

I. COUNTRY REFORM PROGRESS

Lesotho is making slow and steady progress in improving public finance by improving tax policies and strengthening revenue and public financial management (PFM) functions. In 2023/24, the tax-to-GDP ratio excluding Southern African Customs Union (SACU) transfers was 29.3 percent with an estimated surplus of 6.1 percent of GDP. The 2025/26 budget speech (February 2025) outlined several tax reform measures including personal income tax (PIT) (schedule adjustments: increasing threshold and rates), value-added tax (VAT) (raising threshold), and new excises on alcohol and tobacco. Parliament was discussing a VAT increase (from 15 percent) to align with South Africa's recent changes (15.5 percent in FY25-26 and 16 percent in FY26-27). However, these changes may not materialize due to the withdrawal of the measure in South Africa. While the government's heavy reliance on SACU revenues (12.9 percent of GDP in FY23 and 24.5 in FY24) has diminished the urgency for revenue mobilization, improving efficiency and equity of the tax system continues to be a priority.

The establishment of a tax policy unit (TPU) in the Lesotho Ministry of Finance (MoF) is long overdue. However, the government continues to build capacity in tax policy in parallel. During a Revenue Forecasting and Analysis workshop, staff from the MoF, Revenue Services Lesotho (RSL), and the Bureau of Statistics developed working revenue forecasting models based on the latest tax collection data for Lesotho. Further improvements in data management are necessary to finalize these models and ensure their continuous refinement over time.

With the support of the IMF's Fiscal Affairs Department (FAD), RSL developed a plan to respond to weaknesses in core tax administration functions identified in the Tax Administration Diagnostics Assessment Tool (TADAT) evaluation undertaken prior to the GPFP-funded project (March 2023). Progress has been made in some areas such as compliance monitoring, debt management and dispute resolution. Staff are now better equipped to interpret revenue collection patterns.

The Ministry of Finance and Development Planning (MoFDP) has made progress in reporting fiscal risks from state-owned enterprises, improving internal controls, and introducing initiatives for gender budgeting. The focus of capacity development (CD) in the MoFDP is on strengthening internal controls to improve the quality of budget execution and fiscal reporting, which in turn will support the orderly preparation and execution of fiscal policy.

However, the lack of an adequate legal framework has constrained progress, including failure to pass the Tax Administration Bill, PFM Bill, and amendments to the Income Tax and Excise Act. Amendments to the Income Tax and Excise Acts have been pending Parliamentary approval for over three years. The progress of the Tax Administration Bill, and PFM Bill may provide impetus to further reforms.

II. PROJECT DELIVERY HIGHLIGHTS

RM I: Revenue Module I – Tax Policy

Key Progress in FY25: A joint tax policy and administration team has supported efforts to strengthen revenue forecasting capacity involving the MoF, RSL, and the Bureau of Statistics. Simple forecasting models have been developed for each major tax category.

Staff recruitment for the TPU is ongoing, with authorities anticipating completion before the end of the calendar year.

Next Steps: The authorities have identified the review of the current tax incentives framework as an urgent priority, in light of growing pressure to grant additional incentives, including those in Special Economic Zones. CD for the newly established TPU will commence once the recruitment process is complete and all staff are in place.

RM II: Revenue Module II – Revenue Administration

Key Progress in FY25: An in-person mission led to the establishment of a cross-organization TADAT response team, which developed—with remote support—a plan to address TADAT weaknesses. The provision of high-level TADAT awareness training as part of a quarterly senior management meeting assisted in developing a shared understanding of good tax administration practice. The joint tax policy-revenue administration workshop provided foundational knowledge to RSL’s revenue forecasting, analysis, and monitoring team, and their analytical skills were enhanced through a follow-up interactive workshop. The team was able to provide reports to senior management with estimates of the revenue impact associated with tax policy proposals, such as raising the VAT registration threshold.

Previous Progress: The TADAT diagnostic conducted in March 2023 provided insights to the administration on the foundational aspects of tax administration that needed to be improved to become more effective.

Next Steps: FAD will continue to support RSL in areas where it has been identified that assistance would be welcome, such as compliance risk management (CRM), tax gap monitoring, and further building analytical skills.

SM II: Spending Module II – Managing Public Finance

Key Progress in FY25: The MoFDP has improved the reporting of fiscal risks from state-owned enterprises (SOEs). The FAD gender budgeting mission in April 2025 conducted a technical workshop for 30 officers from government agencies on key concepts, practical tools of gender budgeting, and international experience in their implementation.

Previous Progress: The MoFDP made significant progress in improving internal controls and the reporting of fiscal risks from SOEs. The latest achievements in managing SOE fiscal risks are based on the enhanced capacity of the public sector development department to analyze financial statements of SOEs.

Next Steps: CD is planned to support the strengthening of internal controls in the Integrated Financial Management System (IFMIS) and provide further training on gender budgeting.

III. LOGICAL FRAMEWORK

Country – Lesotho		
RM I: Objective - Strengthen Policy Monitoring, Evaluation, and Institutions - TPM		Rating - 2
Outcome	Rating	Narrative
Improved structures (e.g., TPUs) or capacity (e.g., models and tools) related to tax policy advice and analysis.	2 Partially Achieved	The hiring of staff for the TPU is still in progress. An FAD mission to improve the revenue forecasting capacity of the government took place in December 2024, and simple models for each tax heading were developed with RSL and the macro team at the MoF.

		Better data management is needed in order to improve the models.
RM II: Objective - Strengthened revenue administration management and governance arrangements (SDG 17.1) - RAM		Rating - 2
Outcome	Rating	Narrative
Capacity for reform increased due to clear reform strategy and a strategic management framework adopted and institutionalized	2 Partially Achieved	High-level plan to address weaknesses identified through TADAT developed, that will provide for easier tracking of progress.
Corporate priorities are better managed through effective risk management	1 Not Achieved	CRM is to be addressed through the TADAT response plan.
RM II: Objective - Strengthened core tax administration functions (SDG 17.1) – TAD		Rating - 1
Outcome	Rating	Narrative
The integrity of the taxpayer base and ledger is strengthened	1 Not Achieved	The TADAT response plan outlines actions to be taken to deregister economically inactive former taxpayers, and to register taxpayers who should be registered. April 2025: Support in this area may still be needed.
A larger proportion of taxpayers meet their payment obligations as required by law	1 Not Achieved	October 2024: Obtaining complete registration and filing statistics remains challenging. April 2025: Filing statistics available, but on-time payment statistics remain a challenge.
Audit and other verification programs more effectively ensure accuracy of reporting	1 Not Achieved	October 2024: Actions have been set out in the TADAT response plan to address weaknesses in audit but are yet to be implemented fully. April 2025: Audit coverage has been improved.
SM II: Objective - Strengthened Budget Management - PBM		Rating - 1
Outcome	Rating	Narrative
Strengthened annual budget process, and effective allocation	1 Not Achieved	The CD will be delivered as planned later this year.
Strengthened identification, monitoring, and management of fiscal risks	2 Partially Achieved	In fiscal risk management, significant progress has been made in disclosing fiscal risks from the SOEs sector. The government's overall fiscal risk statement is under consideration by the MoF. The preparation of a comprehensive fiscal risk statement will require more work in future years. The MoF published the FY2022 Annual SOE Report in August 2024.
Strengthened medium-term frameworks	1 Not Achieved	No progress has been made on this front. The Fund has yet to start delivering CD in this area.
SM II: Objective - Frameworks to Build Sustainable Fiscal Institutions and Frameworks - FIF		Rating - 2

Outcome	Rating	Narrative
Strengthened fiscal policies, frameworks, institutions, and laws	2 Partially Achieved	Based on Fund CD, follow-up support is provided by the World Bank.
Strengthened capacity to plan, implement and sustain digitalization	2 Partially Achieved	There has been definite progress in the implementation of internal controls. However, progress is slow. Out of the 61 activities, 10 have been completed, and 27 are in progress. There have been improvements in securing IFMIS, its user access, and addressing some configuration gaps. The key initiative to implement digital signatures and eliminate paper usage is yet to be implemented. The Ministry of IT has decided to provide digital signature services to the Treasury. The Treasury has planned the implementation of digital signatures in processing fund transfer instructions to the Central Bank of Lesotho. Further improvements in hardware infrastructure are planned to support implementation.

IV. RISK ASSESSMENT

Description	Rating	Mitigation Measures
External Climate/Conditions		
All: Risk that external events create a more challenging environment to implement reforms.	Medium	Monitor closely, ensure sufficient flexibility in program execution across countries and allow for ability to adjust activities in the case of adverse events.
Political Support		
RM I, RM II; SM II: Lack of political support for reforms inhibits required actions.	High	Ensure fiscal risk CD is focused on priority areas and engage regularly with Ministers and senior management to ensure government ownership of reforms.
RM I, RM II: Uneven political ownership of reforms – tax reforms need to be accompanied by governance reforms.	Medium	Regular engagement with ministers and senior management, to ensure full understanding of reforms required.
Management and Technical Staff Support and Commitment		
RM I, RM II: Low commitment of management and staff to adopt and implement changes needed to the legal framework.	Medium	Engage regularly with senior management and technical staff and explain the importance of strengthening domestic revenue mobilization.
RM I, SM II: Gaps in capacity of management and technical staff lead to changes in priorities and ability to absorb technical assistance.	Low	Maintain flexibility to adjust CD as needed, in alignment with skills and priorities.

Description	Rating	Mitigation Measures
RM II: Low commitment of management and staff to adopt and implement improvements to core tax administration processes.	Medium	Engage with senior management and technical staff proactively and explain the importance of strengthening core tax processes.
Resource Adequacy		
RM I, RM II: Insufficient technical capacity and human resources necessary to implement reforms are limited.	Very High	Ensure CD plans include sufficient capacity building and training elements and prioritize CD to priority or highest risk areas, where resources are limited. Regular remote follow-ups, to facilitate progress.
Other Risks		
All: Multiple donors are providing technical assistance on DRM and PFM, and gaps or overlaps may arise as a result.	Low	Engage with other donors to ensure support is well coordinated, through multilateral and bilateral meetings during missions, and maintaining regular contact with more active development partners.
SM II: A legal framework to support digital signature implementation and internal controls is missing	High	Apply internal controls in parallel.

V. PROJECT MANAGERS CONTACT INFORMATION

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