Swaziland

Despite the windfall South African Customs Union (SACU) revenues, decisive fiscal reforms that would put public finance on a sustainable footing and stimulate growth have only been partially undertaken.

2013/14 presents another opportunity as SACU revenues are expected to remain high, further easing the fiscal constraint.

Given limited natural resources, Swaziland's growth prospects depend on increased investments in high value-added manufacturing and services as well as skill development.

Overview

The year 2013 presents an opportunity for the government to redirect its fiscal policy by utilising the projected high SACU receipts and to address some of the longer-term fiscal challenges. In this endeavour, the government can draw on reform recommendations in its updated Fiscal Adjustment Roadmap (FAR), which, over the medium term, puts emphasis on: *i)* adoption and implementation of the Public Finance Management (PFM) Bill; *ii)* removing pro-cyclicality of fiscal policy; *iii)* developing a medium-term expenditure framework (MTEF); and *iv)* strengthening domestic resource mobilisation. The fiscal measures, together with reforms of the investment climate and the development of comprehensive social protection schemes, are needed to bring the economy onto an inclusive growth path.

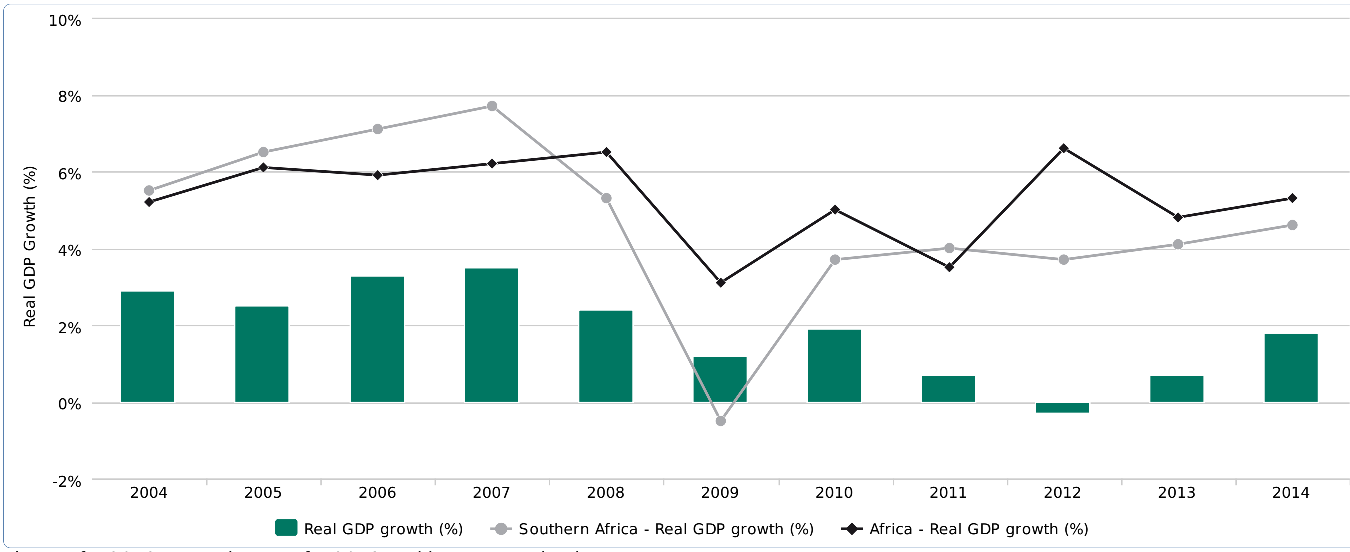
In 2012, Swaziland's economic growth remained one of the lowest in sub-Saharan Africa (SSA), despite a marked increase in the SACU revenues.[1] Although official estimates put real gross domestic product (GDP) growth at 0.2%, it is estimated that the economy marginally contracted by 0.3%, reflecting subdued global recovery, structural bottlenecks and the delayed impact of the fiscal crisis. With population growth at 1.3%, the decline in GDP per capita should have been steeper. The government arrears slashed performance of the private sector and especially small- and medium-sized enterprises (SMEs) in services, since many of the enterprises relied on government contracts. Even though the country re-launched the Investor Road Map and started its implementation, the overall unconducive investment climate poses challenges to growth, alongside persistent skills shortages and mismatches.[2]

The hopes that the windfall SACU revenues would help put the public finance on a sustainable path and stimulate growth over the longer term did not materialise in the 2012/13 fiscal year. Despite fiscal space created by the SACU revenues, only limited progress was made in managing total expenditures and rebalancing them from recurrent expenditure to capital outlays. Subsequently, the capital expenditures (in terms of GDP) are among the lowest in the region. The pace in clearing domestic payment arrears accumulated in 2011 has been slow, undermining private investment. On a positive note, despite the pressure of rising food prices in late 2011/early 2012, overall inflation remained in single digits throughout 2012. The official international reserves returned to adequate levels (above three months of imports), dissipating the earlier concerns about the sustainability of the lilangeni-rand peg.

While the fiscal situation in 2013/14 is likely to stabilise, underlining structural bottlenecks will need to be addressed in order to achieve high and sustainable growth. These problems also highlight the risk of the worsening of already weak social indicators and a possible reversal of the poverty gains made before the fiscal crisis, when poverty declined from 69% to 63% in 2010. In fact, the 2012 UN Rapid Assessment of the Fiscal Crisis documented the negative impacts of the crisis on the most vulnerable groups. Given the weak growth prospects, reducing poverty and unemployment (estimated at 29% of the labour force in 2010) will be key policy priorities.

A key challenge for the Swazi economy is job creation in high value-adding sectors. Despite the dependence of the majority of the population on agriculture, the contribution of the sector to GDP has been declining, with a rising role of services, especially trade. Limited investments in the resources sector have seen the mining sector remaining stagnant. With skills development failing to adapt to the changing structure and new demands of the productive activities, Swaziland faces both skill shortages and a mismatch between skills possessed by its workforce and those demanded by employers. This impacts particularly negatively on employment opportunities among the young – at 52%, the country had one of the highest youth unemployment rates in Africa in 2010. Investments in human capital and skills development are required to enhance the dynamism of the labour market and technological readiness of the country, alongside creation of decent jobs (productive and secure).

Figure 1: Real GDP growth 2013 (South)



Figures for 2012 are estimates; for 2013 and later are projections.

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Table 1: Macroeconomic indicators

	2011	2012	2013	2014
Real GDP growth	0.7	-0.3	0.7	1.8
Real GDP per capita growth	-0.7	-1.7	-0.7	0.5
CPI inflation	6.1	8.9	6	5.3
Budget balance % GDP	-9.6	3	-0.1	-0.2
Current account % GDP	-10.3	-2.6	-11.7	-12.6

Figures for 2012 are estimates; for 2013 and later are projections.

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Table 2: GDP by Sector (percentage of GDP)

	2007	2011
Agriculture, forestry & fishing	-	-
Agriculture, hunting, forestry, fishing	8	7.4
Construction	3.5	2.2
Electricity, gas and water	0.9	1.3
Electricity, water and sanitation	-	-
Extractions	-	-
Finance, insurance and social solidarity	-	-
Finance, real estate and business services	9.7	7.2
General government services	15.3	21.2
Gross domestic product at basic prices / factor cost	100	100
Manufacturing	41.7	43.5
Mining	0.3	0.4
Other services	1.9	-0.4
Public Administration & Personal Services	-	-
Public Administration, Education, Health & Social Work, Community, Social & Personal Services	-	-
Public administration, education, health & social work, community, social & personal services	-	-
Social services	-	-
Transport, storage and communication	7.5	7.4
Transportation, communication & information	-	-
Wholesale and retail trade, hotels and restaurants	11.1	9.9
Wholesale, retail trade and real estate ownership	-	-

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In 2012, Swaziland's economy has again underperformed compared to its regional peers. Despite the 8.3% growth in agriculture in 2011, the sector contracted by almost half a percentage point in 2012 due to lower maize, citrus and livestock production (a 10% decline in maize harvests resulted in a maize deficit of 39 285 metric tonnes). The mining sector has also experienced setback, when production of unprocessed iron ore plummeted by 25.6% in the 3rd quarter, due to lower world iron ore prices and construction at the mine site. Similarly, manufacturing contracted by 0.6%, making it the only sector that has contracted for four consecutive years, with a cumulative decline of almost 8%. The services sector, which had grown by more than 5% in 2009 and 2010, has experienced a significant slowdown in economic activity. In 2012, the services sector recorded a mere 0.4% growth. Good rains since the beginning of the 2012/13 season are likely to improve harvests in 2013. This, coupled with rising sugar prices, is expected to boost the growth in the agricultural sector.

On the demand side, weak growth both globally and in South Africa, as well as continuing fiscal challenges (especially the slow pace in clearing government arrears) have negative implications for private sector recovery. The freezing of civil service salaries for the past two years has limited the purchasing power of about 10% of the labour force and further reduced consumer confidence and domestic demand.

However, there were positive developments in 2012, with government taking decisive actions to clear domestic payments arrears to the private sector. About SZL 260 million (Swazi lilangeni), largely owed to SMEs have been repaid. Government also reached an agreement to securitise SZL 720 million owed to the Public Service Pension Fund. The resumption of work at some of the major infrastructure projects such as the Sikhuphe airport and Lower Usuthu Smallholder Irrigation Project (LUSIP) provided a boost to the construction sector. In spite of these developments, recovering job losses incurred as a result of the effects of the 2008 financial crisis and the fiscal crisis since 2010/11 require significantly higher and inclusive growth than that envisaged for the outlook period.

The growth outlook for 2013 is mixed. Despite the expected recovery in agricultural growth, the primary sector performance is likely to remain weak. Initial interest in mining investments after the approval of the Minerals Act in 2011 did not yield tangible results. The re-opening of the diamond mine at Dvokolwako that was expected in August 2012 had not taken place by the end of the year. Other potential mining investments in gold, coal and iron ore have not generated interest among investors. On the other hand, the recovery in textile demand from the United States provides an opportunity for manufacturing growth. By the end of the third quarter of 2012**,** Swaziland's exports to the United States amounted to USD 18.9 million, which is more than 94% of trade realised for the whole of 2011. The recovery in sugar prices and increased output from the sugar mills is also expected to enhance export earnings. The services sector growth, which has been propelled by the telecommunications and financial services sub-sectors in the past, will however face some challenges. The telecommunications regulatory framework remains rigid and prevents the entry of new investors. At the same time, the relative stability of the financial sector is unlikely to promote significant growth in view of the depressed activities in the SME sector, increased credit risk and reduced demand from the corporate sector.

Overall, risks to growth tilt to the downside, emanating from an uncertain global and regional outlook, especially for South Africa, and the lack of reforms. Weak South African growth prospects in particular pose serious risks to Swaziland's growth, since the country conducts almost 90% of its total trade with South Africa. Besides reduced exports from Swaziland, slackening growth also reduces South African imports, which directly affects Swaziland's fiscal position through reduced SACU revenues.

The slow implementation of FAR and the Economic Recovery Strategy has prolonged the negative impacts of the fiscal crisis. Subsequently, public and private investments have remained low, even by regional standards. Therefore addressing the structural weaknesses characterising Swaziland's slow growth remains critical - the business environment and management of public resources need to be improved to build confidence in the economy and encourage private investment. Further actions are also required to address skills shortages. The timely passing of the PFM Bill would help rationalise the expenditure side of the budget necessary to boost growth. At the policy level, government also needs to reallocate the available resources to sectors with the greatest potential to generate domestic growth. The large allocation from the SACU revenue pool for the 2013/14 fiscal year should thus provide a basis for such decisions. However, passing and implementation of such measures will be challenging in the 2013 election year.

Macroeconomic Policy

Fiscal Policy

Following a windfall increase in SACU revenue transfers of almost 150% (SZL 7.1 billion compared to SZL 2.9 billion the previous year), Swaziland's budget for 2012/13 fiscal year shows a primary fiscal surplus of 3%, an outcome that cannot be sustained in the near future without fiscal reforms. As at end-March 2012 payments arrears stood at about SZL 1.5 billion (4.7% of 2012/13 GDP), of which an estimated SZL 400 million (1% of GDP) is to the private sector. If all payments arrears were to be cleared, a fiscal deficit of 2.4% would be realised. Still, this would represent a huge improvement compared to a deficit of 14.3% in the 2010/11 fiscal year and an estimated 9.6% in 2011/12. A marginal decline in recurrent expenditures was recorded in 2011/12 compared to its level in 2010/11, with the wage bill falling by almost 2% in nominal terms. Capital expenditures were cut by an even larger margin, declining by almost 50% and amounted to SZL 1.02 billion. Private sector firms that depend on government, especially those in construction were seriously affected while suppliers of consumables were affected by the arrears accumulation.

Despite the 3% fiscal surplus for the current year, the government continued facing challenges in meeting its obligations – some of which could not be met timeously. Rationalisation of some important expenditure in higher education had to be made with a view to reducing the overall budget. Unlike the previous years when government provided university grants to all qualifying students, in 2012 some programmes became ineligible for grant financing. Delays were also encountered in disbursing elderly and Orphans and Vulnerable Children (OVC) grants, underscoring the importance of establishing a comprehensive and sustainable social protection scheme.

On the revenue side, the windfall SACU revenue transfers lifted total expected revenues to just under SZL 1 billion for 2012/13. The challenge that the government continues to face is that only 40% of these revenues are collected locally. With the private sector struggling to increase its share of GDP and gain independence from the government (*i.e.*, most contracts being with the government), reducing dependence on SACU revenues remains a challenge for the medium-term outlook. Reflecting the job losses that have been associated with the fiscal crisis, the personal income tax revenue category is expected to be below target by year end, but VAT collection has exceeded budget. An improved fiscal position, coupled with the maintenance of the SACU revenue transfers for 2013/14 at the same level as that for the current fiscal year will provide government with an opportunity to increase its expenditure and boost growth through expenditure reallocation.

An update of the FAR that the government prepared in September 2012 – with the technical assistance of the United Nations Development Programme (UNDP) and the African Development Bank (AfDB) – highlighted the key areas for fiscal reform, over both the short and medium term. Acknowledging the potential risks of the current expenditure path, the updated FAR emphasises greater efforts at reducing recurrent public expenditures, especially the wage bill, while reallocating savings to the capital budget and social sectors. The updated FAR also emphasised repayment of arrears. The good news is that by the end of 2012 government had come up with clear plan for addressing the payments arrears that would smooth expenditure. Better management of volatile SACU revenues, strengthened domestic revenue mobilisation and phasing out pro-cyclical fiscal policies, possibly with expenditure rules, are priorities over the medium term.

Table 3: Public Finances (percentage of GDP)

	2009	2010	2011	2012	2013	2014
Total revenue and grants	34.1	23.7	24.2	38.9	39.2	39.7
Tax revenue	32.1	22.6	23.3	38	38	38.6
Oil revenue	-	-	-	-	-	-
Grants	0.4	0.2	0.5	0.5	0.7	0.7
Total expenditure and net lending (a)	40.1	37.9	33.8	35.9	39.2	39.9
Current expenditure	31	30.3	27.8	26.8	29.4	29.7
Excluding interest	30.1	29.6	27.2	25.7	27.9	28.1
Wages and salaries	16.8	15	14.5	15.1	15.4	15.2
Interest	0.9	0.7	0.6	1.1	1.5	1.5
Primary balance	-5.1	-13.6	-9	4.2	1.4	1.3
Overall balance	-6	-14.3	-9.6	3	-0.1	-0.2

Figures for 2012 are estimates; for 2013 and later are projections.

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Monetary Policy

By virtue of its membership in the Common Monetary Area (CMA), Swaziland's monetary policy is closely tied to that of South Africa – with the Central Bank of Swaziland's main *de facto* role being that of supervising and regulating the financial sector. The capacity of the Central Bank in carrying out these important functions is thus critical in ensuring a sound financial sector. The recent increase in non-bank financial institutions and their growing asset base called for the establishment of a Financial Services Regulatory Authority (FSRA), as advised by the IMF. The government has since established the FSRA, which is still to become operational. The status of the non-bank financial institutions needs to be well understood to remove risks they may pose to the overall financial sector.

The slow clearance of arrears by government has put a strain on the operations of some banks. The IMF's September 2012 assessment noted liquidity problems faced by the banking sector. For example, at least one of the foreign-owned banks has had to request additional liquidity from the parent bank. Given the limited resources available from the Central Bank, it is important for the government, Central Bank and the FSRA to agree to a dispute resolution framework to protect depositors, including a limited deposit insurance scheme.

Reflecting liquidity challenges faced by the banking sector, the third quarter of 2012 also saw total bank assets decrease by less than a percentage point. Improvements in deposits over the same period could signal changing fortunes, particularly if household credit growth, which declined by about SZL 370 million between July and August 2012, recovers. The recovery in consumer credit will also depend on inflation trends in view of the signs of a weakening rand.[3] Despite the upside risks in inflation, the Central Bank of Swaziland maintained the discount rate at 5% (mirroring that in South Africa) and the prime rate at 8.5%. This is consistent with the South African Reserve Bank (SARB) policy and the goal to stimulate growth.

Despite an accommodating monetary stance (discount rate was at 5% for most of the year) and reintroduction of expanded credit guarantee schemes, the growth of private sector credit plummeted to low single digits in the second half of 2012 (and was thus negative in real terms).[4] This worrisome outcome reflects reduced credit growth to both the household and business sectors. It points to a breakdown in a monetary transmission mechanism and the need to address structural bottlenecks in the system.

The developments in credit growth have been reflected in inflation dynamics, with the headline inflation declining since May. Inflation dropped from the in-year peak of 9.6% to less than 8.5% in August 2012. The depreciation of the rand against major currencies, however, is likely to cause some inflationary pressures. Despite inflation stubbornly remaining outside the 6% upper band set for the Common Monetary Area (CMA), it is now lower than the three-year peak of 9.6% registered in April. Yet Swaziland still has one of the highest inflation rates in the region.

As part of its commitments during the presentation of the 2012/13 budget, the government has continued to build foreign reserves, thanks to the large inflow of the SACU revenue receipts. However, gross official reserves have been volatile over the year – showing large increases at the beginning of every quarter when SACU transfers are received and gradually falling over the quarter. Overall, gross official reserves rose from 1.9 months of import cover in March to about 3 months by the end of 2012, alleviating concerns about de-pegging that occasionally appeared in 2011.

Economic Cooperation, Regional Integration & Trade

As a land-locked and small open economy, trade and FDI are at the centre of Swaziland's development strategy. The country's multiple membership of regional trade blocs – Common Monetary Area (CMA), SACU, SADC, and Common Market for Southern and Eastern Africa (COMESA) – present both opportunities and challenges. These different trading blocs have no unified rules and regulations, which strain the limited capacity of the International Trade Department (ITD) in the Ministry of Commerce, Industry and Trade (MCIT) that is responsible for trade policy, regional integration and economic co-operation. The complicated regulations also make doing business challenging and impede foreign direct investment (FDI). Rationalisation of membership to regional blocs could therefore reduce costs of trade and encourage regional integration with priority regions (fast growing countries in East Africa, etc.).

Regarding the product composition of exports, the erosion of Swaziland's trade preferences, especially with regard to its main export product – sugar – requires that the country's competitiveness be enhanced. Both trade and non-trade barriers hamper the trading environment. The World Bank's "Trading across Borders" category of the *Doing Business 2012* report ranked Swaziland at 148 compared to 144 in the previous year. The 2012 Global Competitiveness Index (GCI) ranked Swaziland at 135 out of 144 countries overall and 120 in the trade barriers category. Among the limited changes to the trading environment in 2012 were operationalising the Automated System for Customs Data (ASYCUDA), while the Swaziland Revenue Authority has improved the turnaround time in the issuance of Certificates of Origin.

Swaziland needs to refocus its trade policies on trade facilitation rather than maximising revenues. Currently, inefficient customs administrations such as burdensome documentation requirements, time-consuming customs procedures, and corruption act as non-tariff barriers by requiring alternative logistics, excessive inventories, and informal payments. Further efforts aimed at reducing the number of documents and declaration points for imports and exports will also help in reducing the costs and time that traders face. Aligning its customs systems to those of South Africa, which would make it easier for the operationalisation of One-Stop–Border Posts, would go a long way in facilitating trade.

At the macroeconomic level, the current account has narrowed for two consecutive years. This is due largely to reduced economic activity and depressed import capacity. The estimated 2.6% current account deficit in 2012 is likely to widen as government expenditure increases in 2013 and beyond. Excluding SACU transfers, all other capital inflows remain subdued. FDI has remained low over the years while remittances from South Africa are likely to be affected due to reduced employment in the mines and farms.

Table 4: Current Account (percentage of GDP)

	2004	2009	2010	2011	2012	2013	2014
Trade balance	6.2	-3.8	-3.8	-2.5	-6.9	-8.2	-9.5
Exports of goods (f.o.b.)	74	52.6	46.4	49.2	49.9	49.1	49
Imports of goods (f.o.b.)	67.8	52.6	46.4	49.2	56.8	57.3	58.6
Services	-5.3	-12.7	-10.7	-8.5	-9.2	-9.2	-8.5
Factor income	0.1	-2.4	-5.8	-1.9	-0.3	-0.1	-0.2
Current transfers	4.4	6	4.7	2.6	13.7	5.9	5.6
Current account balance	5.4	-12.9	-15.6	-10.3	-2.6	-11.7	-12.6

Figures for 2012 are estimates; for 2013 and later are projections.

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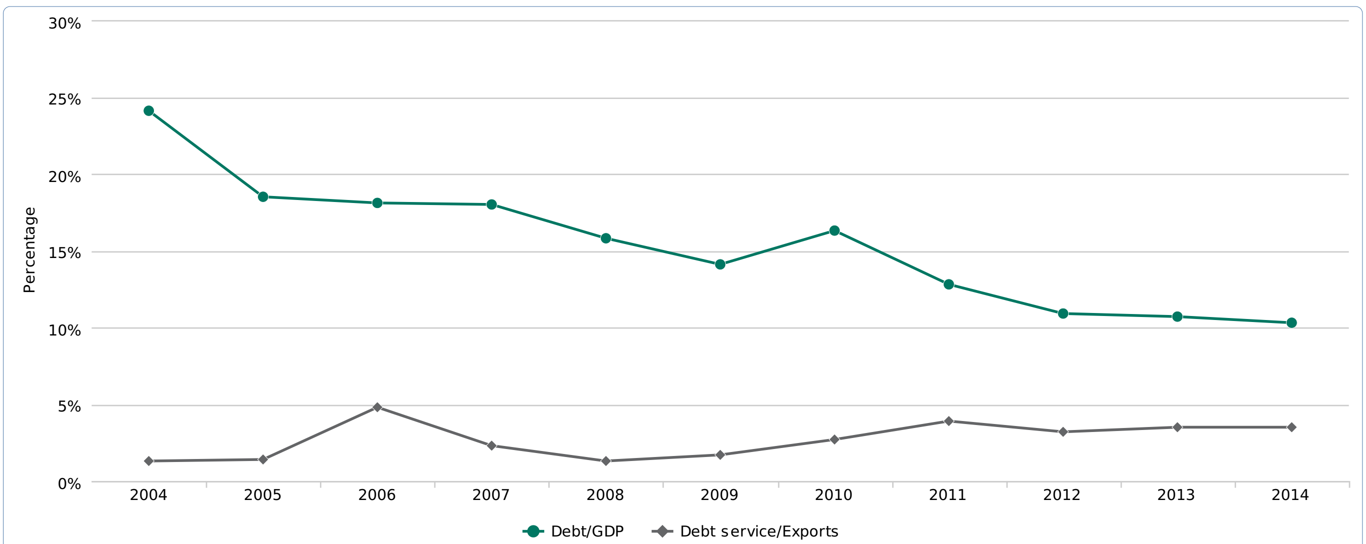
Debt Policy

While Swaziland’s total public debt is sustainable, the public finance stance of 2010 and 2011 is not. Correspondingly, after moderating in 2009/10 to about 13% of GDP, public debt has grown steadily through 2011/12 to about 17% of GDP (among the lowest in SSA), driven by domestic debt. Government constraints on borrowing, both externally and within domestic markets, partly contribute to the low debt level.

To put public finance on a sustainable footing, government updated its FAR and will create a fully-fledged debt management unit at the Ministry of Finance. Swaziland has a debt management unit but it needs strengthening to enhance its functionality. Under the proposed PFM Bill and the PFM Action Plan, development partners have agreed to provide technical and financial support to the debt unit. The PFM Bill also proposes clear processes for debt contracting, provides a medium-term debt management strategy with annual updates and reporting requirements to parliament, as well as procedures for issuing guarantees.[5]

Securing stable and well-priced long-term financing remains a challenge for government. In the 3rd quarter of 2012 a 182-day treasury bill was introduced, with only 50% of bids being received in August 2012 out of which only 20% were allocated, due to high interest rates requested by lenders. The September treasury bills issue achieved 100% in bids, with only 30% allotted at higher interest rates of more than 7%. In parallel to developing domestic debt markets and strengthening capacity for debt sustainability analysis, over the medium term Swaziland may also like to create conditions for issuance of external sovereign bonds, following the successful example of Namibia.

Figure 2: Stock of total external debt and debt service 2013



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Economic & Political Governance

Private Sector

Swaziland made strides in support of private sector activities in 2012. The country was recognised in the 2012 United Nations conference on Trade and Development (UNCTAD) Investment Promotion Awards. The investment authority (SIPA) was awarded the runners-up prize for its role in attracting FDI by facilitating the provision of factory space and the facilitation of necessary licenses, permits and tax concessions. The revised Investor Roadmap launched in 2012 also reveals government intentions to enhance private sector participation in economic activities. In addition, government has been working with UNDP on recognising obstacles and opportunities to youth entrepreneurship, in an effort to improve employment prospects for youth.[6]

Following the approval of the Companies Act and the VAT Bill in 2011, as well as the new tax regulations, existing businesses now find it easier to deal with their tax obligations. In particular, the establishment of the large tax payers' unit and subsequent operationalisation has improved efficiency in tax administration and revenue collection. Companies are now also able to file their tax returns online.

Promotion of private sector activities still faces major challenges. Increased risk to investing in Swaziland, due mainly to the heightened macroeconomic instability, is a drawback to the country’s ability to attract new investments. Slow implementation of new procedures and processes required to start a business has also played its part in the worsening business environment. Although company registration is supposed to take three days in practice this still takes 21 days. The cost for a company to start operations is almost SZL 5000. The country’s overall ranking in the World Bank report, *Doing Business 2012-13* therefore did not change from the previous year and is ranked at 123 out of 185. However, in the “Starting a Business” category, Swaziland fell from 160 in the previous year to 165 – below the SSA average.

Swaziland’s ranking in the GCI has deteriorated, falling from 134 out of 142 countries in the 2011-12 to 135 out of 144 countries in 2012-13 rankings. The main challenges faced by businesses are an inefficient bureaucracy, corruption, and access to finance. Swaziland is also considered as not being technologically ready – worsened by poor outcomes in tertiary education and skills training, which negatively impact on its ability to compete at the global level.

Furthermore, Swaziland’s authorities should support private sector development by enacting laws that would promote competition in all sectors of the economy to avoid sending mixed signals. Whereas the energy generation sub-sector opened to new players through the establishment of Independent Power Producers and a regulatory environment that promotes competition, a monopolistic environment still exists in the telecommunications industry. Other sectors such as water and transport are also still heavily regulated. In the transport sector, the permit system that is in place limits the number of operators per route. Similarly, the Global Competitiveness report ranks Swaziland at 132, 106, and 111 in terms of labour productivity, flexibility of wage determination and hiring and firing practices, respectively.

Financial Sector

Swaziland’s financial sector is one of the sub-sectors driving the high growth in the services sector. This is a positive development, since the financial inclusion and especially access to credit are limited (FinScope, 2012). At the same time, non-bank financial services have grown to a point where they need proper regulation and supervision to avoid future financial risks. The banking sector is considered stable and sound, thanks to the disciplines that the South African-owned banks have brought to the market. The Central Bank has also been able to enforce its regulations effectively. The operationalisation of the FSRA is expected to address possible risks that the growth of non-bank financial services might bring.

According to the World Bank data, non-performing loans have been increasing since 2009 and are estimated to have increased by almost 300% by the end-August 2011. During its September 2012 mission, the IMF estimated that for every four debtors, one was experiencing payments difficulties. The banks have responded by tightening credit conditions. However, given the limited resources held by the Central Bank, the persistence of the fiscal crisis could precipitate a financial crisis. As a result, the government has been urged to expedite the clearance of payments arrears to the SME sector in particular.

Swaziland’s banking sector remains dominated by foreign banks, with three of the four banks being subsidiaries of South African banks. There are also 230 savings and credit co-operatives. The sector has also remained shallow and undiversified. Despite the pension and insurance firms mobilising significant resources, lack of investment instruments on the local market resulted in most of the resources being channelled to South Africa. To address capital flight, the government introduced a new requirement compelling financial institutions to invest at least 30% of their resources on the domestic market. The government hopes to tap into these resources to finance some of the infrastructure projects. Indeed, although interest rates have remained high, subscription to treasury bills rose to 100% with the introduction of the minimum domestic investments requirement. Despite this recent change, there are limited instruments through which these resources could be tapped to finance government programmes. In the absence of a prudent and sustainable macroeconomic stance, the financial sector is averse to long-term government borrowing.

Although it is not obvious what an increase in the number of banks could bring, the large interest spread between deposit and lending rates (up to 7%) as reported by the World Bank suggests that the market is not competitive. The risk premium charged by banks has remained the same (4.1%) in 2011 and 2012. It is however noted that the high inflation rate reduced the real interest rate spread from about 8.7% in 2010 to 1.4% in 2012.

Banking sector coverage is limited, with only 53% of businesses reported to have access to credit facilities. Based on the available information, less than half of Swaziland's adult population has access to formal banking services, while 37.5% (44.4% for the rural population) are excluded entirely from any form of financial services. Reflecting high unemployment among the young, about 78% of the 18-19 age group has no access to any form of financial services. Access to credit is also affected by lack of adequate collateral, especially in the face of rising non-performing loans. While there is no Public Credit Bureau, the Private Credit Registry has strengthened credit information.

Public Sector Management, Institutions & Reform

With the recent fiscal crisis revealing the weak governance systems in Swaziland, the delay in passing the PFM Bill does not augur well for a speedy resolution of the challenges facing the country. Availability of financial resources alone is not a solution as the management of such resources remains weak. The Ministry of Finance, is, however, keen to see the PFM Bill presented to parliament as early as possible so that it gets the legal backing for the urgent actions that need to be undertaken. Development Partners, including the African Development Bank, World Bank, EU, IMF and UNDP are supporting the process.

Given the weak PFM systems and also that specific legislation to cover various elements of private property protection are still to be approved by parliament, foreign investment flows have been negatively impacted. However, private property ownership in Swaziland is recognised and protected under section 19 of the 2005 Constitution, including disposal of such property. Intellectual property is covered under section 227-235. Other legislation that has a bearing on private property and still to be approved include the Swaziland Communication Bill, Swaziland Electronic Communication Bill, National Payments System Bill, Decentralisation Bill, Public Service Bill, Tourism Establishments' Regulations, Construction Bill and Sectional Title Bill. Investments are protected under the Swaziland Investment Promotion Act of 1998 and Swaziland is a signatory to the Multilateral Investment Guarantee Agency (MIGA) of the World Bank that provides legal protection of private investments, especially for foreign firms. Swaziland is also a member of the International Centre for the Settlement of Investment Disputes (ICSID). There are thresholds for foreign ownership or repatriation of profits and wages of approved employees. Swaziland is ranked poorly on investment protection (106 out of 144), judicial independence and protection of property rights, all of which are part of the 1st Pillar categories in the *Global Competitiveness Report 2012*.

Although the dual legal system of governance comprising Roman-Dutch law and customary law in Swaziland poses complications, the government has a relatively good reputation for handling industrial disputes. Disputes brought before the traditional courts can be transferred to the formal court system and resolved according to the Conciliation, Mediation and Arbitration Commission's procedures. Resolving such disputes or enforcement of contracts, however, is time consuming and costly, hence investors are cautious in undertaking long-term investments. It takes about 972 days to resolve a contractual dispute while the costs towards legal redress could be as high as 56% of the value of the contract compared to 19% for the OECD and 50% for sub-Saharan Africa.

Reflecting a deteriorating economic and social environment, the United States Department of State noted that the rate of crime in Swaziland is increasing, with violent economic crimes taking place, especially in the main city areas of Manzini and Mbabane. As a result, Swaziland has been designated a Critical Threat Crime Spot. Although robberies and carjacking are not common, such activities have been carefully targeted against businesses in recent times and have resulted in deaths or serious injuries. Swaziland is ranked 28 out of 54 countries, with a score of 43.8 out of 100 in the Mo Ibrahim Governance Index.

Natural Resource Management & Environment

Although the legal and regulatory frameworks for natural resource management exist, rehabilitation and ecological protective measures within the mining sector are not strictly enforced. Therefore, particular attention should be paid to the possible environmental effects of these activities, despite the employment gains and business opportunities for subcontractors. The 2003 National Mining Policy, the 2002 Environmental Management Act and the 2011 Mines and Minerals Act provide the framework for dealing with environmental concerns. In addition, Swaziland has potential to mine precious minerals like gold and diamonds, yet it has not signed up to global transparency arrangements such as the Extractive Industries Transparency Initiative (EITI). Also, the increased frequency of uncontrolled fires has damaged forests despite the increase in planted forest areas.

Political Context

The last two years have been characterised by social unrest, linked mainly to the stifling of political freedoms, as enshrined in the 2005 Constitution. Protest action has been organised mainly by labour unions representing teachers, quasi government institutions and civil service employees, demanding, among other things, legalising political parties, better public resource management and better remuneration. This culminated in the holding of

the People's Parliament (Sibaya) in August 2012, presided over by the King as the supreme executive. Some of the issues that were raised during Sibaya include the removal of Finance Circular No. 1 of 2010 that provides for the benefits of politicians; dismissal of cabinet as a result of its failure to manage the economy; legalisation of political parties and the transition to multi-party democracy; transparency in public sector recruitment, especially the security forces; fighting corruption; and greater decentralisation of government services. Similar concerns were raised when Parliament passed a vote of "No Confidence" in the cabinet that was later reversed.
With parliamentary elections scheduled for the third quarter of 2013, it remains to be seen if there is sufficient political will to address some of the challenges facing the country. Among some of the pressing issues is the reduction in the number of ministries, which is meant to reduce the wage bill. The large wage bill has remained one of the major issues that stalled progress on discussions for a second Staff Monitored Program with the International Monetary Fund.

Social Context & Human Development

Building Human Resources

In 2012, the lingering effects of the fiscal crisis have had an impact on resource allocation to the social sector. This, together with the weak private sector, unable to maintain existing jobs, reduced households' capacity to provide for some of the basic requirements on health and education. At the same time the government withdrew blanket university grants, leaving prospective students without financial support to take courses of their choice. With Swaziland being one of the countries with the highest literacy rates in Africa, this decision may not have any immediate effect as the affected courses were identified as not being in demand among employers. However, the affected students were not warned in advance, and this has disrupted their educational plans. The government's Free Primary Education programme has continued to be supported. It is at this level where the greatest impact of education can be felt as it lays the foundation for higher levels. Timely release of primary education grants, however, has remained a challenge. Reflecting the erosion of government's capacity to fully fund education grants to orphans and vulnerable children, the release of funds for the Free Primary Education programme was delayed to allow for an audit of the fund. Prioritisation of social expenditures, especially those that are meant for the vulnerable, is therefore essential.

Overall, Swaziland has made good progress with respect to achieving universal primary education, with net enrolments having risen from 72% to over 92% in 2010. Also, in 2009/10, 73.9% of children who started Grade 1 reached Grade 7 without repeating more than twice, compared to 59.8% in 2006/07. However, the Human Development Index (HDI) for Swaziland remains low at 0.522, placing the country at 140 out of 187 countries.

Swaziland's main health challenges are to reduce the incidence of HIV/AIDS and tuberculosis. Although inadequate funds have been made available, Swaziland is continuing to provide life-saving drugs to HIV/AIDS patients with the help of donors. Despite the financial challenges facing the health sector, marginal declines have been recorded in the prevalence of HIV/AIDS. Swaziland's greatest achievement in fighting disease has been to almost eradicate malaria. However, drug resistant TB is increasing.

Poverty Reduction, Social Protection & Labour

Despite the estimated reduction in the incidence of poverty from 69% in 2007 to 63% in 2010, the UNDP's 2012 rapid assessment suggests a possible reversal of these gains. In this regard, the inadequate support to the National Emergency Response Council on HIV and AIDS (NERCHA) given the large numbers of children affected by HIV/AIDS, compromises the running of neighborhood care points where supplementary feeding is provided. In addition, government support to rural farmers, in the form of subsidies, to enable them to switch to commercial farming should be intensified. This could improve their earnings and food security. Furthermore the crop diversification strategy could also broaden the nutrition base for the communities.

Swaziland, with the assistance of UNICEF, has developed new legislation and policies aimed at scaling-up service delivery to reach the most vulnerable children. Strategic plans, guidelines and standards such as the National Plan of Action for Children 2011-15; Social Development Strategic Plan 2011-15; Guidelines and Standards for Alternative Care; Strategy and Actions on Violence Against Children, provide an opportunity for the operationalisation of an international convention on the protection of children. Service delivery in this area is targeted at national, regional and community levels. However, without adequate resources being made available to implement the programmes, little may be achieved.

The government is also developing a National Social Security Strategy for those in employment so that they would be covered in the event of loss of employment or disability. A grants programme for the elderly is in place but is inadequate. Other than the existing pension and other income protection schemes, the government does not provide any social protection to the people.

Gender Equality

Despite Swaziland being ranked low in the Gender Equality Index 2011, with a score of 0.546 and ranked 110 out of 146 countries, it is on track to achieve its targets on eliminating gender disparities in primary and secondary education and political participation. The main challenge concerns women's participation in paid and non-agricultural employment. The target for this participation was set at 50% by 2015 but is still estimated at below 30%. Progress on gender equality has been made following the strategic positioning of the Gender and Family Issues Unit in the Deputy Prime Minister's Office, the ratification of the SADC Protocol on Gender and Development, approval of the National Gender Policy, the establishment of Domestic Violence Child Protection and Sexual Offences Units at all police stations and placement of career guidance officers at the regional offices.

Thematic analysis: Structural transformation and natural resources

Swaziland is endowed with many minerals such as asbestos, coal, iron, soapstone, green chert, gold, tin, copper, nickel and chromium, as well as forest resources. However, only a few of these minerals are of commercial value. Coal deposits are estimated at over two million tons, most of which are in the Mhlume, Mpaka and Maloma areas. Mhlume is not operational after Gencor ceased operations in 1992 but was recently acquired by Midwinter Resources which is involved in exploratory activities. Investors have also expressed interest in green chert, diamonds, and gold mining. Whereas the exploitation of dumps at the Ngwenya Iron Mine resumed in 2011, Bulembu Asbestos Mine has remained closed since 2001 and diamond mining stopped in 1997. Currently, Swaziland mines coal, quarried stone and iron ore.

The contribution of natural resources to GDP is likely to remain small, given the limited investments in mining and the closure of Sappi Usutu Pulp Company in 2010. Mining contributes just over 2% to both GDP and exports, while planted forests of pine and eucalyptus used to support value-adding activities, including the production of sawn timber and unbleached wood pulp. Wood pulp production used to absorb half of the forest supply. Before its closure, Sappi Usutu generated exports worth about SZL 40 million a year. Swaziland's forests cover 563 000 hectares. Planted forests, which are among the largest in the world, cover 161 000 hectares, which is about 9% of the country's land area. The forests are a source of round wood, mainly for the South African mining industry.

Prospects for the mining and quarry sector are mixed. The outlook for the quarrying sector is negatively impacted by the minimal infrastructural investments in the sector and subdued construction sector. In an effort to boost the economic recovery, the government is also considering reviving the country's diamond industry, as estimates indicate that up to 80 000 carats of diamonds could be mined each year. In anticipation of the resumption of diamond mining, Swaziland took steps to satisfy the requirements of the Kimberley Process membership, which it did in May 2011. Still, given the overall limited extraction activities, the outlook for the mining sector is not expected to change much over the medium term.

Attracting investment into the mining sector faces three major challenges: *i)* private investors are restricted to 50% shareholding; *ii)* lack of transparency on royalties and shorter periods for prospecting rights; and *iii)* requirement for two free equity stakes of 25% each to the King and government. The 2011 Mines and Minerals Act and the Diamond Act have not addressed these challenges, in spite of the efforts to attract foreign investment into mining.

Swaziland was more attractive to foreign direct investments compared to Namibia and Botswana during the 1980-93 period. Structural rigidities and a non-conducive investment environment have reversed the trends, negatively impacting growth. Industrial growth, in particular, has slowed down and has also been worsened by the recent fiscal challenges. Over the last two decades, agriculture and industrial outputs have been trending downwards. Their shares in GDP fell from 12% and 34% in 1990 to 8.7% and 27.5% in 2012, respectively. In contrast, the share of private services in GDP has increased its share from 20% to 30% over the same period. Construction and public services have been observed to maintain their share, with little variation.

The revised Investor Road Map of 2012 and the Economic Recovery Strategy of 2011 identified the main challenges to attracting investment, including lack of transparency and accountability in concluding and implementing contracts guiding foreign investors. The civil society has also noted limited national capacity to negotiate mining contracts, and this should be strengthened. A more open process, with a multi-stakeholder participation would also improve the collection and allocation of revenues generated from the sector. In particular, the widespread and *ad hoc* application of tax incentives granted to foreign investors entering the sector should be abolished.

The potential for value-added activities in the extractive sector is limited. Nevertheless, efforts should be made to ensure that communities benefit from mining activities. There is need to ensure decent wages and skill development for employees, strategic procurement, infrastructure development, environmentally friendly operations and tax compliance. A comprehensive policy addressing environmental and health protection also needs to be developed.

Notes

1. SACU revenues rose by about 150% between 2011/12 and 2012/13 and remain high in the 2013/14 fiscal year.

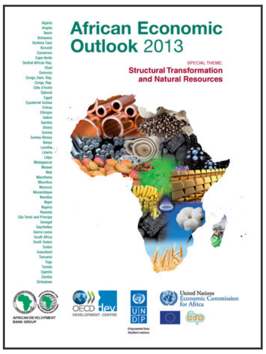
2. Efforts to address growth constraints identified in the Investor Road Map, the Economic Recovery Strategy and the updated Fiscal Adjustment Road Map are ongoing, albeit at a slow pace.

3. The rand/USD exchange rate remained stable over the 3rd quarter. The lilangeni is pegged at par to the rand.

4. In the first half of 2012, the private sector credit grew by about 20%; it dropped below 3% in the 3rd quarter.

5. The Finance Management and Audit Act (1967) and Amendments of 2011 give a basis for government borrowing. Parliament authorises all proposals to contract debt, while the Ministry of Finance initiates the process. All debt proposals have to be in line with the national development objectives. The Ministry of Economic Planning and Development and the Central Bank offer advice on contracting and managing loans.

6. The 2013 UN report, *Opportunities and Constraints to Youth Entrepreneurship* provides detailed findings.



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