, weak investor confidence and underdeveloped capital markets. The Maseru Securities Market (MSM) has low trading volumes, with market capitalization significantly lower than other regions. In contrast, South Africa leads in market capitalization, reflecting the depth and maturity of its financial markets. To improve trading volumes and expand access, the Central Bank of Lesotho (CBL) is proposing a full automation of trading in MSM that would allow bids to be sent electronically. Lesotho's private sector credit to GDP is low though it has been strengthening the last few years, and in November 2024 it showed a growth of 10.4% on an annual basis despite venture capital being scarce. Improving business capital infrastructure is crucial. Policies should streamline business registration, develop capital markets, and enhance credit access to drive innovation and growth.

2.5 Lesotho's human capital

2.5.1 Current state of human capital in Lesotho

Lesotho has made significant progress in human development, but the country still has gaps in education and health outcomes. The Human Capital Index (HCI) Report 2020 reveals that on average a child born in Lesotho will only achieve 40% of their potential productivity, on a par with peer countries like South Africa, Eswatini, Botswana and Namibia. Maternal and infant mortality rates remain high at 566 maternal deaths per 100,000 live births and 39 infant deaths per 1,000 live births (Lesotho Health and Demographic Survey 2024). These figures highlight the gaps in skilled care and support during all parts of the antenatal, natal and post-natal process.

Lesotho's unemployment rate stands at 30.1%, with the youth (15-35) unemployment rate standing at 38.9% and a labor participation rate of 52%. Primary education is free, but high dropout rates, especially in rural areas, and amongst boys, remain a concern due to indirect costs. The non-transition rate from primary to lower secondary education is 13%, from lower to upper secondary is 15%, and 73% of students discontinue their studies after upper secondary education.

Table 3: Key Indicators of Education, Health, and Workforce in RMC

Education	2007	2017	Health	2014	2024 or latest	Workforce	2019	2024
Primary school pupil-teacher ratio	37	33	Life expectancy	51	57.8	Total population, millions	2	2.3
Primary school enrollment (% net)	87	93	Infant mortality rate, per 1000	59	39	Labor force participation rate	49.9	52
Secondary school enrollment (% net)	27	41	Maternal mortality rate, per 100,000	649	566	Youth unemployment rate	29.1	38.9

Sources: Lesotho Bureau of Statistics; Lesotho Health and Demographic Survey; World Bank Data

2.5.2 Major barriers to human capital development in Lesotho

Human capital development in Lesotho faces financial limitations, with underfunded health and education systems, and poor infrastructure. Many schools lack basic facilities and areas lack hospitals and essential medical supplies. Digital infrastructure is weak, with limited affordable internet access. There are shortages of well-trained teachers and doctors, and education systems often do not align with labor market needs, leading to a skills gap. Brain drain due to emigration of Basotho to mainly South Africa exacerbates these issues. Misallocation of funds also hampers the effectiveness of investments in health and education.

2.5.3 Investing in education and skills development

Lesotho faces clear disparities in access to education, especially in rural areas. To address this, the government has implemented policies such as free primary education, enhancing access. School feeding programs have also been introduced, improving learning outcomes, while a textbook rental scheme reduces costs. Fees are now regulated to prevent exorbitant charges, and bursaries support higher education. The government has also introduced new curricula, particularly in science, technology, engineering and mathematics (STEM), to meet the needs of the market. Incentives to educators particularly in rural areas are used to ensure talent retention. As of 2023, the share of government expenditure on education as a percentage of total expenditure was 11.3%, though most of the education budget is allocated to recurrent expenditures such as salaries and operation costs.

Box 4: Reforms and investments in education that have worked well

Lesotho has made progress in education through free primary schooling, school feeding programs, textbook rental schemes, and regulated fees, all of which have improved access and learning outcomes. The government has prioritized rural education by investing in teacher training and offering incentives for those teaching in remote areas. Universities are introducing new, accredited programs, particularly in STEM to meet market needs. Collaboration with the private sector is enhancing internet access in schools, supporting digital learning and preparing students for a technology-driven future.

2.5.4 Health as a pillar of human capital development

Lesotho's health sector faces significant challenges, including inadequate infrastructure, a shortage of qualified medical personnel, and limited funding. According to the World Health Organization, the country has only 21 healthcare workers per 10,000 people—well below the recommended threshold of 44.5. Rural communities are particularly underserved. Major health concerns include high prevalence rates of HIV/AIDS and tuberculosis, as well as environmental risks such as unsafe water and poor sanitation. Government initiatives aim to reduce the disease burden and improve healthcare delivery. Opportunities exist to leverage last-mile information, communication and technology (ICT) connectivity to enhance services through telemedicine and mobile health applications.

2.6 Financial capital

2.6.1 Domestic Capital and/financial markets

Domestic capital and financial markets in Lesotho remain relatively underdeveloped but hold significant potential for economic growth. The CBL's efforts to increase investor participation in the financial markets through regulatory reform, improved financial infrastructure, digitization, and enhancing investor confidence could boost their contribution to development financing.

At the same time, remittances, which accounted for 22.9% of GDP in 2023, can also play a vital role in development financing. Inflows have remained relatively stable though the number could be underreported. Compared to peer countries like South Africa (0.2%), Eswatini (1.8%), and Namibia (0.7%), Lesotho's remittance inflows are substantial, providing a critical source of income for many households. However, barriers such as high transaction costs and limited access to formal financial services hinder their full potential.

2.6.2 The state of financial development in Lesotho

Based on the IMF's Financial Development Index, Lesotho's financial development has gradually improved over time, with the latest overall score of 0.15 (2021), though it remains relatively limited. The Financial Institutions Efficiency Index improved significantly from 0.33 in 1980 to 0.46 in 2021, peaking at 0.64 in 1997. However, access and depth indicators underperformed. The Financial Institutions Access Index only improved marginally from 0.03 to 0.1, likely due to high transaction costs and inadequate financial infrastructure, while the Financial Institutions Depth Index failed to maintain its gains after peaking in the 1990s. On the other hand, Lesotho's Financial Markets indicators remained negligible, indicating a virtually absent capital market. These trends demonstrate a narrow financial system largely centered on banking institutions with limited reach. However, mobile money platforms such as MPesa, and EcoCash have helped bridge the access gap.

2.6.3 Mobilizing financial resources for Lesotho's development

Insurance institutions and pension funds in Lesotho could play a vital role in mobilizing resources for development. However, insurance institutions face challenges such as low penetration and cultural barriers. Most individuals primarily seek coverage for death-related risk, while other forms of protection remain underutilized. Public awareness and understanding of the value of insurance also remains low leading to low penetration rates and high premiums. In the agricultural sector, climate-induced risks are high and unpredictable making product design and pricing challenging. Additionally, the high cost of living places insurance low on the list of household priorities.

The pension funds industry is relatively new and is unregulated and underregulated with the implementation of the Pensions Act 2022 underway. The CBL continues to register more pension funds including the Public

Officers Defined Contribution Pension Fund and has been able to repatriate 98% of pension funds that were in South Africa. The CBL aims to maximize returns on funds while managing risk exposure, with the goal of channeling resources towards development in Lesotho.

2.6.4 Offshore linked financial resources for Lesotho's development

Lesotho's cross-border financial system is undergoing regulatory reforms to better align with international standards and regional oversight mechanisms. As of 2024, the CMA, comprising Lesotho, South Africa, Namibia, and Eswatini, discontinued the low-value cross-border Electronic Funds Transfer (EFT) and collections system. This reform aims to address compliance deficiencies, particularly in relation to Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) frameworks. While cross-border payments are still permitted, enhanced data reporting requirements have become mandatory. In parallel, offshore-linked financial services are being more tightly regulated. Foreign insurance companies and other entities operating in Lesotho are now required to open local bank accounts to collect funds. These measures aim to improve traceability under domestic regulations, strengthen financial integrity, limit unregulated capital outflows, and promote the domestic anchoring of financial transactions, ultimately supporting greater capital mobilisation for Lesotho's development.

2.6.5 Innovative finance

The fintech ecosystem in Lesotho is advancing rapidly supported by a maturing mobile money landscape and projects such as LeSwitch, led by the CBL. LeSwitch is part of a broader payment systems roadmap aimed at increasing efficiency and financial inclusion through digital infrastructure. The system is poised to improve domestic transaction processing and expand access via ATMs, points of sale terminals, and QR codes. As mobile money adoption grows, fintech can serve as a conduit for broadening savings mobilization and credit extension, particularly for the underserved, hence unlocking the potential of savings in driving economic growth and development.

2.7 Policy recommendations

Lesotho possesses abundant domestic capital, but its mobilization and utilization remain constrained by structural inefficiencies and inadequate investment. Sustainable development depends on managing both renewable and nonrenewable resources equitably, all while avoiding overexploitation and maximizing their development impact through value addition. This approach ensures intergenerational equity while maintaining the economic importance of mining. Addressing the current fragmentation in natural resource governance, it will be critical for the government to follow through on the Ministry of Natural Resources' plan to create an overarching policy to govern natural resources under the Natural Resource Policy. Human capital must be strengthened through the education and health sectors reforms aligned with market needs to build a productive and resilient workforce. Reversing the brain drain would further enhance national capacity. To mobilize financial capital, the country must strengthen tax compliance, continue to broaden the tax base, tackle illicit financial flows, and deepen capital market participation, including from the diaspora, where a Diaspora Investment Fund is currently in the conceptual phase.

Improving the business environment through legal and policy reforms is also essential to spur private sector growth. Finalizing and operationalizing the national strategy for the private sector — currently being developed with support from UNDP — will guide private sector investments and support business environment reforms.

Strengthening national data systems is also critical, as the limited availability of data continues to hinder effective planning, monitoring, and evaluation. The Lesotho Bureau of

Statistics is making commendable efforts using the limited resources at its disposal, however, both government and development partners need to be more intentional and consistent in allocating funding for data systems. Without reliable data, it is difficult to measure progress or make evidence-based decisions.

Furthermore, greater inclusion of academia with institutions such as the National University of Lesotho in policy consultation and implementation would enrich the policy making process. Researchers and scholars possess valuable knowledge and analytical expertise that can inform more effective and context-specific development strategies.

Through these targeted reforms, investments, and enhanced governance, Lesotho can close its development financing gaps. Support from Development Finance Institutions (DFIs) including the African Development Bank (AfDB) would provide funds as well as guarantees, technical assistance and policy advice needed to mobilize financing for structural transformation.

HARNESSING LESOTHO'S CAPITAL POTENTIAL AND RESOURCES FOR DEVELOPMENT

3



Key Messages

- Lesotho continues to face persistent governance challenges stemming from political instability, weak public financial management (PFM) frameworks, and an underdeveloped policy environment. Addressing these issues is essential for the effective management and utilization of the country's capital resources. Although Lesotho has held regular democratic elections since 1993, political instability remains prevalent due to fragmented coalition governments, weak state institutions, and the politicization of the security apparatus. This instability undermines investor confidence by creating an unpredictable business environment that deters both domestic and foreign investment.

- To address these concerns, reforms must prioritize strengthening the legal and judicial systems to ensure greater contract enforcement, reduce resource leakages, and build trust between the public and private sectors. According to the 2024 CFR, Lesotho lost an estimated USD 9.537 million to illicit financial flows between 1980 and 2019. Retaining such capital could have significantly bolstered the country's development financing capacity. Despite these constraints, Lesotho is making strides to improve institutional quality through targeted governance reforms.

3.1 Introduction

Institutional quality, governance, and the influence of the rule of law play a central role in shaping Lesotho's capacity to mobilize and effectively manage its natural, human, and financial capital. Persistent political instability, weak public financial management systems, and corruption continue to undermine development outcomes and deter investment. Strengthening institutions, improving transparency, and enforcing legal frameworks are essential for reducing financial leakages and enhancing resource efficiency. Prioritizing these reforms will allow Lesotho to leverage its capital for sustainable growth and structural transformation.

3.2 Institutional arrangement for the management and utilization of the various forms of capital

Lesotho has faced persistent challenges in governance indicators due to political instability, weak PFM legislation and a weak policy environment. The country's Corruption Perception Index (CPI) score dropped two points compared to 2023 to 37/100, ranking 99 out of 180 countries, and scoring the lowest in the last decade. Governance performance as measured by the 2024 Mo Ibrahim Index placed Lesotho at 21 out of 54 in Africa, scoring 53.9 out of 100.0, higher than the continental average (49.3) but lower than

the Southern Africa regional average (54.6). The 2023 Open Budget Index score of 35 out of 100 highlights the need for improved transparency in budget documents. These trends underscore the challenges in implementing government reforms in Lesotho that would be needed for effective management and utilization of its capital.

The Country Fiduciary Risk Assessment 2025 highlights several critical institutional weaknesses that would impact Lesotho's investment climate and capital mobilization. (PFM systems are outdated, with inadequate staffing in oversight teams, aging equipment, weak cash management systems, and significant delays in auditing government financial statements.) Despite holding regular democratic elections since 1993, Lesotho has experienced political instability due to weak state and governance institutions, continuous splintering of coalition governments, and politicization of security establishments. Additionally, the Directorate on Corruption and Economic Offenses lacks prosecutorial powers, and there are no anti-corruption courts, leading to persistent corruption issues as evidenced by Lesotho's low score on the CPI. These issues also pose a challenge in deepening institutional quality and the effectiveness of key resource mobilization bodies.

Weak state capacity and poor institutional quality significantly contribute to resource leakages in Lesotho, limiting the country's ability to harness capital mobilization effectively. Inadequate budget controls undermine the credibility of the budget and lacks reliable information on arrears. Weak internal controls, characterized by low levels of compliance with set procedures, high vacancy rates, and low skills levels in internal audit functions, lead to undetected errors and inefficiencies. The absence of procurement regulations and guidelines and the lack of a fully operational Public Procurement Authority result in procurement inefficiencies and potential abuse. Moreover, the Lesotho Revenue Authority (LRA) faces challenges in ensuring tax compliance and in detecting tax evasion due to the absence of a single national identification system.

Despite these challenges, the country is making efforts to improve institutional quality that would support Lesotho's management. With support from the AfDB, Lesotho is working on strengthening its capacity in public debt management and reviewing and developing a medium-term debt strategy. Additionally, the digitalization of financial Management and reporting systems — including the rollout of the Integrated Financial Management Information System (IFMIS) connectivity and functionality in key foreign missions and district administration offices — has enhanced financial management and reporting systems. Moreover, the development of the National Asset Management Strategic Plan will help in better management of national assets. These measures would lead to tangible outcomes in improving institutional capacities.

3.3 Governance challenges in the management and utilization of the various forms of capital for resource mobilization

The extractive sector, particularly diamond mining, is crucial for Lesotho's economy, though governance issues have led to a poor regulatory framework, inadequate compliance, and enforcement of contracts, resulting in environmental degradation, resource leakages and inefficiencies. Additionally, foreign entities often hold majority ownership of the mines, limiting the share of economic returns retained by Lesotho. These issues are not unique to mining. Water resources, another key resource, are similarly affected by inadequate oversight and benefit-sharing mechanisms. The government is working on an overarching policy, the Natural Resources Policy, that will focus on the sustainable management of its natural resources.

Lesotho's tax system, managed by the LRA, is characterized by a narrow tax base, with a significant portion of the economy operating in the informal sector. This limits the government's ability to maximize domestic resource mobilization. Additionally, there is only a ten percentage point difference between the

income tax of the highest earners compared to the lowest earners, leading to a disproportionate tax burden on lower-income groups. While the 2025/26 budget proposed an increase in alcohol, tobacco and gaming levies by 2.5%, 5%, and 2.5% respectively, they are unlikely to raise substantial revenue. The property tax system is also underdeveloped, resulting in significant untapped revenue potential, accounting for just 3% of total revenue. The absence of coherent tax policies exacerbates issues of corruption, tax evasion and illicit financial flows which could provide much needed resources for infrastructure development and public services.

To enhance governance and leverage its capital for development, Lesotho must improve the efficiency and effectiveness of the LRA including expanding the tax base by formalizing the informal sector. Efforts on this are underway with the ongoing development of a National Digital Transformation Strategy. The Business Licensing and Registration Act of 2019 and Registration Regulations 2020 also aims to formalize businesses and facilitate speedy issuing of licenses and registration of businesses.

Tackling corruption and illicit flows is essential for strengthening Lesotho's governance and economic resilience, for better management and utilization of Lesotho's capital. Empowering anti-corruption bodies like the DCEO with prosecutorial powers and establishing anti-corruption courts would enhance accountability and enforcement. At the same time, strengthening the legal and judicial systems, particularly in the extractive sector, can curb resource leakages and enhance trust between the public and private sectors. Lesotho is also engaging in international efforts to improve financial transparency and combat illicit financial flows, including through regional cooperation. Partnerships with cross-border institutions play a key role in strengthening Lesotho's financial governance. SADC, through its Protocol on Finance and Investment and Anti-Corruption Committee, promotes cooperation on financial regulations, transparency, and capital movement, and strengthen regional efforts to combat corruption and illicit financial flows. Similarly, the African Peer Review Mechanism and the African Tax Administration Forum of the African Union assess governance and economic policies to prevent capital leakages and facilitate cooperation on tax transparency and fair taxation. By addressing these governance issues, Lesotho can create a more conducive environment for capital mobilization and utilization, ultimately driving sustainable economic growth and development.

3.4 The rule of law, the management and utilization of the various forms of capital

Like in many countries, state capture -- where private interests unduly influence public decision-making -- has had a detrimental effect on Lesotho's economic growth, investment climate, and the effective mobilization and utilization of capital. This undermines investor confidence by creating an unpredictable business environment, particularly when political institutions are unstable. In Lesotho, where the average government tenure has been just 2 to 3 years, such volatility has made long-term investment planning increasingly risky.

Yet, Lesotho has considerable potential to harness its natural resources, notably water and renewable energy. Improving the business environment and fostering stronger private sector engagement are critical to leveraging these resources for economic growth. Support from development partners — especially in infrastructure development and economic and financial governance — will be vital to ensure sustainable management and utilization of these assets.

Establishing a robust rule of law is essential to attract both domestic and foreign investment, including from the diaspora. The Government of Lesotho is implementing a Remittances Strategy to formalize remittance channels and improve financial literacy. Complementary policies, such as the Diaspora Investment Policy, aim to inform Basotho abroad about

business opportunities and encourage their involvement in national development. Efforts are also underway to map the diaspora to identify potential investors and implement skills transfer initiatives, including hosting homecoming events and attracting professional expertise from abroad. Without legal certainty, these efforts would fall short.

Lesotho can draw inspiration from countries like Botswana, which has maintained political stability and enforced contracts effectively, key drivers of sustained economic growth and foreign investment. These strengths are reflected in its Regulatory Framework score of 65.96/100 in the World Bank's 2024 B-Ready report. In 2022, Botswana attracted USD 216 million in FDI according to the United Nations Conference on Trade and Development (UNCTAD) data, underscoring investor confidence in its governance and legal systems. Similarly, Rwanda has significantly improved its business environment by strengthening legal institutions and the rule of law, attracting considerable foreign direct investment. These reforms have earned Rwanda a Regulatory Framework score of 70.43, one of the highest globally, and helped it attract USD 399 million in FDI in 2022. In comparison, Lesotho scored 54.87 on the same index and recorded 8 million in FDI, indicating more investment left the country than entered. Back in 2001, FDI inflows to Botswana, Rwanda, and Lesotho were USD 31 million, USD 19 million and USD 30 million respectively, showing that Lesotho once attracted levels of investment comparable to its peers. By learning from these examples, Lesotho can cultivate a more enabling environment for investment, entrepreneurship, and inclusive economic development. Potential lies in harnessing Lesotho's abundant water resources, developing its capacity to generate hydropower and wind energy, exploring opportunities for agro-industrial production, and leveraging its unique landscapes for sustainable tourism, including ski tourism. These sectors could become key drivers of economic growth if supported by sound governance, targeted investments, and regulatory reforms.

3.5 A Pan-African approach to strengthening the rule of law, institutions and governance for harnessing Lesotho's capital

Through policy harmonization and capacity building initiatives, the African Union and Regional Economic Communities can support reforms and regional infrastructure developing, facilitating cross-border investment and trade. The African Continental Free Trade Agreement (AfCFTA) could play a key role in intra-African trade, reducing tariff and non-tariff barriers, and harmonizing regulations. For Lesotho, AfCFTA offers opportunities to expand market access, boost industrialization, and reduce reliance on SACU revenues. Furthermore, by formalizing cross-border trade, AfCFTA could help curb informal economic activities, ensuring greater revenue mobilization.

3.6 Conclusion and policy recommendations

Strong institutions, governance, and the rule of law are crucial for unlocking Lesotho's potential for sustainable development. The AfDB is actively supporting reforms in public financial management and domestic resource mobilization. To enhance financial capital, the AfDB, through the Tax Modernization Project, aims to expand the tax base, modernize tax collection and compliance systems and strengthen the legal and institutional framework for tax administration. However, progress continues to be undermined by delays in passing key tax legislation including the Tax Administration Bill, Income Tax Amendment Bill, and the VAT Amendment Bill. Accelerating legislative action is critical to realizing the full benefits of these reforms.

In the area of anticorruption, while currently not a focus of Bank support, there is urgent need to enhance institutional enforcement capacity. This includes considering granting prosecutorial powers to the DCEO and establishing anticorruption courts to expedite case resolution and strengthen deterrence.

Improving public financial management, particularly procurement processes and audit systems and fully operationalizing the Public Procurement Authority will further increase efficiency and transparency.

Additionally, leveraging the diaspora through the formalization of remittances and targeted investment initiatives can unlock new sources of capital. Ongoing efforts such as diaspora mapping (with the support of the International Organization for Migration), diaspora homecoming initiatives and other programs to attract diaspora investment are welcome steps in the right direction.

Finally, effective governance of both renewable and nonrenewable natural resources would unlock economic opportunities, strengthen resilience, and ensure long-term wealth creation. The overarching Natural Resource Policy being explored by the government is a promising step forward.

Collectively, these policies would enhance institutional quality and governance, attracting investment and fostering growth.



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