A MACROECONOMETRIC MODEL FOR THE ECONOMY OF LESOTHO: POLICY ANALYSIS AND IMPLICATIONS

By

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Abstract

This study develops a macroeconometric model for the economy of Lesotho with the view of assessing existing and alternative macroeconomic policies. The model is designed to capture the structural characteristics of the economy while also exploiting the developments in economic theory and statistical analytical tools. It consists of seven sectors, namely, the production sector, the employment sector, the aggregate demand sector, the government sector, the balance of payments sector, the monetary sector and the price sector. The model is estimated using time-series data spanning the period from 1980 to 2000 using the Engle-Granger two-step cointegration technique, capturing both the long-run and short-run dynamic properties of the economy.

The construction of this model follows the lines of the aggregate supply-aggregate demand framework. The economy is assumed to be demand driven by multiplier effects operating through private consumption and private investment with the prices system ensuring that the economy operates within capacity constraints. It is noteworthy that the level of disaggregation adopted in the model is considered sufficient to explore the necessary policy options and is dictated to a large extent by the availability and quality of data.
The tracking performance of the model and its forecasting accuracy is satisfactory as evaluated by means of the MAE, the MAPE, the RMSE and the Theil inequality coefficient.

It is evident from the policy options assessed in this study that fiscal policy remains the main and most potent policy instrument available to policy makers. It is also evident that the effectiveness of fiscal policy is not exclusive as monetary policy can still be used to some extent. A salient outcome of the policy simulation experiments is that the stimulation of the economy from the supply side affects key macroeconomic variables such as output and employment in a more sustained and robust way than when the economy is stimulated from the demand side. In addition, the economy of Lesotho is highly vulnerable to external shocks, as they tend to work their way through practically all sectors of the economy.
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<td>2SLS</td>
<td>Two Stage Least Squares</td>
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<td>ADF</td>
<td>Augmented Dickey-Fuller</td>
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<td>AGOA</td>
<td>African Growth and Opportunity Act</td>
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<td>AIH</td>
<td>Absolute Income Hypothesis</td>
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<td>ARCH</td>
<td>Autoregressive Conditional Heteroscedasticity</td>
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<td>ARMA</td>
<td>Autoregressive Moving Average</td>
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<td>BOP</td>
<td>Balance of Payments</td>
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<td>BOS</td>
<td>Bureau of Statistics</td>
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<td>CBL</td>
<td>Central Bank of Lesotho</td>
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<td>CGE</td>
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<td>Consumer Price Index</td>
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<td>ECM</td>
<td>Error Correction Model</td>
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<td>GDP</td>
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<td>KIPPRA-Treasury Macro Model</td>
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<td>LCH</td>
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