

**GOVERNMENT OF THE KINGDOM OF
SWAZILAND**

FISCAL ADJUSTMENT ROADMAP (FAR)

(2010/11-2014/15)

ACRONYMS AND ABBREVIATIONS

AG	Auditor General
AfDB	African Development Bank
BD	Budget Department, Ministry of Finance
CBS	Central Bank of Swaziland
CIFA	Country Integrated Fiduciary Assessment
CMA	Currency Monetary Area
EU	European Union
EVERS	Enhanced Voluntary Retirement Exit Scheme
FAR	Fiscal Adjustment Roadmap
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HDI	Human Development Index
IMF	International Monetary Fund
IAD	Internal Audit Department, Ministry of Finance
IPSAS	International Public Sector Accounting Standards
LUSIP	Lower Usuthu Small-holder Irrigation Scheme
MOF	Ministry of Finance
MOPS	Ministry of Public Service
MPED	Ministry of Planning and Economic Development
MTEF	Medium-term Expenditure Framework
NBFIs	Nonbank Financial Institutions
NDS	National Development Strategy
NES	National Export Strategy
PAC	Public Accounts Committee of Parliament
PBC	Planning and Budget Committee
PFM	Public Financial Management
PPPs	Public Private Partnerships
PRSAP	Poverty Reduction Strategy and Action Program
SACCOs	Savings and Credit Cooperatives
SACU	Southern Africa Customs Union
SADC	Southern African Development Community
SIPA	Swaziland Investment Promotion Authority
SMEs	Small and Medium Enterprises
SRA	Swaziland Revenue Authority
SWAp	Sector Wide Approach
RBS	Reserve Bank of South Africa
TA	Technical Assistance
TFG	Task Force Group of the Fiscal Adjustment Roadmap
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
VAT	Value Added Tax

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I. INTRODUCTION

1.1 This Fiscal Adjustment Roadmap (FAR) is produced out of Government's desire to implement decisive immediate measures and reforms over the medium-term to deal with the challenges of the global financial crisis, most notably, the sharp deterioration in the fiscal outlook elaborated in this year's budget. It is necessary to consider this roadmap given that the 2010/11 budget reflects an increasingly volatile revenue source in the Southern Africa Customs Union (SACU) receipts that has shrunk the resource envelope considerably. The importance of a steady and consistent stream of domestic revenues and improved allocation of expenditures can never be over emphasized to ease government's fiscal circumstances and boost its ability to promote an environment to foster sustained economic growth and poverty reduction. One of the fundamentals of this document is to bring the fiscal position to sustainable levels through revenue enhancement and better expenditure control, particularly the relatively large wage bill, and create space for the Government's commitment to increase spending in the health and education sectors. The roadmap also focuses on efforts to promote a robust private sector to complement the envisaged more efficient public sector in mobilizing domestic and foreign investment, diversify the economy, and accelerate employment creation.

1.2 This requires Government to not only '*tighten the belt*' but also to make critical decisions on its revenue and spending priorities in the medium term and seek more innovative methods of meeting its commitments, realize savings, and improve efficiency. The need for this approach comes at a time when the country is faced with serious socio-economic challenges, which include food insecurity, high unemployment, sluggish economic activity, poverty, and a high prevalence of HIV/AIDS and TB. These challenges call for an increase in government spending to deal with them effectively and this is increasingly difficult given the current domestic revenue generation capacity.

1.3 The FAR is formulated at a most difficult time when the global economy is recovering from a major recession yet as a small developing country, Swaziland's success is highly reliant on a thriving world economy. Thus, the roadmap takes into account both the remedies to slower economic growth and the need to set a clear direction on corrective measures to restore macroeconomic stability. The FAR further seeks to accelerate job creation and broaden economic participation, whilst maintaining an acceptable level on the delivery of public services and infrastructure development, improving livelihoods and fighting crime. This certainly calls for careful prioritization of key interventions.

1.4 This roadmap is proposing some strategies to grow the economy and therefore sustainable government revenue. Such strategies include improving labor intensive foreign direct investment (FDI) for export development, addressing the bottlenecks in the mining sector, enhancing and exploiting Swaziland's tourism potential, and facilitating trade through extended border hours and harmonization of border procedures.

1.5 In developing the proposed reforms, the FAR draws extensively on policies and reforms in the National Development Strategy (NDS), Vision 2022 covering the period 1997-2022, the Poverty Reduction Strategy and Action Programme (PRSAP) and the 2010 Budget speech. The PRSAP presents the Government policies and strategies for the realization of the NDS. Its six pillars seek to (i) maintain macroeconomic stability and accelerate broad-based growth; (ii) empower the poor to generate incomes and reduce inequalities; (iii) fair distribution of the benefits of growth through fiscal policy; (iv) human capital development;

(v) improving the quality of life of the poor; and (vi) improving governance and strengthening institutions.

1.6 Most of the PRSAP reform strategies were adopted following broad-based consultations with the relevant stake holders, including Ministries, Agencies, and Departments, civic society, and development partners, and duly incorporated their views. A number of the more specific reforms are also underpinned by recommendations of various studies and technical assistance (TA) reports and are thus technically sound. Further broad consultations have been undertaken on the FAR within Swaziland and with our development partners to ensure continued ownership and the necessary support for the reforms. Unfortunately, while accepted as sound and necessary, many of these measures and reforms have taken time to implement putting the country at a disadvantage within the region.

1.7 A paradigm shift is in order, if Swaziland is to arrest economic deterioration and start on a steady path to address the underlying problems and help enhance the country's overall relative economic position. To this end, Government is determined to adopt an aggressive policy stance and more determined efforts to implement the proposed FAR reforms.

1.8 The rest of the document is organized as follow. Section II provides the background on Swaziland's current economic situation. Section III covers the overall adjustment strategy, while section IV presents the planned fiscal adjustment to bring about a sustainable budgetary outlook. Section V covers the medium-term structural reforms aimed mainly at improving the environment to foster robust private sector activities. Section VI elaborates on the issues in implementing the FAR reforms, including the risks, and how the Government intends to address them. Section VII is the conclusion.

II. BACKGROUND

2.0 Even before the global economic downturn begun, the Swazi economy had been beset by underlying longer-term structural weaknesses and the spread of HIV/AIDS, which had slowed GDP growth and the capacity to create employment. The second round effects of the global financial crisis resulted in a steep reduction in world demand, which adversely affected the Swazi economy via halving of its GDP growth to 1.2 percent in 2009, with a modest recovery of 2 percent projected for 2010. Meanwhile, inflation moderated to 5.4 percent by end 2009 and to 4.3 percent by end July 2010; going forward, inflation is expected to converge toward the South African rate over the medium-term, which is projected to remain within the 3-6 percent band. The most severe impact of the global downturn has been on the fiscal and external positions as SACU revenues have fallen dramatically. Both the overall fiscal and the external current account deficits are projected to remain at high levels over the medium-term averaging about 14 percent and 9 percent of GDP, respectively. Gross official reserves are projected to fall below two months of import cover, while total government debt is projected to increase rapidly from 12.5 percent of GDP to 52.4 percent by 2014.

2.1 Slowing economic growth

2.1.1 Following more than two decades of strong, albeit volatile growth in the 1970s and 1980s, Swaziland's growth weakened over the last ten years. GDP growth deteriorated from 2.9 percent in 2003 to 2.2 percent in 2005. Though growth recovered to 3.5 percent in 2007, thanks to the completion of a sugar irrigation scheme, the global crisis contributed to its

continued decline to the 1.2 percent growth recorded in 2009. Growth has thus averaged only 2.4 percent in the past six years, 2.6 percentage points short of the minimum required growth rate to reduce poverty¹.

2.1.2 The sluggish economic growth over the recent period is attributable to a combination of factors that include; prolonged drought, changes in the market environment for the country's exports, low levels of FDI, difficult macro-economic environment and the impact of the recent economic recession.

2.1.3 With the deepening global economic crisis, the textiles sector suffered a slowdown in external demand. Production levels rapidly fell as global market continued to shrink resulting in a loss of about 3,000 jobs, which further brought down employment in this sector to 12, 000 by mid-2009. The economy has been severely affected as the wood pulp Sappi Usuthu Company closed down at the end of January 2010 due to the combined effects of forest fires and the effects of the global economic downturn. A total of 4,100 jobs were lost with further adverse impact on revenues to the fiscus.

2.1.4 The agriculture sector is traditionally the mainstay of the economy contributing 8.5 percent to GDP in 2008 and the main source of livelihood for the Swazi population. It is also the major support for the mostly agro-based manufacturing sector. However, the sector is currently experiencing challenges of over dependence on a few commodities some of which are already facing stiff international competition. Production has been declining, a trend, which has been exacerbated by the high cost of farm inputs and erratic rainfall in recent years. Increased prices of farm inputs have also threatened subsistence maize production affecting the most vulnerable groups and further threatening their livelihoods. The increase in costs has also had a negative effect on the agro-industrial sector.

2.1.5 Swaziland's tourism sector remains an important sector of the economy with the potential to contribute significantly to job creation and poverty eradication. In the past, the sector mainly expanded due to community based tourism initiatives. However, in 2008, tourist arrivals recorded a decline of 3.6 percent to 1,186,000 due to the decline in overseas tourists. This decline was mainly influenced by the economic downturn and the appreciation of the exchange rate.

2.1.6 Notwithstanding the historical success with economic transformation, which enabled Swaziland to reach low-middle-income-country status, an estimated 69 percent of the population lives below the poverty line and food poverty stands at 37 percent. Swaziland's Human Development Index (HDI) stood at 0.572 in 2007 ranking the country at 142 out of 182 countries. The population's life expectancy is one of the lowest in the world (45.3 years). One of the country's greatest threats to sustainable socioeconomic development is the HIV/AIDS pandemic. Reduced economic growth rates in the last several years have resulted in high unemployment. The official unemployment rate stands at 30 percent (40 percent for the youth) and is not expected to recover soon because of the global downturn and its repercussions on Swaziland's domestic economy.

¹ Government's vision (see the NDP, Vision 2022) to reduce the poverty rate by 50 percent by 2015 requires a minimum annual economic growth rate of 5 percent.

2.2 Worsening Fiscal Outlook

2.2.1 The fiscal outlook has taken a dramatic turn for the worse since 2009/10, reflecting largely a sharp drop in SACU revenue coupled with continued growth in total expenditure, underpinned by unsustainable growth in the wages and salaries component. The relatively faster growth in revenue initially resulted in a broadly improved overall fiscal balance; the deficit was reduced from 4.6 percent of GDP in 2002/03 and converted to sizable surpluses in both 2006/07 and 2007/08. However, accelerating expenditure growth in 2008/09 was largely responsible for a sharp deterioration in the overall fiscal balance turning into a deficit of 0.2 percent of GDP. With the reduction in SACU receipts in 2009/10 and in the 2010/11 budget of 5 percent and 11 percent of GDP, respectively, the overall deficit expanded to 7 percent and is projected to reach 14 percent of GDP, respectively.

2.2.2 Since 2002/03 total revenues and grants grew rapidly, increasing from 26.7 percent of GDP to 40.5 percent of GDP in 2008/09. Virtually all this growth was accounted for by SACU revenues, thanks largely to the growth in the global economy and SACU imports. On average SACU receipts constituted over 60 percent of total revenues and grew at an annual rate of 28.9 percent during 2004/05 to 2008/09 period. Such favourable financial conditions fuelled a rapid growth in expenditure over the same period amounting to 9.3 GDP percentage points of which, wages and salaries accounted for 5.5 GDP percentage points to fund a combination of hiring and wage increases. Subsidies and transfer and capital expenditure and net lending grew more modestly at 2.3 percent of GDP, and 3.1 percent of GDP, respectively. The underlying pattern of expenditure allocation has exacerbated budgetary rigidity (wages and salaries grew from 46.5 percent of recurrent expenditure in 2002/03 to 53.6 percent in 2008/09) while curtailing the scope for public investment in essential infrastructure and space for other poverty reducing expenditure.

2.2.3. During 2009/10, and under the budget for 2010/11, the collapse of the main revenue base has been accompanied by continued high levels of recurrent expenditure of 34 percent and 30 percent of GDP, respectively. Moreover, wages and salaries are projected to average about 17.5 percent of GDP during the two fiscal years, considerably above the average for sub-Saharan Africa of 8 percent of GDP. Under the baseline scenario (without adjustment), the projected deficits, all exceeding 11 percent of GDP through 2014/15, would be financed by drawing down of deposits and domestic borrowing, and contribute to the projected growth in public domestic debt from 1.5 percent of GDP in 2009/10 to about 37 percent of GDP in 2014/15. In any case, such borrowing will be feasible only with amended legislation to increase the domestic debt ceiling of E 1 billion, potentially leading to interim accumulation of arrears.

2.2.4. A number of the emerging fiscal problems reflect a weak though improving fiduciary environment. The World Bank's Country Integrated Fiduciary Assessment (CIFA) concluded that "although there have been improvement in some areas compared to 2007, the public financial management (PFM) system in Swaziland has yet to achieve levels of good practice that will ensure fiscal discipline, strategic allocation of resources, efficient, economical and effective service delivery and accountability. Most PFM indicators continue to lag basic levels of good performance. There remain key risks in the PFM system that require further mitigation- (i) over-expenditure due to poor discipline in expenditure controls; (ii) high levels of expenditure arrears due to lack of full implementation of a commitment system; (iii) weak accountability arrangements due to inadequate capacity in financial reporting, internal audit, Auditor General and the Parliamentary Public Accounts Committee

(PAC); (iv) weak payroll systems; and (v) fiscal shortfalls as there are no appropriate fiscal planning tools and effective tax institutions.”²

2.3 Monetary sector

2.3.1 Monetary policy in Swaziland is implemented in line with the monetary policy stance adopted by the Reserve Bank of South Africa (RBS). This is part of the provision of the Common Monetary Area (CMA) agreement to which Swaziland is a member. This membership means the Government cannot independently determine interest rates, exchange rate policy, nor influence the direction of monetary policy. The RBS has pursued an inflation target of 3 to 6 percent as a framework for price stability. The policy implementation was successful in 2005 and 2006 but has been above the target range in the subsequent years as there was a high pass-through effect of the exchange rate on prices. In the recent period, inflation in Swaziland peaked at 12.9 percent in 2008 before moderating to 5.4 percent in 2009 and is projected to converge to about 5 percent in the near term.

2.3.2 Swaziland therefore exercises the fiscal policy instruments to maintain macroeconomic stability. However over the last decade developments have made the fiscal position unsustainable and have impacted negatively on growth. The running-down of the country’s foreign reserves cannot fund projected budget deficits indefinitely and would threaten the sustainability of the Rand/Lilangeni currency peg and could in turn ignite inflation. The volatility of the Rand has been of major concern for business and industrial developments in the country.

2.3.3 While the Swazi financial sector has so far weathered relatively well the global crisis, some vulnerabilities and areas of improvement remain. To this end, the Central Bank of Swaziland (CBS), which is responsible for ensuring monetary stability and prosperity in the financial sector, needs to assist with establishing a regulatory system for the Savings and Credit Cooperatives (SACCOs) and for the nonbank financial institutions (NBFIs) as well as the capital market. Greater collaboration with other stakeholders is necessary to lifting the ceiling on government domestic debt and developing appropriate securities for such market and separately, to enhance financial inclusion of the poor (with better access to micro credit, deposits, insurance, and money transfers) to empower their economic activities.

2.4 External sector

2.4.1 Swaziland suffers from the symptoms of a small open economy. The country’s openness as reflected by the share of total trade in its GDP has averaged 170.1 percent for the period 2005-2008 and the latest data reveal that it is now 191.6 percent of GDP³. Furthermore, the country’s export market index (75.9) and export product index (40.1) during 2005-2008 are respectively very high reflecting high concentration of export markets and moderate concentration of export products in a few sectors mainly agriculture, minerals and manufacturing. The country mainly relies on exports of processed food (41 percent) and clothing (29 percent), which altogether constitute 70 percent of total exports. The rest comprise textiles, information technology and consumer electronics, non electronic

² Swaziland Integrated Fiduciary Assessment Report, May 18, 2010, page ix.

³ World Trade Indicators 2009/2010

machinery, wood products, miscellaneous manufacturing, basic manufactures, minerals and fresh food. The high level of openness makes the country vulnerable to external shocks by directly and positively causing income fluctuations. Similarly, high export concentration causes income fluctuations through its effect on terms of trade. In all these cases, economic growth will be indirectly and negatively affected by external developments, most recently, the global economic crisis with its dampening effect on global demand.

2.5.2 The problem of a narrow export market is amplified by the fact that over the past few years, growth in sugar exports (the European Union) and textiles exports (United States) have been largely dependent on preferential treatment. However, such treatment will not continue forever and the country must prepare to compete and sustain its external sector when such preferences are removed. In order to stabilize incomes, and foster economic growth, there is urgent need for the country to diversify its products and export markets.

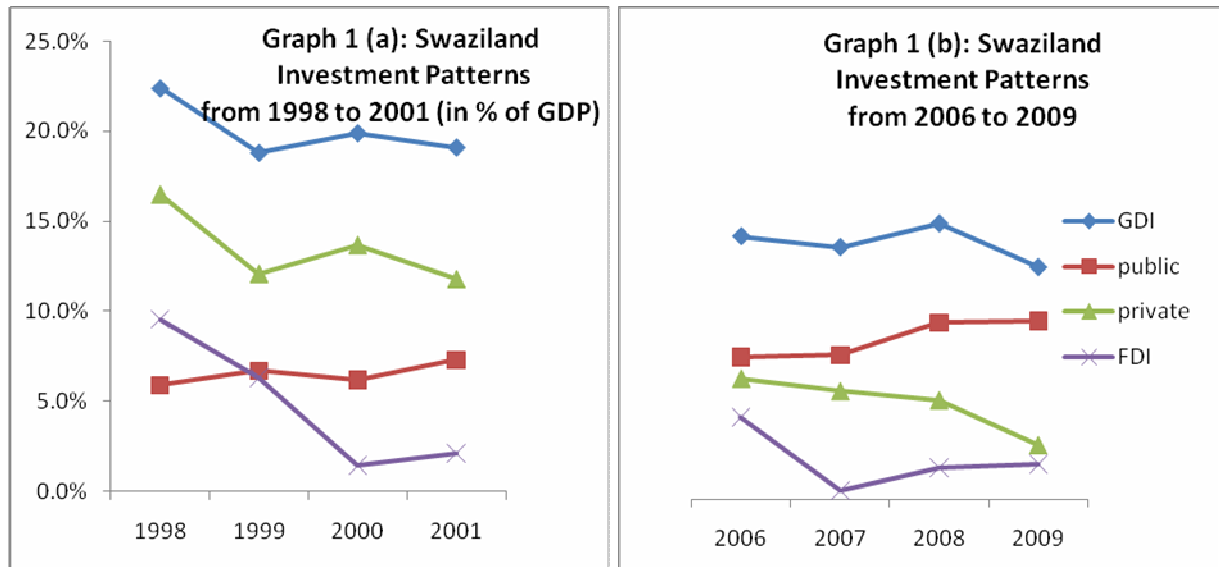
2.4.3 Swaziland is limited by a small market size despite its continued efforts to integrate and negotiate for preferential treatment from various markets. The country is also landlocked and needs to explore sources of efficiency improvements across all sectors of the economy including telecommunications and infrastructural development which will link it to the regional markets.

2.4.4 In the past, the country's close proximity to South Africa and growing economies in the Southern African region, high labor productivity, low and stable inflation had been instrumental in bolstering the country's investment climate. However, with the gloomy global economic environment, a lot needs to be done to attract and keep investors in the country. The latest World Bank Doing Business 2010 Report revealed that the burden of regulation is still an impediment to economic growth. Swaziland ranks 115 out of 181 countries covered. Comparatively, its ranking in 2010 is below some of those of neighboring countries South Africa (34), Namibia (66), Botswana (45), and Zambia (90) but higher than those for Lesotho (130), Malawi (132), and Mozambique (135). Critical areas of poor performance include protecting investors, starting a business, registering of property, trading across borders and enforcing contracts⁴. Because of these, the country's investment climate is a major constraint on competitiveness and medium term economic growth. The pace of implementing reforms in these areas has been slow and has impacted negatively on investment in particular, FDI.

2.4.5 Furthermore, the country comparatively performs poorly in relation to sub-Saharan Africa and OECD averages in terms of procedures and time required for business to build warehouse, obtain licenses and permit, cost of imports and exports and lengthy requirements for imports and exports. While the country has continued to register some growth in net FDI in 2008, comparative data for 2007 reveal that Swaziland was below the SADC average in terms of FDI as a percentage of capital formation. Graph 1 (a) and (b) and Figure 1 below show the deteriorating trends in investment patterns and FDI inflows in Swaziland; currently, the country has the lowest level of FDI within the Southern African region.

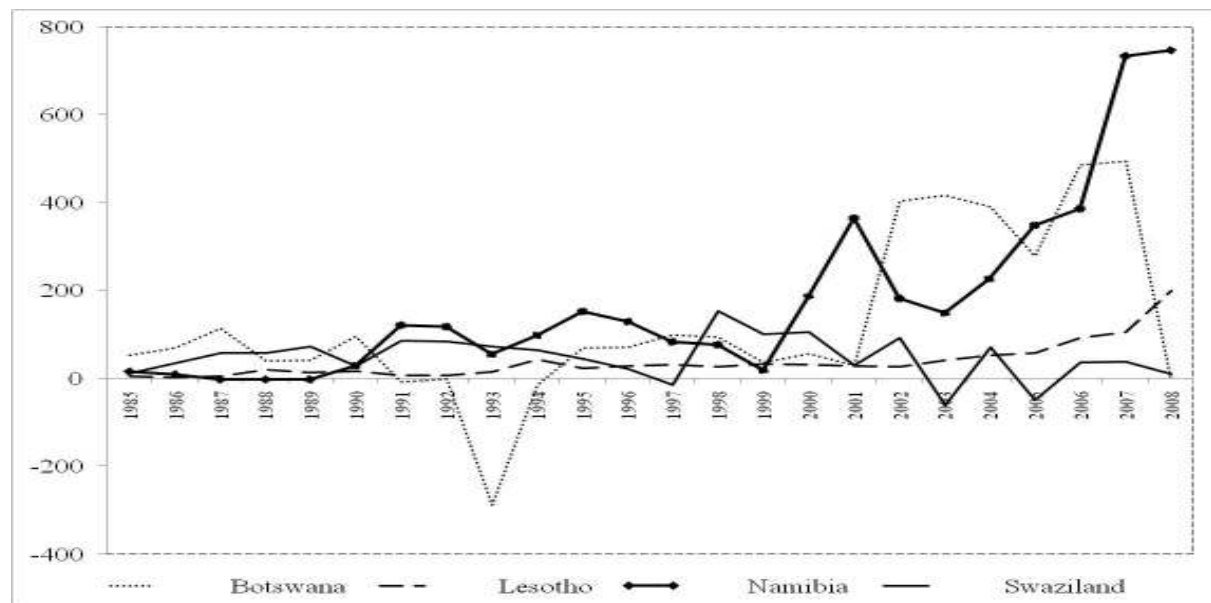
⁴ The key success factors of consistent reformers are not adequately entrenched. Doing business (2010) reveals that consistent reformers follow a long term agenda tailored at fostering competitiveness at all levels of production, as is the case of Rwanda and Egypt, push forward and remain proactive with reforms, they are comprehensive- introducing a number of reforms every year covering various areas e.g Georgia, Rwanda and Egypt, they are inclusive involving various stakeholders in institutionalizing reforms at the highest level and have a clear direction in their policy agenda and are responsive to new economic realities.

2.4.6 This is compounded by lack of a comprehensive investment policy to guide the country's efforts to attract back the old investors who had migrated to neighboring countries and attract new ones. Developing the right package of incentives for investors is key to bridging the current saving-investment gap. At present, the country's gross domestic savings rate of 13.78 percent, which is almost half the SADC average for 2008, is still low.



Source: IMF and World Bank staff estimates.

Figure 1: FDI inflows (US\$ millions)



Source: World Bank and UNCTAD FDI/TNC database.

2.4.7 The economic dominance of the South African goods and investment in the Swaziland economy-South African investments account for 9 percent to 20 percent of the GDP in the neighboring countries including Swaziland⁵-points to the need for the country to explore new engines of growth that will minimize the potential impact of this dependence.

III. THE ADJUSTMENT STRATEGY

3.1 In order to address the challenges of the current fiscal situation, Government has to introduce immediate measures to improve the fiscal balances, while pursuing complementary structural reforms to foster a more robust economy. In the medium-term, fiscal consolidation and structural reforms should help improve the business climate and promote private sector growth and employment. To support fiscal consolidation the PFM system should be strengthened to ensure that resources are used efficiently and for the purposes they are intended.

3.2 The following strategies will be adopted to achieve this:

- i) Introduce fiscal reforms to broaden the tax base and tax collection whilst reducing the tax burden on the poor and impediment to economic activity;
- ii) Restructure, right-size, and improve the efficiency of the public expenditure and services;
- iii) Improve governance so as to build investor confidence and allow for greater transparency and accountability;
- iv) Improve the export base and facilitate increased participation of the SME sector in the international trade; and
- v) Attract FDI and provide support for the development and the involvement of domestic investors in the manufacturing and other businesses.

3.3 Government is still working with donors to further develop specific reforms to promote the private sector. Notably, the AfDB will undertake a diversification study to explore sectors in which the country has a comparative advantage and develop an action plan. On a similar note Government has engaged the World Bank to assist with a growth diagnostics study. The outcome of these studies will greatly enhance Swaziland's policy formulation and the Swaziland Investment Promotion Authority (SIPA)'s drive to promote FDI, leading to greater diversification of the economy, which is critical for the country's growth.

3.4 A summary of and phasing of the measures and reforms envisaged over the medium-term, and where available their revenue/cost impact, is provided in the attached Policy Reform Matrix (PRM), Annexes, and Tables.

IV IMPROVING THE FISCAL POSITION AND PUBLIC FINANCIAL MANAGEMENT

4.0 The fiscal trends elaborated in section 2.3 are clearly undermining macroeconomic stability and call for drastic and sustained measures to restore fiscal sustainability. Short-term measures to enhance revenue and curtail expenditure must be complemented by medium-term reforms designed to improve the non-SACU revenue and reprioritize expenditure allocation through better controls and accountability in the budgetary system. Such reforms

⁵ IMF Working Paper 05/58 2005, The implications of South African Economic Growth for the Rest of Africa

should be complemented by improved reporting, internal and external audit systems, and Parliamentary oversight to enhance transparency in PFM that would also facilitate donor assistance through budget support.

4.1 Revenue Enhancement

4.1.1 The initial revenue enhancement measures were incorporated in the Budget Speech for 2010. Thus, effective February 17, 2010, excise taxes were increased for cigarette tobacco to 16.1 percent, pipe tobacco to 8 percent, cigars to 6.34 percent while those on alcoholic drinks were increased for spirits to 8.9 percent, for beer to 8.2 percent, for alcoholic fruit beverages to 8.3 percent and for natural unfortified wine to 8.1 percent. The budget speech also announced that effective July 1, 2010, additional measures comprising a minimum income tax of 3 percent, capital gains tax on disposal of business assets were introduced while the casino Levy and Lotteries and Gaming taxes were increased from 4 percent to 15 percent. However, these tax measures require amendments to the Finance Act and Income Tax Order to take effect.

4.1.2 The additional revenue enhancing measures and reforms will be anchored on the establishment of an autonomous Swaziland Revenue Authority (SRA), the introduction of a broad-based VAT (to replace the current narrower-based sales tax), and improved tax administration and services to taxpayers.⁶ While this will have a positive effect on SACU revenue, mainly through improved trade statistics, the reforms are targeted mostly on non-SACU revenue in order to broaden the tax base and reduce the dependence on the SACU revenue and provide a more stable revenue source. Moreover, the emerging tax system will also be more harmonized with the other SACU member countries and thus facilitate regional trade and investment to benefit Swaziland⁷. These measures are projected to generate revenue of about 4 percent of GDP by 2014/15 (for details see Annex Table).

4.1.3 The various revenue reforms have been informed by technical assistance from and are supported by a number of development partners, including the AfDB, the IMF, and UNCTAD, while other donors have been approached to provide further assistance.

4.1.4 The SRA will be officially launched by February 2011, but its skeleton staff, including two resident advisors, is already working with KPMG to recruit the rest of staff and prepare a strategic plan and work program. The latter entails merging the current two MOF Customs and Excise and Income Tax Departments into one semi-autonomous entity, creating a large taxpayer office to enhance efficiency and services to taxpayers, and introducing IT systems that will release resources to other critical operations in revenue administration such as auditing. The program calls for the introduction of a unique tax identification number for individuals and companies. A draft VAT Bill has been prepared and will be submitted to Parliament in time for the scheduled launching of the VAT in 2012/13.

⁶ A comprehensive review and recommendations on these reforms is provided in the IMF technical assistance report "Strategy to Modernize Revenue Administration, May 2007.

⁷ Hitherto, Swaziland has been the only SACU member country with a sales tax (with a narrower base and distorting cascading tax features) and without an autonomous revenue authority and a VAT. Moreover, Swaziland has been operating two separate tax departments without a unique tax identification number or large taxpayer office thus imposing burdens to taxpayers.

4.2 Expenditure Rationalization Measures

4.2.1 The rationalization of recurrent expenditure is imperative not only to help bring these outlays under control and improve the fiscal balance but also to provide a basis for reforms designed to improve future allocations and efficiency in providing the priority public services. In this regard, efforts will be made to freeze vacancies, eliminate redundant or non priority posts and relocate other posts to where they better serve priorities. Waste and nonpriority allocations for goods and services will be eliminated and where feasible government will outsource services to enhance efficiencies over time.

4.2.2 Government has set the ambitious target of reducing the overall size of the public service by 7,000 posts. This will be achieved through the implementation of the enhanced voluntary retirement exit scheme (EVERS), outsourcing of certain services, and through the creation of autonomous agencies (e.g. the SRA, Civil Aviation Authority and CTA), which will operate largely on commercial basis and squeeze all costs while improving delivery efficiencies. The adoption of private-public partnerships in the implementation of some capital projects will be pursued as part of the reforms. To ensure that the wage bill remains under control, Government will review the compensation policy and introduce performance management systems (with technical assistance from the Commonwealth Secretariat), which provide incentives for better productivity and output. Savings on the wage bill are targeted to reduce such allocation by 4.5 percent of GDP by 2014/15.

4.2.3 Cuts in expenditures on goods and services will in some cases go hand in hand with reduced or abolished staff positions. New controls will be put in place to ensure greater efficiencies in the delivery of goods and services. In particular, the planned PFM reforms to improve procurement, accounting, and auditing practices should, overtime, reduce discretion and incentives to misallocate goods and services. Total saving in this area is projected at 5 percent of GDP by 2014/15.

4.3 Public Financial Management Reforms

4.3.1 The Government has been assisted by a broad range of developing partners to assess and design reforms and a work program on improving the quality of spending and strengthening PFM, which is crucial for the success of the fiscal adjustment. Most of the PFM reforms also address the recommendations of the 2010 CIFA report. This will include modernizing of the MOF, strengthening the budgeting system, consolidating procurement reforms, expenditure reporting, internal and external auditing, and Parliamentary oversight.

4.3.2 The PFM reforms are anchored by the PFM Bill, which clarifies the roles, responsibility, and accountability of the MOF and spells out various internationally accepted standards to carry out these activities in an effective manner. The Bill is largely drafted and will be submitted to Cabinet for approval and to Parliament for its enactment before the end of 2010/11. Government will then approve and implement a PFM Action Plan, although in practice, departments and agencies have already commenced with requisite reforms.

4.3.3 Modernizing the MOF is a critical first step to PFM reforms, to ensure that the ministry can strengthen its broad oversight and accountability over public resources, and thus play a central role in directing the requisite improvements.⁸ In this context, the MOF will be

⁸ For details see the IMF's technical assistance report, Modernizing the Ministry of Finance, May 2009.

restructured in order to strengthen the Budget Department (BD) to act as the main locus of coordinating functions for budget reforms within the Ministry and to act as a more effective secretariat to the Planning and Budgeting Committee (PBC). The PBC itself is a sector wide coordinating unit comprising the three ministries that play a central role in budgeting public resources, namely MOF, Ministry of Planning and Economic Development (MPED), and Ministry of Public Service (MOPS). The BD in MOF will also undertake to significantly enhance budget monitoring and participate also in the Cash Flow Monitoring Committee, in both cases working very closely with the Central Bank of Swaziland. The BD will also take the lead role in strengthening the budget process, including collaboration with line ministries to strengthen their internal budgeting, monitoring, and reporting processes.

4.3.4 The MOF will be further restructured through the establishment of units to (i) develop tax policy and effectively set targets for the SRA; (ii) coordinate and improve debt management; and (iii) coordinate with donors/development partners in implementing the PFM and, indeed the FAR reforms and mobilizing additional funding and technical assistance. The other departments will need to refocus their work and provide task managers for reforms in their own units, and act also as members of the Task Force Group (TFG), chaired by the Principal Secretary in MOF, to oversee and coordinate the broader PFM reforms and the more comprehensive FAR.

4.3.5 In an effort to strengthen the current planning and budgeting framework, the PRSAP is being implemented using the Sector Wide Approach (SWAp) which promotes a wider participatory and transparent budgeting process. Government has identified key sectors in which the sector wide approach is being piloted, and these include education, health, agriculture as well as water and sanitation. It is anticipated that through the SWAp, duplication will be minimized within agencies and effectiveness of the available resources be increased. In line with this approach, Government is addressing the challenges faced in the implementation of the capital program to reduce project costs, while enhancing timely implementation and quality of the projects.

4.3.6 Government intends to prepare future budgets in line with medium-term expenditure framework (MTEF) guidelines as well as implement a medium-term fiscal framework that clearly defines the resource envelope and policy priorities. By closely monitoring expenditures through quarterly reports on sectoral spending, Government can exercise greater control in determining its expenditure patterns. It would also allow Government to build its data and statistics to aid greater analysis and better policy making. Efforts are already underway to build longer-term forecasting models and devise macroeconomic modeling to achieve this end.

4.3.7 Proposed reforms at the Treasury Department include (i) enacting legislation to enhance the quality of financial reporting; (ii) adopting the International Public Sector Accounting Standards (IPSAS)-Cash Accounting basis and assisting other line ministries in adopting the same; (iii) developing a chart of accounts; (iv) introducing cash flow management; (v) consolidating expenditure reporting using the IPSAS; and (vi) timely production of final accounts (3 month from end of fiscal year) to forward to the Auditor General (AG)⁹.

⁹ There is an accrual period of three months following the end of the fiscal year to clear payments authorized in the previous budget period. This has to be taken into account in establishing the target period for closing Government accounts.

4.3.8 A separate Internal Audit Department (IAD) within the MOF was established in 2008, and it is intended to provide for its legal framework in the PFM Bill, including details of its core functions in undertaking internal audits. Internal audit efforts will be assisted by Audit Committees in the Ministries and all government agencies. Management in the unit is in the process of developing a strategic plan and eventually a detailed work program to guide its reform activities. In this regard, a contract has been awarded to KPMG to advise and work closely with the IAD in developing the work plan, including a comprehensive training program.

4.3.9 The extent of AG's work is limited by inadequate capacity-number of staff and professional qualification-and budget allocations. The AG's auditing activities do not cover local governments and public enterprises, which are currently audited by private companies. In addition, the AG does not apply recognized auditing standards – the auditing standards of the International Organization of Supreme Audit Institutions (INTOSAI) and International Standards on Auditing – which negatively impacts on the quality of audits. There is some delay before audited accounts are submitted to Parliament for review – 11 months – and the extent of implementation of the AG recommendations is low. To address these problems, the Government plans to introduce amendments to the Audit Act, which will also ensure that the AG's office has greater independence in its activities.

4.3.10 Timely auditing of accounts (the target is 6 months after the close of the financial year) will enable the Parliamentary (PAC) to undertake its oversight role more effectively. Under the reforms, the PAC will be provided a secretariat, funded from the budget, to improve the scope and quality of its reviews and exert more pressure on the Government to enhance the level of implementation of the PAC recommendations.

4.3.11 Greater impetus to procurement reform started from a public outcry on the need to review the tendering process. A review study was commissioned and Government is reviewing the recommendations of Global Procurement Consultants Ltd (GPCL), a procurement consultancy firm whose work was funded by the AfDB. The Procurement Bill, which will provide a legal framework for reforms, was approved by Cabinet in 2008 and is currently being debated by Parliament, having been passed by the House of Assembly. In the meantime, a new set of regulations was gazetted and a unit was established in MOF with a mandate to start implementing some elements of the procurement reform. Liaisons have been established with all officers who are involved in the procurement of goods and services for Government. In the medium term, Government has put forward ambitious targets to operationalize the Public Procurement Authority and establish a specialist procurement unit in the Ministry of Health on a pilot basis. Plans are underway to update procurement regulations and ensure full compliance with regulations and implement training programs. The introduction of a Procurement Manual by 2010 will go a long way in institutionalising the Procurement Act and compliance with regulations.

4.3.12 The implementation of the PFM reforms would significantly benefit from the proposed EU project allocating Euro 8.2 million for the period 2011-2015. The UNDP and World Bank will contribute Euro 1.9 million and a grant of Euro 0.6 million respectively, while the Government has allocated Euro 0.3 million for the same period. The project will not only provide financial resources but cover technical assistance needs as well. Other development partners are also committed and/or have been approached to provide financial and technical assistance to implement the PFM reforms.

4.4 Reviewing Government assets

4.4.1 In the early 2000's Government announced an interest in selling some of its buildings, especially those housing the civil servants. This program has become even more relevant today as Government shifts its focus to outsourcing of public goods and services. Over and above this, with dwindling Government revenues, there will be even less devoted to the maintenance of these buildings. A roadmap on the sale of government shareholding has already been prepared by the MOF and submitted to Cabinet for approval. Where Government's shareholding is of strategic importance, Government will be putting some caveats in the sale of such assets.

4.4.2 Government assets such as buildings and roads come with maintenance costs of the facilities. Millions of Emalangeni have been spent acquiring such assets, which Government has failed to maintain lowering their useful life thus her investment in the process. The introduction of PPP's will also come with a transfer of the maintenance responsibility to the private sector and government will only pay rent. Beginning this year (2010/11), Government has set aside E10 million to build toll gates on the Ngwenya-Mbabane-Manzini highway. This will create space to divert a part of the maintenance budget for priority spending.

4.5 Debt Management

4.5.1 Total external debt is projected at about 13.4 percent of GDP by end 2010 and to grow to 14.3 percent of GDP by 2014. Public debt is projected to increase as a result of the projected large deficits and reach 52.4 percent of GDP by 2014.

4.5.2 Financing of this debt will remain a challenge due to the budget bias towards recurrent spending as part of the government capital programme is implemented through the PPP arrangement. This implies that government will rely more on domestic debt to finance this deficit. Also important to highlight is the fact that the higher the level of debt the higher the level of scrutiny on the quality of government spending. In line with the increasing debt levels, interest payments will also increase to reach 2.9 percent of GDP in 2014/15.

4.5.3 Given that our debt ratio is likely to increase in the medium term, it is imperative for government to develop a cohesive Debt Management strategy going forward. Such a strategy would clearly define and prioritize available funds whether obtained through external or domestic debt financing. Government is committed to developing a comprehensive Debt Management strategy by 2011/12 and to rationalizing the aid co-ordination mechanism.

V. ENABLING ENVIRONMENT FOR THE PRIVATE SECTOR

5.0 Swaziland faces a major challenge to respond to the emerging realignment in the regional and global economic setting within which the private sector and especially the export sector have not fared well in contributing to economic growth and employment. Government's response to reverse this trend is two pronged. First, measures and reforms are being put in place to address the large fiscal imbalances and restore macroeconomic stability essential to fostering a robust private sector. Second, a comprehensive package of reforms will be pursued to improve the investment climate and business environment by removing as many binding constraints as possible. The implementation of these reforms, combined with

expedited action on priority existing, ongoing, and prospective investment in Swaziland will support a target to create 25,000 to 30,000 new jobs in the private sector through 2014/15, which will more than offset the envisaged reduction in the size of the civil service.

5.1 Economic diversification

5.1.1 Reforms and initiatives aimed at improving the country's competitiveness include the Investor Roadmap, Industrial Policy, and National Export Strategy (NES). In addition, Government will be putting in place measures to implement the privatisation roadmap, expand financing for the SME sector that have been identified as bedrock for growth in the economy and strengthen entrepreneurship training.

5.1.2 The NES provides direction on how to improve the competitiveness of the country's exports and thus achieve sustainable economic growth through enhanced competitiveness, value addition, and export diversification in targeted sectors as well as through strong public private partnerships.

5.1.3 The specific objectives of the NES are as follows:

- i) To expand the export base and ensure an increased combination of exports thus reducing the burden on the sugar industry as the main foreign exchange earner;
- ii) To strengthen the existing relationships with current markets to ensure that industry takes full advantage of preferences offered by existing markets;
- iii) To enhance market access for Swaziland exports through branding and improved product quality;
- iv) To improve trade facilitation through the establishment of strong PPPs; and
- v) To pave a way for technological innovations that will enhance competitiveness of Swaziland exports by ensuring the use of low cost production methodologies that do not compromise the national objective of employment creation.

5.1.4 The NES focuses on seven priority areas drawn from agriculture, manufacturing and services. These areas are: (i) Sugar; (ii) Forestry; (iii) Horticulture and Citrus Exports; (iv) Handicrafts; (v) Food and Beverages; (vi) Tourism and (vii) Information Communication Technology. Special efforts will be made to identify promising projects in these areas, which can be fast tracked to generate employment over the next three years. The completion of the large new airport at Sikhuphe, in particular, provides an opportunity to anchor several projects to boost tourism significantly.

5.1.5 Government is implementing three separate major small holder irrigation schemes, which together will cover some 25,000 hectares when completed. The most advanced is the Lower Usuthu Small-holder Irrigation Project (LUSIP) to develop 6,500 hectares in Phase I and another 5,000 hectares under Phase II to benefit 2,618 household by improving food security, sanitation and access to clean water, as well as income generation. Three dams and irrigation pipes and canals have been completed and cropping under Phase I, mainly sugar cane (eventually to cover 4,500 hectares and other crops to help diversify the economy) started in 2010 and should be fully operational by 2014. Phase I is estimated to provide direct employment to about 2,600 and many others indirectly through support services. Farmer access to credit is a major constraint to crop expansion and while Government will assist with

its own resources, it is piloting a scheme where farmers' associations will team up with other private sector to access credit through production sharing.

5.1.6 Government is looking into prospects for exploiting LUSIP's greater potential beyond irrigation and to serve as a model for other similar projects to generate additional employment and investment. For instance LUSIP has potential for small scale hydroelectricity generation and, through its water reservoirs, could support tourism and a fisheries industry. Moreover, the Swaziland Water and Agricultural Development Enterprise, which is implementing the project, is a parastatal with a very good performance record (its workers are all on contract) and is a good candidate for privatization.

5.1.7 Swaziland's proven substantial deposits (in excess of 1 billion tons) of high quality and environmentally less harmful coal provides also a major opportunity to generate sizable employment through the proposed thermal power plant to generate 300 MW of electricity and identifying potential investors to export significant quantities. The Mines and Mineral Bill, which, among other things, will improve the clarity of mineral rights was recently approved by the Cabinet and has been submitted to Parliament.

5.1.8 During 2010/11, an economic diversification study will be carried out in conjunction with AfDB to determine the sectors within which Swaziland is deemed competitive. It is envisaged that in the medium term, Government will promote development in these sectors through investments in infrastructure and further promote niche sectors for growth and development.

5.2 Attracting FDI

5.2.1 It is important for Swaziland to improve its competitiveness to be in a position to attract FDI flows. To this end, in December 2009, Government established a Cabinet Sub-Committee on investments, comprising the Ministers of Finance (chair); Planning and Economic Development; Trade, Commerce and Industry; and Agriculture. The Committee meets weekly to drive the process of attracting, increasing, and retaining investment in the country. The Committee's effectiveness is linked to the progress made in improving Swaziland's standing with regard to the World Bank 'Doing Business Report'.

5.2.2 In the medium term, Government will streamline licensing arrangements to reduce the current number of days required for licensing and registration of businesses (from 21 to about two months, respectively) to 7 days as well as implement the Investment code. In addition, Government has committed to implementing a competition framework, the streamlined Companies Act and create incentives for labor intensive FDI to enter the market. Such measures will reduce the cost of doing business in Swaziland and complement policies that will reduce costs in ICT, open up the telecoms sector to competition, and expand power supply to provide business with the necessary infrastructure to support their activities.

5.3 Improvement to the Legislature Framework

5.3.1 The SIPA has taken a leading role in reviewing the investment legislation framework. It has undertaken an audit on the implementation of the Investor Roadmap and has developed a strategy to address the outstanding issues. A draft investment policy has been prepared,

with the assistance of the USAID Trade Hub, for consideration by government. The policy will go a long way in providing protection to investors. Government through the Ministry of Justice and Constitutional Affairs is in the process of establishing small claims courts to facilitate processing of such cases.

5.3.2 The vibrancy of the financial sector is another critical condition for investment promotion. The Ministry of Finance has submitted a revised Securities Bill to parliament. This is expected to improve the regulatory framework of the stock market that will boost private sector investment (both domestic and foreign). PPPs can be effectively implemented with a functional stock market that will ensure that growth benefits trickle down to the people, thus improving income distribution. A well functioning stock market is not only good for private investment promotion, but also expands Government's capacity to finance the budget deficit. To generate activity in the market after the approval of the new Securities Bill, Government will also be reviewing her shareholding in various private companies with a view of putting it on the market. The Financial Services Regulatory Bill has been approved by Parliament and is awaiting His Majesty's signature to become law. It provides for the establishment of a regulatory authority to supervise SACCOs, NBFIs, and micro-financial institutions and should benefit the sector's contribution to promoting the private sector.

5.3.3 There is also the need to put in place regulatory mechanisms that will protect investors in the country; this includes the need to create an independent regulator for competition in ICT to encourage reduction in costs and expansion in services. To this effect, Government is taking steps to introduce a telecommunication regulator by 2010/11 and a fully operational energy regulator by December 2011¹⁰. The latter will facilitate licensing the planned power plants (for 300MW and the private sector 28MW unit) and the potential LUSIP mini-hydro plants.

5.4 Trade facilitation

5.4.1 The promotion of exports is a critical strategy for Swaziland's growth. Top on the list will be engaging with the South African Government to discuss the issue of extending border hours, which will initially target one border post (Ngwenya) in the medium term. This is the port of entry that handles more than half the country's trade in each year. Effort will be made to look at Lavumisa as well, which is the gateway to the Durban port, the biggest access route to markets outside of SACU. One-stop border posts will streamline customs formalities for traders at the border and ensure the process of clearing goods is straightforward.

5.4.2 Considerable effort has also been made by Government to computerize merchandise clearance at the borders through the implementation of ASYCUDA++. This does not only reduce time spent at the border but also increases compliance with customs formalities. As noted above, reforms in the tax system should enhance its harmonization within the region and facilitate trade as well.

5.5 Public-Private Partnerships and Privatization Policy

5.4.2 PPPs are important tools which can be used to assist the Government in delivering more and better services to the people. By conducting partnerships with the private sector

¹⁰ The energy regulator is physically in place but has to develop regulations and licensing procedures to become fully operational.

Government can supplement its limited resources with those available from the private sector. Thus PPPs have a potential to attract foreign capital to boost domestic investment to grow the economy. It is the government's intention to prepare and finalize a policy framework for PPPs to facilitate private involvement. This is premised on the belief that PPPs would provide yet another investment vehicle for pension funds and insurance companies in response to the 30 percent local asset requirement imposed by the legislation governing this sector. Government also has a PPPs initiative in the pipeline for the E1.5 billion Institutional Housing programme to be led by the National Housing Board, with the potential to be relieved of the responsibility of providing institutional houses for civil servants. This will free up resources for utilization in other critical sectors of the economy. Government will be piloting this programme in the creation of other joint assets such as government offices and factory shells.

VI. ISSUES IN IMPLEMENTING THE FAR

6.1 The Government is aware that Swaziland faces a challenge in implementing the FAR. Among the risks involved are (i) the inertia that has delayed reforms in the past; (ii) ability to effectively coordinate such a comprehensive reform program; (iii) garnering adequate internal ownership and support for the planned reforms; and (iv) impediments to attracting adequate supporting resources, including technical assistance, to implement some of the key reforms.

6.2 To mitigate these risks, Government has undertaken careful planning to involve many stakeholders at an early stage. The reforms planned in MOF including the establishment of a FAR coordinating unit and reform task leaders, many of whom will be also members of the coordinating TFG for the FAR should help with institutional support for reforms. Moreover, the TFG has broad representation across Ministries, agencies, and the private sector and thus draws on the goodwill and expertise in key areas of the economy. Regular meetings of the TFG should help to identify and make timely interventions to introduce corrective measures.

6.3 There have been broad consultations on the draft FAR, including through a stakeholders' workshop. The views provided through the workshop and other channels have been fully reflected in the revised FAR. The comprehensiveness of its proposed reforms is also potentially an advantage because it covers the scope of reforms essential to turn the situation around but only as an integral piece. Attempts to implement only parts of the FAR will not be up to the task at hand. Moreover, such an approach risks pre-empting the full realization of the synergies entailed in the entire package of reforms.

6.4 Efforts have been made also to draw on support and advice of development partners and to identify potential areas that will need further support, including the provision of technical assistance. Through the planned active committee to enhance donor coordination, we hope that we should be able to get timely cooperation from development partners to provide additional support as needed. Moreover, the EU project on PFM reforms and progress made thus far with establishing the SRA, provide a strong basis to anchor the rest of the FAR reforms.

VII. CONCLUSION

7.1 Our country is at crossroads, buffeted not only by deep seated domestic economic problems but now also by the global economic crisis and ongoing realignment of regional and

global economic settings. We must not only seize the opportunity of these crises to address domestic economic issues but must look beyond our borders to develop and implement strategies to reposition the country in the changing world economic setting. Fiscal adjustment—to broaden the tax base, reduce recurrent expenditure and introduce medium-term PFM reforms—must be implemented side by side with reforms to create an environment that is more supportive of private sector economic activities to accelerate economic growth and employment creation.

7.2 We believe this comprehensive reform package provides a good opportunity to launch this journey to greater prosperity for all of our people.