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Institute of Policy Research and Analysis

December 2011

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IPRA Working Paper 35

Institute of Policy Research and Analysis, Kampala

December 2011

Abstract

This paper examines the stance of fiscal policy in Swaziland since the 1980s, and the attempts that have been made to restrain the excessive deficits that have built up over the past 15 years. Swaziland's fiscal difficulties have arisen in part from two decades of slow growth, and falling revenue from SACU's revenue sharing pool, aggravated by the collapse of the fiscal discipline. It would be easier to reduce fiscal deficit and stabilise debt burdens if growth were to pick up and the tax system restructured. But growth alone or expanding the revenue sources per se won't resolve the problems. Bold actions to rationalize government expenditures and strengthen mechanism for public debt management are essential for the needed adjustment. The fiscal adjustment road map, if firmly implemented, could bring the deficit down to a sustainable level and reduce dependence on SACU transfers, and government debt would remain sustainable over the medium term. However, policy inaction would be a sure recipe for deeper crisis as the overall fiscal balance would remain above 14.5 percent over the medium term and debt to GDP ratio would rise to unsustainable levels (over the medium term).

JEL Classification: E62, E65, H12, H62, H63

Key words: Fiscal policy, fiscal risk, debt sustainability, soverign debt, Swaziland.

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1 Introduction

Since Swaziland's economic bubble burst at the beginning of the 1990s, growth remains dismally low, and the last twenty years can be described as "the lost decades" for the Swazi economy. From 1999 to 2009, economic growth averaged 2.3 percent per annum. Between 2008–2012, growth deteriorated to a level not seen since 1980s: at 0.2 percent in 2009, 1.3 percent in 2011 and 0.8 percent in 2012, far short of the growth necessary for tackling the problem of unemployment, poverty and the HIV/AIDS pandemic (Ayoki, 2011). Moving forward, government is faced with a delicate choice between the need to limit future spending increases so as to bring the fiscal deficit under control, and to ensure a return to robust economic growth through structural increase in public spending. Balancing these goals is a difficult choice that is complicated by the declining domestic revenues.

Given this elevated level of fiscal deficit, what will happen to public debt if there is no adjustment to the primary balance in the medium term? What kind of fiscal adjustment will be required in order to reduce or stablish the public debt stock? This paper endeavours to address these questions using more recently available data from IMF Article IV Staff Reports and the joint World Bank–IMF Debt Sustainbility Analysis and other government sources (the Ministry of Finance and the Central Bank of Swaziland).

An increase in the structural budget deficit beyond current level of 14 percent of GDP (as at 31 March, 2011), which one of the highest in Sub-Saharan Africa—would see the burden of government debt and interest payments increase to unsustainable levels. If left unaddressed for too long, persistently sluggish growth will result in contracting revenue base, an expansion of fiscal deficit, worsening poverty and unemployment. To this end, the Government of Swaziland launched in 2010, a‘Fiscal Adjustment Roadmap’ in which general government expenditure is expected to be reduced by more than 10 percent of GDP – from 53.2 percent to 34.7 percent of GDP – over a six-year period: 2011–2016. It is hoped that this will bring down fiscal deficit to 10 percent of GDP in 2011/12 and less than 3 percent in 2014/15. One-third of the adjustment is expected to come through increases in revenues, with the remainder coming through real-terms spending cuts, mostly the wage bill, which is the single largest public expenditure item.

According to the adjustment roadmap, the economy could see up to E 2.4 billion (accumulated 8 percentage point of GDP) in spending cuts in the next four years (2013/14 – 2016/17). This will be augmented by the privatization and divestiture of state enterprises and assets that began with Swazi Bank; raising revenue through the new Swaziland Revenue Authority, increase in tax rates on a number of goods and services, to bring them in line with those in South Africa, and to broaden the tax base by bringing into the taxnet, items such as air time and electricity.

The impact of all these measures on the economy is not very clear. Whereas the importance of fiscal adjustment in bringing about the stability of fiscal system is not in doubt, further fiscal contraction in an already fragile macroeconomic and growth environment can fuel further instability and perhaps new economic downturn. The decade of persistently sluggish growth has resulted in an expansion of poverty and unemployment, which together with the high prevalence rate of HIV/AIDS (32.4 percent) continues to exert considerable pressure on government resources (Ayoki, 2011). Unfortunately, existing literature says very little about potential effects of fiscal adjustment for countries in similar situation as Swaziland. We have not come across studies that provide evidence on effect of fiscal policies in restraining fiscal deficits in Swaziland or else where in Sub–Saharan Africa—from which we could draw policy lessons. For instance, what is the optimal mix of the austerity versus non-austerity measures in restraining fiscal deficits? What lessons do the outcomes have for policy makers in Swaziland and elsewhere?

A rough estimate by IMF suggests that "a budget cut equal to 1 percent of GDP reduces domestic demand by about 1percent and raises the unemployment rate by 0.3 percentage point."[1] As for the case of Swaziland, the IMF staff estimate suggests that fiscal adjustment would dampen the real GDP growth to -1.9 percent in 2011, with about 8 percent rise in consumer price inflation (from 6.25 percent in 2010). These changes reflect higher domestic taxes and levies on various products, and increase of food and fuel prices on international markets. The only positive impact is on current account to GDP ratio, which would improve to 12.3 percent.

This paper analyses the reform initiatives and the implications of some specific policy commitments/goals. In what follows, Section 2 provides an overview of fiscal development in Swaziland, exploring the link between the fiscal crisis in Swaziland and the two areas of tolerance: the collapse of the fiscal discipline and external dependency (i.e. over

[1] *World Economic Outlook*, October 2010, Chapter 3, "Will It Hurt? Macroeconomic Effects of Fiscal Consolidation," p. 113.

reliance on SACU revenue and primary commodity exports). Section 3 provides detailed accounts of total public spending in Swaziland. It explores the first area of tolerance: the collapse of fiscal discipline, within the overall context of public expenditure, and tries to provide clues into Government's priorities and commitment to key sectors vis-à-vis other sectors over the years. Having explained the measures introduced to improve fiscal sustainability, this section goes further to document the challenges facing their realization and effective implementation ranging from political constraint to other issues. In Section 4, the evolution and levels of government debt is explained and compared with it comparators in the region, and various benchmarks used internationally. It examines the circumstances giving rise to each of those debts and to make fine judgments about the extent, if any, of a political interest or negligence. Chapter 5 focuses on fiscal adjustment strategies and Section 6 concludes with a set of challenges facing fiscal adjustment, both short- and long-term.

2 An overview of the fiscal developments in Swaziland

This section unveils the drivers behind the fiscal developments in Swaziland as the result of two areas of tolerance: the collapse of the fiscal discipline and and external dependency (over reliance on SACU revenue and primary commodity exports). It highlights the challenges ahead (arising from recent financial and global economic crisis) and areas that require special attention from policymakers. Swaziland, whose economy is closely linked to that of South Africa and exported primary commodities, suffered from declining export prices, which impacted negatively on output.

2.1 Swaziland's external trade and revenue trend

2.1.1 Swaziland's foreign trade

Historically, Swaziland has relied heavily on import revenues and its trade ties with South Africa—its main trading partner—who accounts for 70 percent of all Swaziland's exports, and about 90 percent of her imports. Swaziland enjoys well-developed road links with South Africa. It also has railroads running east to west and north to south. The older east-west link, called the Goba line, makes it possible to export bulk goods from Swaziland through the Port of Maputo in Mozambique. Before the political conflict in Mozambique, most of Swaziland's imports used to be shipped through this port. Conflict in Mozambique in the 1980s diverted many Swazi exports to ports in South Africa. Swaziland mainly uses the port today for exports of sugar, citrus, and forest products, with future usage of the port expected to increase. A north-south rail link, completed in 1986, provides a connection between the Eastern Transvaal rail network and the South African ports of Richard's Bay and Durban.

Swaziland's second trading partner (second to South Africa) is the European Union that account for about 15 percent of her exports and the United States (14 percent of total exports). Swaziland exports citrus fruits, sugar and beef to the European Union, wood pulp to Japan, and textiles to the United States. Manufacturing sector accounts for

42.3percent of GDP, and agriculture that accounts for 7 percent of GDP and 70 percent of total employment is strongly linked to the manufacturing sector. Sugar is Swaziland's leading export earner and private-sector employer. Other important export earners are soft drink concentrate, wood pulp and lumber from cultivated pine forests, pineapple and citrus fruit. Swaziland also mines coal and diamonds for export. In 2005, mining contributed about 0.6 percent of Swaziland's GDP. The services sector is dominated by finance and banking, and transport industry – and it contributed about 38 percent of GDP in 2008. Tourism contributes about 7 percent of GDP – earned from over 424,000 visitors that the country hosts annually, mostly from Europe and South Africa.

Beginning in mid-1985, the depreciated value of the domestic currency helped to increase the competitiveness of Swazi exports and moderated the growth of imports, generating trade surpluses. From the mid–1990s, the country started to ran into small trade deficits, partly due to appreciation of the lilangeni. The situation deteriorated when the financial and economic crisis hit, in September 2008.

The economic and financial crisis that has unfolded over the past few years has caused a dramatic deterioration in Swaziland's external trade, with implications for growth and government finances. Tax revenues declined by 10 percentage point of GDP, from 29 percent of GDP in 2009 to 19 percent of GDP in 2010 due to deteriorating trade receipts (SACU revenue). As a result, fiscal deficit reached 14 percent of GDP in 2010 pushing up public sector borrowing to 60.7 percent of GDP in 2011.[2]

The experience of the twentieth century has shown that countries with economies dependent on revenues from a few primary commodity exports and foreign inflows are likely to suffer big swings of income through causes over which they frequently have little or no control. Swaziland is no exception to this. Fiscal policies in the importing countries especially when caused by events such as the recent debt crisis in Europe will affect demand in importing countries and revenues of the trading partners; and special trade agreements may improve the position of some suppliers vis-a-vis the rest.

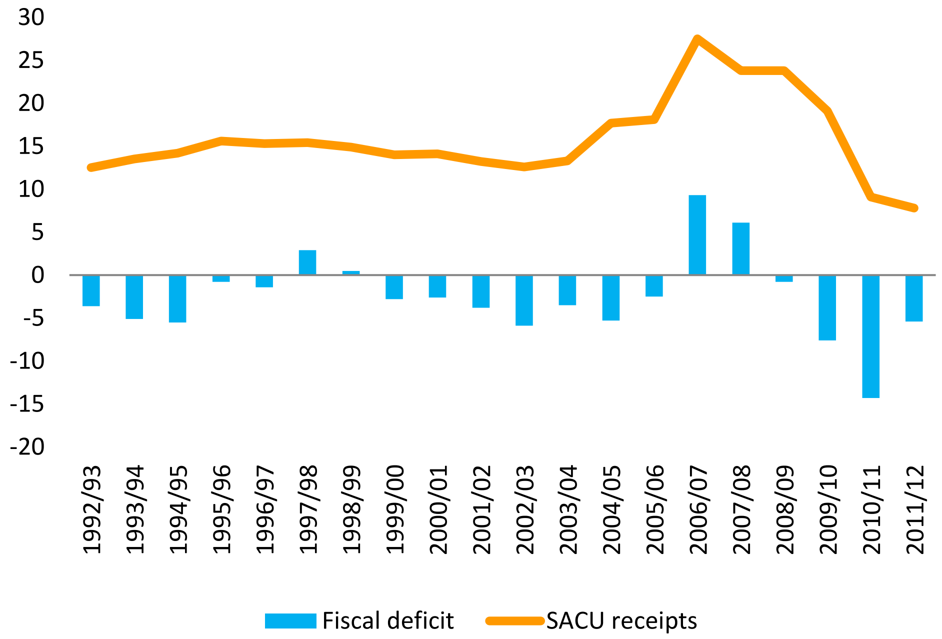
2.1.2 SACU receipts and Swaziland fiscal balance

For several years, increased SACU revenue helped the Swaziland Government to realise large fiscal surpluses and accumulate substantial international reserves (receipts from

[2] Swaziland's economy grew by 2.4% in 2008 before declining to an estimated 0.2% in 2009. Projections for 2010 and 2011 are that growth will rebound to 2.2% and 2.4%, respectively, below the 5% government target to reduce poverty to 30% by 2015.

SACU account for over 60 percent of government operating revenue). Between 2005 and 2007, SACU receipts (accrued to Swaziland) increased by 6 percentage points of GDP, from 18.1 percent of GDP in 2005/06, to 24 percent in 2008/09, with a peak in 2006/07 (28 percent of GDP) - translating into a huge surplus of E1.957 billion in 2006/07 (9 percent of GDP) and E612.9 million in 2007/08. This was driven by South Africa's growing economy and the rise in international trade, resulting into increased SACU customs revenue pool.[3] In 2009/2010, SACU revenue fell by about two-thirds (11 percent of GDP) as a result of the global economic crisis and the country slipped into deficits (Figure 2).

Figure 1. Fiscal balances and SACU revenue (Percent of GDP)



In FY 2010/11, SACU imports fell sharply due to the contraction of economic activity in South Africa and the unwinding of infrastructure spending after the 2010 World Cup. Consequently, the transfers from the common revenue pool to Swaziland fell by 11 percentage point of GDP in FY 2010/11. The shortfall in SACU revenue and a high wage bill fueled a fiscal crisis. While other countries have reduced their reliance on international trade taxes during the last two decades and increased their reliance on direct and indirect domestic taxes, Swaziland has not made much progress in increasing her reliance on other taxes as a source of fiscal revenues, making her vulnerable to external shock.

[3] The new SACU revenue sharing formula came into force in 2005/06. The new formula was meant to facilitate equitable and transparent sharing of SACU revenues amongst the member states, and to facilitate efficient fiscal planning.

Unless robust corrective measures are implemented, and if the decline in SACU revenue continues, the deficit could deteriorate to 10 percent of GDP in 2011/12 given a further wage increase granted in mid-2010.

2.1.3 External shocks and Swazi manufactures exports

Change in preferential trade regime of the EU excebrated the situation. The year 2007 marked the end of the EU preferential treatment for Swaziland's main sugar and textile exports. From the same year (2007) that the European Community began to remove subsidies on sugar, Swaziland's exports of raw and processed sugar declined steadily in value. With prices set by the Sugar Protocol and the EU, the 60 percent rise in world sugar prices in 2009 (came on the heel of a failed sugar crop in Brazil) did not have significant impact on the sector's performance. Appreciation of lilangeni eroded the benefits from increased sugar export receipts.

Being unable to respond to the external shocks and current account deficits by devaluing its currency as its currency is pegged to the South Africa Rand, Swaziland's output contracted by 2.4 percentage point of GDP as a result, that year (2009). Swaziland faced reduction in export volumes for most of its manufacturing products (cement, agricultural machinery, electronic equipment, refrigerator production, footwear, gloves, office equipment, confectionery, furniture, glass and bricks) as a result of the slowdown in global demand. The manufacturing sector contracted by 1.6 percent in 2008 and 2 percent in 2009, and 0.7 percent in 2010 before showing a slight recovery of 1.5 percent in 2011. The most affected sub-sector was wood and wood products[4].

The effect continues to be felt in employment front as companies retain cost cutting measures such as scaled down production. For example, Usutu Pulp used to be the leading wood pulp processing company and Swaziland's largest employer, with a capacity to produce 220,000 metric tons of bleached kraft pulp every year. In January 2010, Sappi, the London-based management of Usutu Pulp, decided to wind up operation in Swaziland, a move that led to a loss of 550 jobs. Some companies restructured their operations, others closed shop entirely. Swazi Paper Mills, closed with a loss of 223 jobs, while Peak Timbers retrenched half of its 170-workforce at its Piggs Peak plantation. Further job losses are likely to occur as the effects of the Usutu Pulp closure cascade through the economy. Most of the 250 or so local firms that supplied the mill may also be forced to close. Others will continue to make losses. In 2009 alone, the Swaziland Electricity Com-

[4] The wood-pulp industry was also further impacted by forest fires that destroyed timber supplies.

pany incurred financial loss of SZL 15.6 million. The Swaziland Railway and other firms providing road transport services might have incurred similar loss of SZL 7 million and SZL 6 million, respectively.

The construction sector contracted by 3 percent in 2009 and 10 percent in 2011, while the textile and apparel sector shed an estimated 3 000 jobs in 2009 due to falling global demand and production cuts. Swaziland's textile and apparel sector thrived on preferential trade arrangement with the United States under the African Growth and Opportunity Act (AGOA) initiative for which Swaziland became eligible in 2000. Swaziland qualified for the apparel provision in 2001 through which over 30 000 jobs, mostly for women, were created in the textiles and apparel sub-sector. This was significant for an industry emerging from the setbacks created by increased global competition when the Agreement on Textiles and Clothing (ATC) came to an end on 1 January, 2005.

Appreciation of the South African Rand (Lilangeni is pegged to the South African rand) also worked against exports. In the wake of the global financial crisis, employment in the textile and apparel sector fell from 15,000 in 2008 to 12,000 by mid-2009. More jobs would have been lost had it not been for the Lilangeni's depreciation, which kept exports going.

The current account deficit rose to 5.4 percent of GDP in 2010 and 7.4 percent in 2011 – the cause being, the drop in SACU receipts and reduced exports volumes arising from fall in export demand in 2010 and 2011. More significantly, customs receipts – the government's primary revenue source – declined, following a fall in Southern African Customs Union (SACU) trade.

Moreover, ever rising recurrent spending and high public wage bill, estimated at 18 percent of GDP and about 52 percent of the overall budget (far above the conventional benchmark of 35 percent) is a major source of worry for the country's fiscal sustainability. However, the analysis also called attention to, among other issues, the loss of jobs and other adjustment costs that would be faced by Swaziland. How much impact shall be faced by the economy is a matter generating a lot of debate a cross section of the public.

In 2010, SACU receipts fell by 60 percent, promoting Cabinet to approve a Fiscal Adjustment Roadmap targeting a deficit of less than 3 percent of GDP in 2014/15.

2.2 Medium–term fiscal challenges

The main instrument of fiscal policy in Swaziland is the central government spending on essential public goods and services such as healthcare, education and infrastructure investment. Government intends to deliver these essential public goods and services, in an efficient manner and to facilitate high rates of economic growth and employment, and reduce poverty. Tax rates have not been used as a fiscal policy instrument in most cases, either in expansionary or in contractionary situations.

2.2.1 Overall budgetary situation

Table 1 summarises government fiscal operations – the public spendings and how they are financed. During the 1990s, the country often ran small budget deficits. Government spending as a share of GDP was broadly stable from 1993 to 1999 at around 30 percent. Government spending rose to 35 percent of GDP in 2004/05 and remained at that level until 2007, then increased dramatically to 40.6 percent in 2008/09 and 43.3 percent in 2009/10 due to salary rise, before returning to 34.5 percent in 2010/11 as fiscal adjustment measures began to take effect. Overall, government spending expanded by a 10.2 percentage points of GDP between 2003/04 to 2009/10 (from 30.4 percent of GDP in 2003/04 to 40.6 percent in 2009/10 before calming down to 34.5 percent in 2010/11).

In contrast, government revenue contracted by a 6.4 percentage points of GDP, from 26.6 percent of GDP in 2003/2004, to 20.2 percent in 2011/12. The primary deficit grew from E434 million (2.9 percent of GDP) in 2003/2004 to E3.647 billion (14.3 percent of GDP) in 2010/11, while Government debt increased from 12.1 percent of GDP in 2009/10 to 14.8 percent in 2010/11 (Figure 2). The fiscal deficit was financed by drawing down government deposits at the central bank, in addition to domestic borrowing (securities, treasury bills and bonds), and an accumulation of domestic payment arrears of E 1.3 billion. The external current account deficit deteriorated to 18.5 percent of GDP in 2010. Consequently, the gross official reserves of the Central Bank of Swaziland continue to decline and stood at about E 4 billion (equivalent to 2.6 months of import cover) on April 29, 2011.

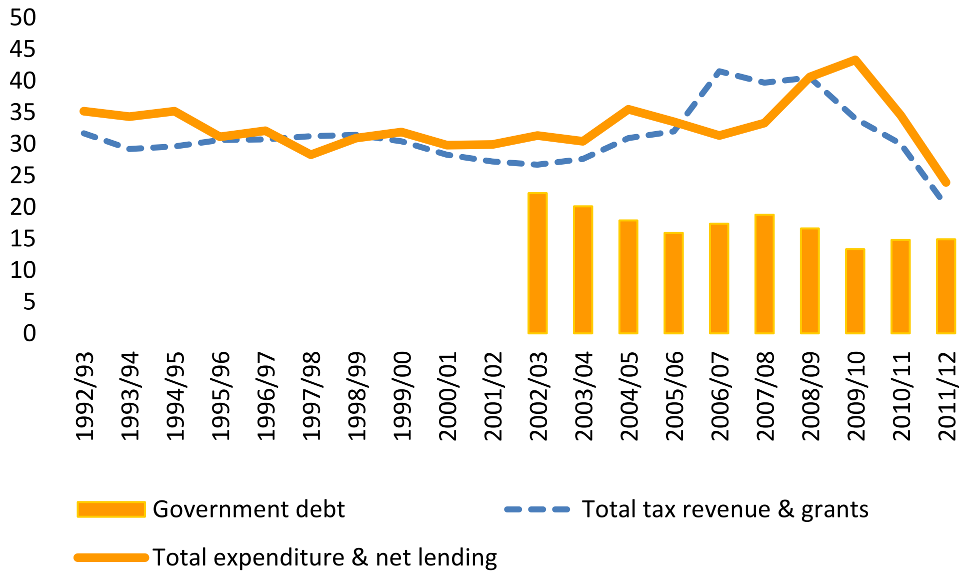
The fiscal deterioration is partly driven by fall in tax revenues (Figures 2 and 3). Tax revenue accounts for over 90 percent of the government operating revenue every year. This has been the trend for the last one decade or so. Other revenues are mobilised through fees and charges as well as grants.

Table 1 Swaziland: Government fiscal operations, 2003/04 – 2010/11

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Revenue and grant	**3,890.7**	**4,842.3**	**5,499.1**	**8,020.4**	**8,085.5**	**9,409.9**	**9,145.7**	**6,584.1**
Revenue	3,763.9	4,726.7	5,326.8	7,854.8	7,898.3	9,264.9	8,899.0	6,084.7
Grant from abroad	126.9	115.6	172.2	165.6	187.3	145.0	246.7	499.4
Total expenditure & net lending	**4,324.7**	**5,557.4**	**5,828.9**	**6,062.7**	**7,472.6**	**9,780.3**	**10,427.8**	**10,231.4**
Current expenditure	3,457.7	4,295.8	4,416.3	4,681.3	5,522.2	7,308.2	7,957.5	7,683.5
Capital expenditure	867.1	1,258.7	1,409.7	1,436.6	1,950.4	2,472.1	2,470.3	2,547.8
Net lending	(0.1)	2.9	2.9	(55.2)	0.0	0.0	0.0	0.0
Overall surplus(deficit)	**(434.0)**	**(715.0)**	**(329.9)**	**1,957.7**	**612.9**	**(370.4)**	**(1282.1)**	**(3647.3)**
Financing	**434.0**	**715.0**	**329.9**	**(1957.7)**	**(612.9)**	**370.4**	**1282.1**	**3647.3**
Foreign	75.2	220.0	211.5	140.2	413.1	(154.1	12.6	357.5
Gross Borrowing	182.8	349.1	383.1	323.4	257.8	236.5	289.4	712.5
Amortization	(107.5)	(129.1)	(171.6)	(183.2)	155.3	(390.7)	(276.8)	(355.0)
Domestic	358.8	495.1	118.4	(2097.9)	(1026.0)	524.6	1,269.5	3,289.8
Capital Invest. Facility								
Monetary Authorities	(179.5)	(59.3)	(705.4)	(1026.7)	(1768.6)	(1823.4)	--	--
Banks	115.0	36.7	(85.8)	48.4	(123.9)	(272.2)	--	--
Other	423.3	517.7	909.6	(1119.7)	866.5	2,620.1	--	--

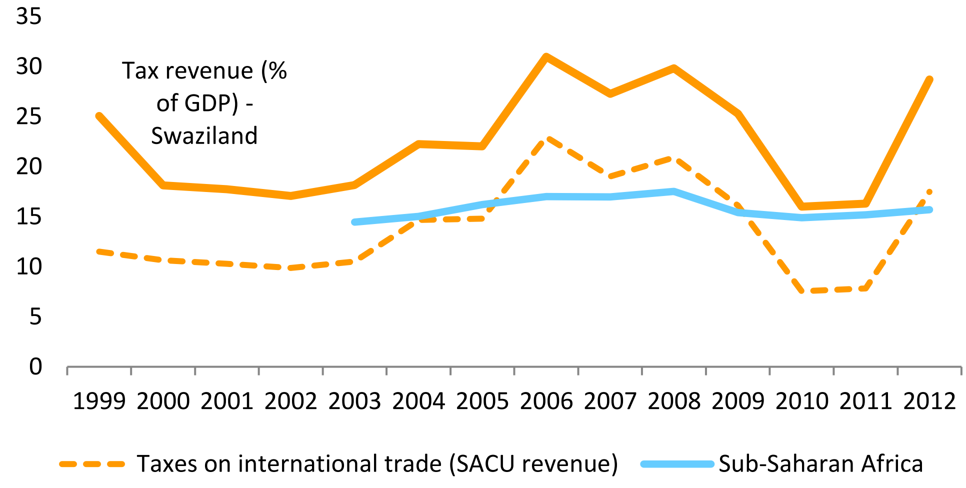
Source: Ministry of Finance
Note: 2009/10 estimated outturn, 2010/11Budget
-- not available

Figure 2. Fiscal developments



In 2010/11 financial year, total tax revenue collected amounted to E 5,574.4 million, representing 72 percent of Swaziland government's operating revenue and about 40 percent of her Gross Domestic Product. Indeed, the tax effort, as measured by the ratio of tax revenue to GDP (at over 44% for the past decades) are far above average for Sub-Saharan Africa (Figure 3). Swaziland relies on international trade taxes (import duties and excise/ sales tax on imports), which account for over 70 percent of total government revenue.

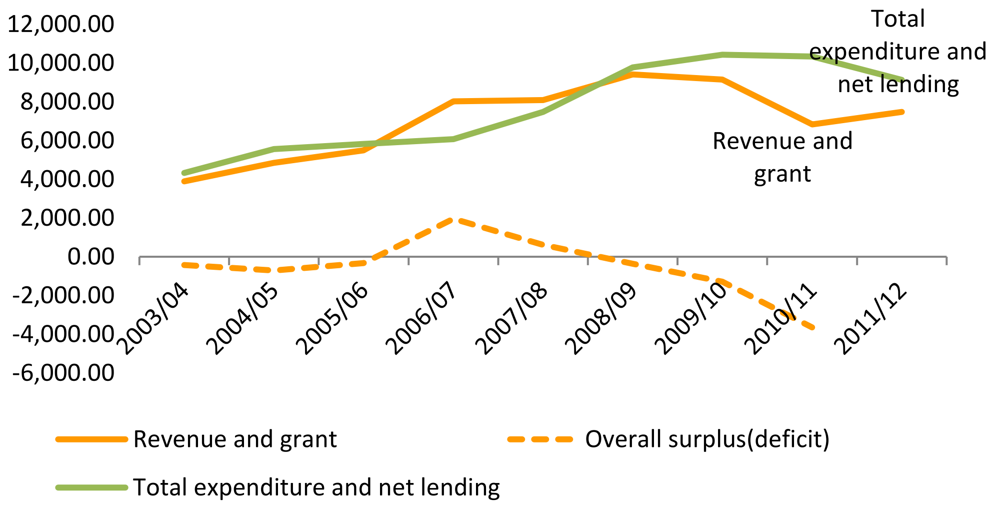
Figure 3. Swaziland's tax effort



Source: World Bank

Over 80 percent of the import revenue comes from SACU Customs Union receipts. Overall, SACU revenue account for about 60 percent of total government revenue.

Figure 4. Government spending, revenue, and budget balance



Source: Ministry of Finance

2.2.2 Fiscal sustainbility

Central Government debt is expected to increase from 15 percent of GDP at end 2011/12 to 20 percent by end of 2016. The country's escalating budget deficit of 14.3 percent of gross domestic product (GDP) for fiscal year 2010/11 that ended March 31, 2011 and deteriorating debt following a fall in SACU revenue has tested the resilience of

Swaziland's fiscal policy. With the reduction in government revenue, and a continuation of current spending, it will be difficult to finance growing deficit (above 10 percent of GDP in 2016) from the domestic resources without resorting to domestic borrowing and stockpiling debt —compromising private sector growth.

Real GDP growth in 2010 was about 2 percent, while inflation was at 4.5 percent. Real GDP per capita contracted by 2.4 percent in the year to March 2009 and grew at 0.1 percent in the year to March 2010. Consumption has increased steadily over the years and is above 85 percent of GDP. Domestic savings remains low and the country can barely sustain a deficit without breaching reserve requirements. Investment has been on declining trend (in real terms from 20.1 percent of GDP in 2002 to 11.4 percent in 2008 and 10.6 percent in 2009).

The budget deficit, estimated at about 14.3 percent of GDP (in 2011) is one of the highest in Sub-Saharan Africa. The large fiscal deficit, which is always financed by domestic borrowing, government deposits at the central bank, and an accumulation of domestic payment arrears amounting to over E 1 billion, annually, is holding the economy hostage and stands on the way of building a vibrant private sector. It is also largely responsible for the growing public debt now standing at about 50 percent of GDP. Although some relief has been provided through the Highly Indebted Poor Countries (HIPC) initiative, the requirements of debt servicing continue to direct investment away from essential social programmes.

Recent experiences with sovereign debt crisis in Europe has reawakened the world to the reality of how fiscal insolvency can destabilise an economy and put at risk the development of a country. Following on from Greece in 2010, to Ireland and Portugal in late-2010 and early-2011, and to Spain and Italy, the domino contagion in Europe continued with significant impact on growth of its economies.[5] Greece, Ireland, and Portugal all had to adopt fiscal austerity measures, in exchange for financial assistance from the IMF. Greece's budget deficit (primary deficit)—excluding interest payments, thus reflecting the underlying fiscal policy stance—stood at 10.1 percent of GDP in 2009.

In October 2009, the newly elected government announced that the Greek deficit statistics had been underreported. The actual size of the budget deficits was much larger than previously thought. High levels of public debt at 126.8 percent of GDP in 2009 and 142 percent in 2010 twiggered a market response that caused the interest rate on Greek bonds

[5] Ireland's fiscal situation became serious when the Irish government decided to rescue their failing banking system, so the origin of Irish crisis was different from that in Greece.

to rise considerably. This was the beginning of the protracted Euro zone sovereign debt crisis. Greece was forced into fiscal adjustment by the market being unwilling to continue to finance a string of deficits. The first rescue package of May 2010 turned out to be insufficient leading to a second rescue package in May 2011, which included a requirement that public debt be reduced to prudent levels. Tough austerity measures and tax increases led to incredible suffering in amongst the Greek population.

In the case of Swaziland, reducing Government expenditure and over-dependence on SACU receipts through increased collections from direct taxes on income and profits, and indirect taxes on goods and services still remains a crucial strategy for the country going forward. In the IMF's baseline scenario, this kind of fiscal crisis leads to significant spending cuts. If left unaddressed for too long, an increase in the structural budget deficit of this size would see the burden of government debt and interest payments increase to unsustainable levels.

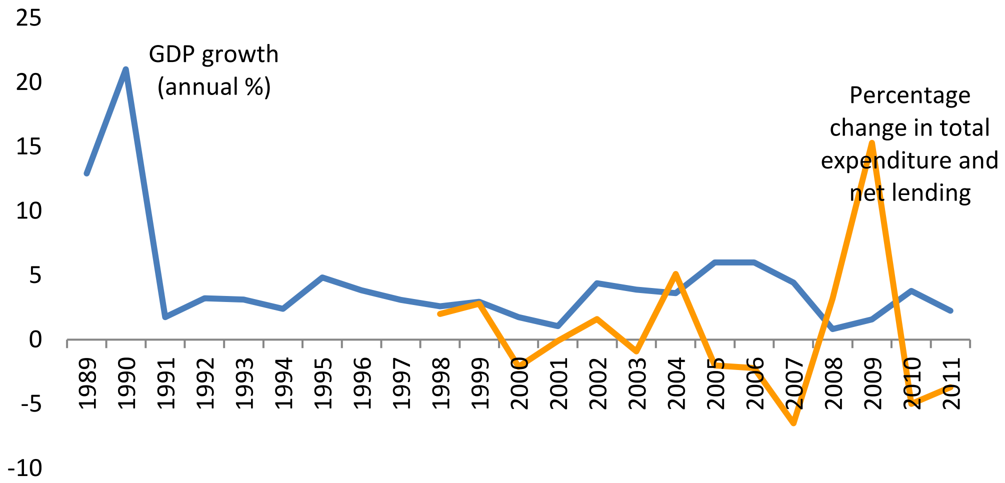
In response, Government has embarked on a fiscal adjustment measures that intend to align the fiscal deficit with available financing. Government is pursuing some form of austerity, aimed at reducing the fiscal deficit, restoring economic growth, creating more jobs, improving the quality and efficiency of public spending and to effectively tackle corruption, but actual implementation has been slow.

During the 2003 Asia crisis, Indonesia enacted the State Financial Law and Government Regulation no. 23/2003 which imposes a limit on fiscal spending. Are we likely to see the same framework for ensuring fiscal sustainability in Swaziland? The Indonesia numerical ceilings of 3 percent of GDP for the fiscal deficit and 60 percent of GDP for public debt were replicated from the Maastricht Treaty of the European Union. Perhaps it would pay off to introduce a similar law that imposes fiscal discipline in Swaziland. In any case, the government will need to strengthen public resource management engaging in consolidated efforts to improve the quality of spending and to direct resources to critical social services, including investment in human capital and infrastructure development order to foster economic growth.

2.3 Does public spending follow economic cycle?

During the booms of the late 1980s, the ratio of total expenditure to national income fell. During years of low economic growth of the late-1990s and during the global financial cris (2008 – 2009), total public expenditure rose as a share of national income (Figure 5). However, the increase in total expenditure as a share of national income between 2005 and 2007 occurred during relatively strong economic conditions. This increase reflects a structural increase in public spending, which does not reflect economic cycles.

Figure 5. Economic growth and changes in government expenditure



To ensure a return to robust and sustainable economic growth; able to tackle the problem of unemployment and poverty, the policy focus should be on revenue mobilization (especially increasing the country's reliance on direct taxes on income and profits and indirect taxes on goods and services) while encouraging a continued recovery in external trade, as well as foreign direct investment (FDI) inflows, including increases in remittances from the Swazis living abroad.

However, the structure of the economy and poverty level impose a challenge to revenue mobilisation. By most social indicators, Swaziland remains one of the poorest countries in the world. Over 60 percent of the population lives in poverty, and close to 70 percent of the youth population is unemployed. An estimated 25 percent of the adult population is living with HIV, and the average life expectancy at birth is by far, the lowest in the world. Moreover, one-quarter of children who enroll in primary school drop out of school before the end of Grade 7. Over 70 percent of Swazis live in rural areas and are engaged in subsistence agriculture, but the question of land use and ownership remains a very sensitive one. Most of the high-level economic activity is in the hands of non-Africans. Nearly 60 percent of Swazi territory is held by the Crown in trust of the Swazi nation. The remaining 40 percent is privately owned, much of it by foreigners.

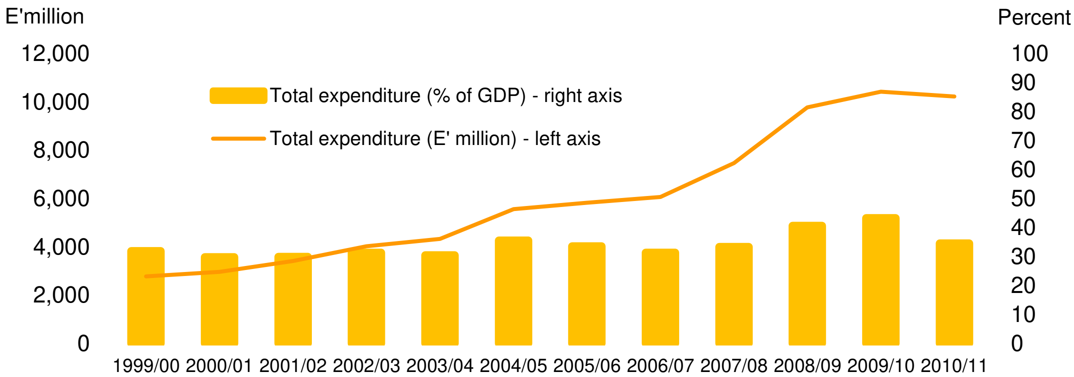
3 Public expenditure

This chapter follows on from the previous discussion, which argues that the fiscal crisis in Swaziland is a result of two areas of tolerance: the collapse of the fiscal discipline and external dependency (i.e. over reliance on SACU revenue and primary commodity exports). This chapter explores the first area of tolerance: the collapse of fiscal discipline within the overall context of public expenditure, and provides clues into Government's priorities and commitment to key sectors vis-à-vis other sectors over the years. Public expenditure is analysed at two levels: at aggregate macro level, and inter-sector level, and in some cases, maintaining a distinction between recurrent and capital expenditure. Trends in expenditure are examined along side government revenue. The recurrent budgets are examined and the proportion of recurrent budget going to different sectors are analysed.

3.1 Aggregate level of government spending

Figure 6 shows the trend in aggregate level of government spending – total expenditures by the entire public sector – the central government, local governments, local authorities, autonomous institutions and public corporations – in value terms and as a share of national income since 1999–2000.

Figure 6. Trend in government expenditure, 199/200 – 2010/11



Source: Ministry of Finance

As Figure 6 shows, total public expenditure has grown relatively steadily in real terms, from E2.77billion (32 percent of GDP) in 1999/2000 to E10.4 billion (43.3 percent of

GDP) in 2010/11–- which translates into about E8,350 for every person in Swaziland. Between 1999/2000 and 2010/11, the average annual real increase in total expenditure has been 13 per cent (peaking at 30 percent in 2009/10), ten-times faster than the national income—driven primarily by spending on wages and salaries and debt interest payments. By 2013, public expenditure is expected to stablise at about 30 per cent of GDP and remains at this level over the medium term when the economy returns to normal growth—assuming a recovery of exports and commodity prices.

3.2 Composition of public expenditure

Government expenditure is divided into recurrent and capital expenditure (Table 2), controlled by the Treasury Department of the Ministry of Finance. Government expenditure, including external development budget averaged 33.3 percent of GDP over the 1992/93–2010/11 period, while total revenue including grants averaged 31.7 percent of GDP during the same period.

Table 2. Government expenditure (recurrent and capital), 2003/4 – 2010/11

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
	(E'Million)							
Statutory expenditure*								318,607
Recurrent expenditure	3,457.7	4,295.8	4,416.3	4,681.3	5,522.2	7,308.2	8,465.1	8,146,487
Capital expenditure	867.1	1,258.7	1,409.7	1,436.6	1,950.4	2,472.1	2,470.3	2,470,263
Total expenditure	4,324.8	5554.5	5826	6117.9	7,472.6	9,780.33	10,935.40	10,935,357
Total revenue & grants	3,890.7	4,842.3	5,499.1	8,020.4	8,085.5	9,409.9	9,642.0	6,944,930
Overall surplus/ (deficit)	(434.0)	(715.0)	(329.9)	1,957.7	612.9	(370.4)	(1,293.3)	(3,990,427)
Financing	434.0	715.0	329.9	(1,957.7)	(612.9)	370.4	1,293.3	3,990,427
Foreign			211.5	140.2	413.1	(154.2)	(58.2)	(54.3)
Gross borrowing			383.1	323.4	257.8	236.5	289.4	289.4
Amortisation			(171.6)	(183.2)	155.3	(390.7)	(347.6)	(343.8)
Domestic			118.4	(2,097.9)	(1,026.0)	524.6	1,351.5	4,044.8
	as share of GDP (PERCENT)							
Overall balance	-3.5	-5.3	-2.5	9.3	6.1	-0.8	-7.6	-9.5
Financing	2.9	4.6	1.5	-10.5	-6.4	0.2	7.1	10.3
Foreign	0.5	1.6	1.2	-5.8	-3.6	-0.4	5.6	2.0
Domestic	2.3	2.9	0.3	-4.7	-6.9	0.6	1.5	8.3

***Source:** Ministry of Finance*
Note: *Exclusing redemption of foreign loan, /2 excluding grants. The fiscal year runs from April 1 to March 31

Recurrent expenditure accounted for 69 percent of total expenditure in 2009/10 fiscal year (capital expenditure accounted for 27 percent and statutory expenditure for 4 percent). Table 2 shows how the expenditures are financed. Discretionary resources available to Government include domestic revenue and external assistance, minus debt service payment. However, volatility has characterised both domestic revenues and donor support (grants), thus complicating management of the budget. The budget deficit (excluding grants) rose from 3.6 percent of GDP in 1992/93 to 14.3 percent of GDP in 2010/11 (Table 2), financed through foreign aid inflows and domestic borrowing, and by drawing down on the reserves. Foreign inflows as percentage of GDP ranged between 2–6 percent. One challenge arising from this is the increase in the stock of external debt, which as a percentage of GDP, stood at 19.5 percent in 2002/03 before receeding to 9 percent in 2011/12.

3.2.1 Inter-sectoral expenditure allocations

Table 3 breaks down the real expenditure into various functional components—the proportion of the government spending going to different sectors of the economy.

Table 3. Sectoral composition of public expenditure

	2003/4	**2004/5**	**2005/6**	**2006/7**	**2007/8**	**2008/9**	**2009/10**	**2010/11**
	(in million emalangeni)							
General public service	2,049.80	2,471.80	2,674.60	2,964.00	3,199.40	4,026.00	4,814.90	4,399.20
General administration	1,419.30	1,627.70	1,918.40	2,138.10	2,330.30	2,900.50	3,049.80	2,733.40
Public order, safety & defence	630.5	844.1	756.2	825.9	869.1	1125.3	1765.1	1665.8
Social services	1,230.90	1,858.30	1,920.40	1,868.50	2,393.60	2,869.00	3,166.20	3,979.60
Education	751	1119.2	1174.1	1176.4	1556.2	1836.4	1732.8	2050.1
Health	367	441.9	422.8	413.8	596.5	812.1	922.1	1282.7
Other community & social services	112.9	297.1	323.4	278.3	240.9	220.6	511.4	646.8
Economic services	875.2	1009.6	977.3	1121.7	1696.1	2619.9	2716.2	2313.3
Agriculture	221.4	244.3	247.9	265	423.4	849.4	825.1	536
Industry & mining	67.6	79.9	90.5	81.5	46	341.3	384.3	373
Transport & communications	476.4	588.7	485.5	537.4	979.8	1088.9	1264.6	1072.5
Other	109.6	96.7	153.4	237.9	247	340.3	242.2	331.9
Public debt interest	168.9	214.8	253.8	163.8	183.6	265.5	238.2	243.4
Total	4,324.8	5,554.5	5,826.0	6,117.9	7,472.6	9,780.3	10,935.4	10,935.4
	(as a share of total govt expenditure, %)							
General public service	47.40	44.50	45.91	48.45	42.82	41.16	44.03	40.23
General administration	32.82	29.30	32.93	34.95	31.18	29.66	27.89	25.00
Public order, safety & defence	14.58	15.20	12.98	13.50	11.63	11.51	16.14	15.23
Social services	28.46	33.46	32.96	30.54	32.03	29.33	28.95	36.39
Education	17.36	20.15	20.15	19.23	20.83	18.78	15.85	18.75
Health	8.49	7.96	7.26	6.76	7.98	8.30	8.43	11.73
Other community & social Services	2.61	5.35	5.55	4.55	3.22	2.26	4.68	5.91
Economic services	20.24	18.18	16.77	18.33	22.70	26.79	24.84	21.15
Agriculture	5.12	4.40	4.26	4.33	5.67	8.68	7.55	4.90
Industry & mining	1.56	1.44	1.55	1.33	0.62	3.49	3.51	3.41
Transport & communica-	11.02	10.60	8.33	8.78	13.11	11.13	11.56	9.81
Other	2.53	1.74	2.63	3.89	3.31	3.48	2.21	3.04
Public debt interest	3.91	3.87	4.36	2.68	2.46	2.71	2.18	2.23

Source: *Ministry of Finance and IMF*

The Government's strategy, "Ingcamu" (adopted in 2008/09) and the Poverty Reduction Strategy and Action Plan (the PRSAP) prioritises public action across various sectors to meet the objective of poverty eradication and identifies key sectors that are given priority in resource allocation—priority ares are: basic health care and education, which have received, on average, 19 percent and 8.4 percent of the government budgetary resources annually over the last eight years. These are also the sectors that are protected from budget cuts. Other priority areas include agriculture and roads maintenance. However, public administration remains by far the biggest spenders of public resources.

Generally, the increases in government expenditure have not been directed towards growth enhancing/stimulating activities, but more towards consumption as revealed by the share of resources going to public administration vis-a-vis education and economic services. Public administration—particularly spending on wage bills continues to be an obstacle—crowding-out spending in other priority programme areas such as infrastructure investment. The Minister of Finance admitted this in the 2004 budget speech that, the public spending steered public consumption by approximately 40 percent in nominal terms at the expense of capital formation. He repeated this concern in subsequent budget speeches. Table 4 shows the growth in public expenditure by functional areas, which shows slow growth of resources to eduction relative to other sectors.

Table 4. Growth in public expenditure by sector (PERCENT)

	2003/4	**2004/5**	**2005/6**	**2006/7**	**2007/8**	**2008/9**	**2009/10**	**2010/11**	**2003—2011 average**
General public service	42.25	20.59	8.20	10.82	7.94	25.84	19.60	-8.63	15.8
General administration	64.58	14.68	17.86	11.45	8.99	24.47	5.15	-10.37	17.1
Public order, safety & defence	8.97	33.88	-10.41	9.22	5.23	29.48	56.86	-5.63	15.9
Social services	-0.92	50.97	3.34	-2.70	28.10	19.86	10.36	25.69	16.8
Education	-8.24	49.03	4.91	0.20	32.28	18.01	-5.64	18.31	13.6
Health	64.72	20.41	-4.32	-2.13	44.15	36.14	13.55	39.11	26.5
Other community & social services	-43.83	163.15	8.85	-13.95	-13.44	-8.43	131.82	26.48	31.3
Economic services	2.33	15.36	-3.20	14.78	51.21	54.47	3.68	-14.83	15.5
Agriculture	45.28	10.34	1.47	6.90	59.77	100.61	-2.86	-35.04	23.3
Industry & mining	30.75	18.20	13.27	-9.94	-43.56	641.96	12.60	-2.94	82.5
Transport & communications	-6.70	23.57	-17.53	10.69	82.32	11.13	16.14	-15.19	13.1
Other	-22.05	-11.77	58.63	55.08	3.83	37.77	-28.83	37.04	16.2
Public debt interest	-64.78	27.18	18.16	-35.46	12.09	44.61	-10.28	2.18	-0.8
Total	7.63	28.43	4.89	5.01	22.14	30.88	11.81	0.00	13.8

Source: Author's calculations, based on data from *Ministry of Finance*

3.2.2 Recurrent expenditures

Recurrent component of the public expenditure is distributed between wage – and non-wage payments, after taking out non-discretionary expenditures on interest payments on public debt and other statutory expenditures. As Table 5 shows, public administration represents the largest share of government recurrent expenditure, with wage bill being the largest single expenditure item over the last eight years or so. Estimated at 52 percent of the recurrent expenditure (18 percent of GDP) in FY2010/11 (Table 6), public wage bill is way beyond the conventional benchmark of 35 percent, and tend to deprive investment in the real sector—much needed to stimulate economic growth.

Table 5. Functional composition of central government recurrent expenditure

	2003/4	**2004/5**	**2005/6**	**2006/7**	**2007/8**	**2008/9**	**2009/10**	**2010/11**
	(in million emalangeni)							
General public service	1,773.3	2,017.3	2,156.2	2,544.5	2,570.3	3,398.1	4,120.5	**3,606.8**
General administration	1,192.2	1,254.5	1,503.7	1,802.3	1,824.5	2,431.0	2,561.5	2,126.2
Public order, safety & defence	581.1	762.8	652.6	742.2	745.9	967.1	1,559.0	1,480.6
Social services	1,071.6	1,540.8	1,568.6	1,572.9	2,147.9	2,580.3	2,810.2	**3,418.0**
Education	718.4	1,083.6	1,146.7	1,143.5	1,500.3	1,720.5	1,619.3	1,867.8
Health	311.3	348.1	311.3	318.4	530.8	705.4	785.5	1,030.9
Other community & social services	41.9	109.0	110.5	111.0	116.8	154.4	405.4	519.3
Economic services	443.9	522.9	437.7	400.2	620.4	1,064.4	1,296.3	1,197.0
Agriculture	171.0	184.1	160.1	142.8	275.1	333.7	265.6	263.4
Industry & mining	62.4	69.9	62.4	54.4	20.2	246.3	243.9	171.6
Transport & communications	168.2	226.7	168.0	156.3	234.2	321.7	573.3	465.2
Other	42.2	42.2	47.1	46.7	91.0	162.7	213.5	296.8
Public debt interest	168.9	214.8	253.8	163.8	183.6	265.5	238.2	243.4
Total	3,457.7	4,295.8	4,416.3	4,681.3	5,522.2	7,308.2	8,465.1	8,465.1

Table 6. Swaziland's central government recurrent expenditure

	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2003–2011 average
	(as share of total recurrent expenditure)								
General public service	51.29	46.96	48.82	54.35	46.54	46.50	48.68	42.61	48.22
General administration	34.48	29.20	34.05	38.50	33.04	33.26	30.26	25.12	32.24
Public order, safety & defence	16.81	17.76	14.78	15.85	13.51	13.23	18.42	17.49	15.98
Social services	30.99	35.87	35.52	33.60	38.90	35.31	33.20	40.38	35.47
Education	20.78	25.22	25.97	24.43	27.17	23.54	19.13	22.06	23.54
Health	9.00	8.10	7.05	6.80	9.61	9.65	9.28	12.18	8.96
Other community & social services	1.21	2.54	2.50	2.37	2.12	2.11	4.79	6.13	2.97
Economic services	12.84	12.17	9.91	8.55	11.23	14.56	15.31	14.14	12.34
Agriculture	4.95	4.29	3.63	3.05	4.98	4.57	3.14	3.11	3.96
Industry & mining	1.80	1.63	1.41	1.16	0.37	3.37	2.88	2.03	1.83
Transport & communi cations	4.86	5.28	3.80	3.34	4.24	4.40	6.77	5.50	4.77
Other	1.22	0.98	1.07	1.00	1.65	2.23	2.52	3.51	1.77
Public debt interest	4.88	5.00	5.75	3.50	3.32	3.63	2.81	2.88	3.97
Wages and salaries	48.6	45.7	55.3	55.3	52.7	53.7	52.2	52.2	52.0
	(as share of GDP)								
Recurrent expenditure	24.3	27.4	25.7	25.1	24.8	30.7	34.1	30.3	27.8
Wages and salaries	11.8	12.5	14.2	13.9	13.1	16.5	17.3	18.5	14.7
Goods and services	7.1	9.1	5.8	6.4	6.4	6.7	9.2	6.4	7.1
Subsides and transfers	4.2	4.7	4.6	3.9	4.3	6.5	6.8	4.7	5.0
Interest	1.2	1.1	1.1	0.9	1.0	1.0	0.8	0.8	1.0

Source: Ministry of Finance and IMF staff estimates

Prior to 2008/09 (since early-1990s), the wage bill was kept within the range of 11–13 percent of GDP. The sudden rise to 17 percent in 2009/10 was driven by salary increases of July 2009 (averaging 12%)—across-the-board. In April 2010, government awarded civil servants and politicians additional wage increase of 4.5 percent (even though it was not budgeted for)—driving public wage bill to 18.5 percent of GDP. As IMF corrected noted, these wage increases cast some doubt on the government's commitment to containing costs, given a request by the Minister of Finance for an additional supplementary budget of SZL 48 million, above the SZL 247 million supplementary budget, tabled earlier to finance the wage increases.

The NPV of the change in personnel spending, 2008–11, is over 150 percent of GDP, the highest in Sub-Saharan Africa. Most Sub-Saharan countries have this figure contained within the range of 30 to 80 percent of GDP (although still high by international standard).

Government priorities as reaffirmed in the 2010/2011 budget are to increase resources to education and health sector (in line with the international declarations as these sectors have an impact on the overall economic growth and development of the country), create more jobs, improve the quality and efficiency of public spending and effectively tackle corruption.

3.2.3 Capital expenditures

Capital expenditure increased from E0.3 billion in 1995/96 (6 percent of GDP) to over E2.4 billion (9 percent of GDP) in 2010/11. In 2009/10, capital expenditure accounted for accounted for 27 percent of total government spending (and recurrent expenditure 69 percent. Statutory expenditure accounted for the remaining 4 percent).

Table 7 indicates that much of capital investment is in infrastructure projects (classified under transport and communication), accounting for over 25 percent of total capital expenditure. Government plans to invest SZL 410.4 million in completing an international airport by 2010/11. Plans are also underway to complete the link road between Mbadlane and Sikhuphe and upgrade the Manzini-Mbadlane road. Another E110 million has been earmarked for investment in the country's road network as part of a Medium Term Budget Policy Statement (MTBPS). Other major public works programmes include completion of the Mbabane by-pass road, rehabilitation of the Swaziland Broadcasting and Information (SBIS) building, the Hlathikulu Hospital, and construction of water treatment plants for Siteki-Lomahasha and Nhlangano.

Table 7. **Swaziland's central government capital expenditure**

	2003/4	**2004/5**	**2005/6**	**2006/7**	**2007/8**	**2008/9**	**2009/10**	**2010/11**
	(E'Million)							
General public service	276.5	454.5	518.4	419.5	629.1	627.9	694.4	792.4
General administration	227.1	373.2	414.7	335.8	505.8	469.5	488.3	607.2
Public order, safety & defence	49.4	81.3	103.6	83.7	123.2	158.2	206.1	185.2
Social services	159.3	317.5	351.8	295.6	245.7	288.7	356.0	561.6
Education	32.6	35.6	27.4	32.9	55.9	115.9	113.5	182.3
Health	55.7	93.8	111.5	95.4	65.7	106.7	136.6	251.8
Other community /social services	71.0	188.1	212.9	167.3	124.1	66.2	106.0	127.5
Economic services	431.3	486.7	539.6	721.5	1,075.7	1,555.5	1,419.9	1,116.3
Agriculture	50.4	60.2	87.8	122.2	148.3	515.7	559.5	272.6
Industry & mining	5.2	10.0	28.1	27.1	25.8	95.0	140.4	201.4
Transport & communications	308.2	362.0	317.5	381.1	745.6	767.2	691.3	607.3
Other	67.4	54.5	106.3	191.2	156.0	177.6	28.7	35.1
Total	867.1	1,258.7	1,409.7	1,436.6	1,950.4	2,472.1	2,470.3	2,470.3
	As percent of capital expenditure							
General public service	31.9	36.1	36.8	29.2	32.3	25.4	28.1	32.1
General administration	26.2	29.6	29.4	23.4	25.9	19.0	19.8	24.6
Public order, safety & defence	5.7	6.5	7.3	5.8	6.3	6.4	8.3	7.5
Social services	18.4	25.2	25.0	20.6	12.6	11.7	14.4	22.7
Education	3.8	2.8	1.9	2.3	2.9	4.7	4.6	7.4
Health	6.4	7.5	7.9	6.6	3.4	4.3	5.5	10.2
Other community/social services	8.2	14.9	15.1	11.6	6.4	2.7	4.3	5.2
Economic services	49.7	38.7	38.3	50.2	55.2	62.9	57.5	45.2
Agriculture	5.8	4.8	6.2	8.5	7.6	20.9	22.6	11.0
Industry & mining	0.6	0.8	2.0	1.9	1.3	3.8	5.7	8.2
Transport & communications	35.5	28.8	22.5	26.5	38.2	31.0	28.0	24.6
Other	7.8	4.3	7.5	13.3	8.0	7.2	1.2	1.4
	In GDP (PERCENT)							
Capital expenditure						10.4	10.4	8.8

Source: Ministry of Finance

Note: 2009/10 estimated outturn, 2010/11Budget

Another ongoing project is the construction of the Sicunusa-Nhlangano Road and the Lubombo Regional Hospital, which began in 2010. The challenge, however, is that money allocated to capital projects is often under-utilised. The second challenge is how to maintain control on recurrent spending to enable government to increase spending on capital projects. Another challenge is how to deal with corruption. Some individuals connive with government officials to inflate contracts or even making government pay for services that were never provided in the first place. Corruption is prevalent in supply of goods and services as well as construction projects. It is estimated that government loses more than E40 million per month due to corruption.

3.2.4 External financing instruments and donor participation

Swaziland is projected to continue to rely on donor support in order to finance its projected current account deficit. In 2011/12 net donor support amounts to 9.4 percent of GDP, with grants constituting approximately 8.4 percent of GDP. Project grants included in the budget are estimated to increase from E207 million in 2011/12 to E376 million in 2012/13. The development partners include China (the Taiwanese Government) and the EU who have increased their assistance for the implementation of a number of projects. The EU funding is supporting interventions in sectors such as agriculture, water, governance, health, and education, while the Taiwanese Government is supporting infrastructure projects. The UN is providing funds for health, gender programmes, statistics and poverty reduction initiatives, while PEPFAR and Global Fund remain the Swazi vital partners in the fight against HIV/AIDS.

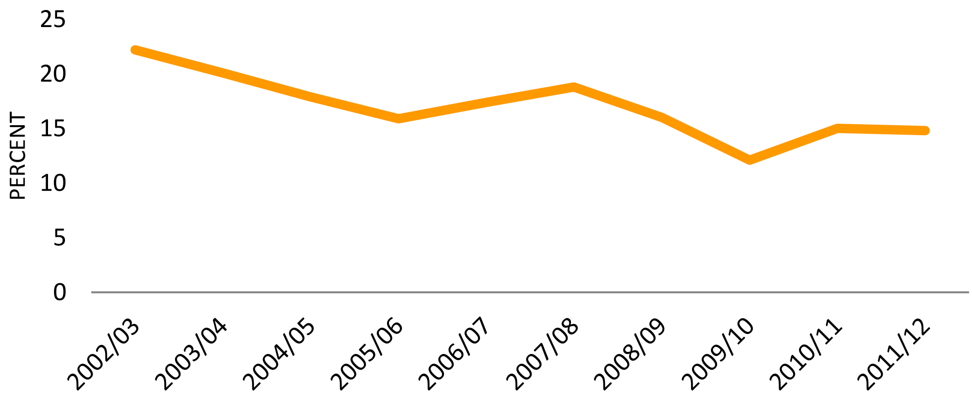
4 Swaziland's sovereign debt

This chapter provides insights into Swaziland's public debt, viz: trends in stock of debt over the years, legislative framework (instruments), as well as how these loans are planned, sanctioned, executed, and documented. To think that a nominal size of a country's stock of debt does not matter as long as it is kept within a range proportional to the country's GDP is being over simplistic.

4.1 Stock of public debt

In the past, Swaziland followed an expansionary fiscal policy which resulted in a sizable buildup of public debt, but this is being reversed with downward trend in debt to GDP ratios (Figure 7). Figure 7 shows how the stock of public debt has evolved over the recent decade by 7.4 percentage point of GDP between 2002/03 and 2011/12.

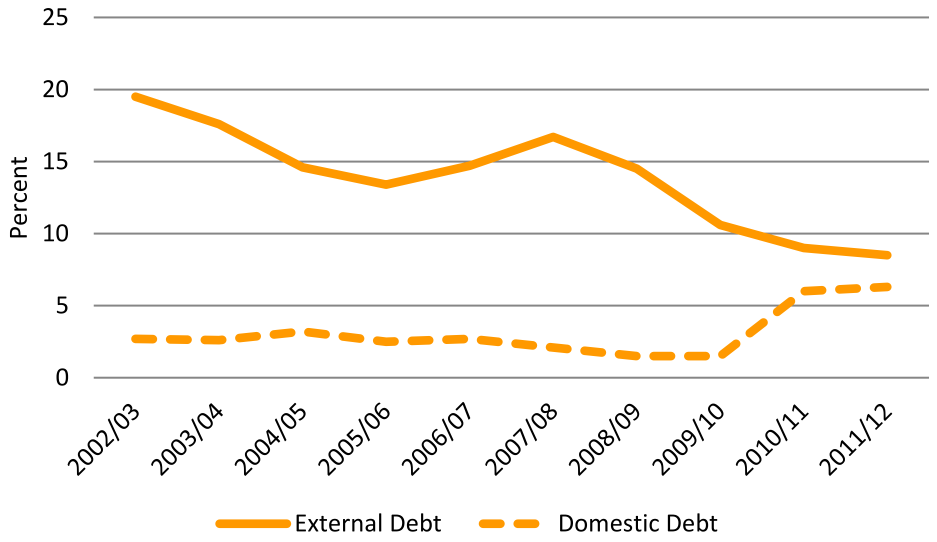
Figure 7. Swaziland's public debt as percent of GDP



Source: IMF and Ministry of Finance

Despite recent increased aid flows from E126.9 million in 2003/04 to E499.4 million in 2010/11, the proportion of the government budget financed by external aid stood at 5 percent of GDP in 2010/11. Figure 8 shows the trends in stock of public debt, distinguished between external and domestic debt over the last ten years. While the trend reveals downward trajectory for external debt, it has happened at the expense of increased domesic borrowing especially from 2009/10 (Figure 8).

Figure 8. Composition of public debt



4.1.1 Stock of external debt

Total external debt stock including private sector nonguaranteed debt stood at E3.164 billion (20 percent of GDP) at the end of March 2010, down from E3.995 billion as at the end of March 2009 (denoting a decrease of 20.8 percent), and E4.1 billion (26.1 percent of GDP) as at 31st December 2004, and E4.4 billion as at 31st December 2003. The appreciation of the emalangeni against major currencies in which most of the external debt was denominated helped to reduce the stock of government debt by 20.8 percent in 2010. There has been an effort by government to negotiate with international financial institutions to provide Rand denominated loans as a way to minimise exposure to foreign exchange risk.

The external debt, which constitutes the largest share of public debt, amounted to E2.694 billion at the end of March 2010, down from E3.443 billion at the end of March 2009. Public external debt (including guarantees to parastatals) decreased from E3.605 billion to E2.812 billion in 2009. Private sector non-guaranteed debt stood at E351 million in 2010 from E392 million in 2009. Total external debt (including private sector non-guaranteed debt) decreased from E3.98 billion in September 2008 to E3.39 billion in September 2009, as two loans from the German government to construct the Mnjoli dam and Mpaka-Siteki Road matured. The appreciation of the lilangeni against the US dollar also helped improve Swaziland's external liabilities. However, the fall in external debt has not changed the overall debt picture as government resorted to domestic borrowing, with share of domestic debt as percent of total debt increasing from 9.7 percent (E0.3877 billion) in 2008/09 to 43 percent (E1.9213 billion) in 2011/12 (Figure 9).

Figure 9. External and domestic debt as percent of total debt

Source: IMF and Ministry of Finance

Most of the outstanding external debt by March 2011 was owed to multilateral creditor organizations, with the AfDB Group being the major creditor accounting for 36.4 percent of total debt stock. Other major multilateral creditors included EIB, IBRD and IFAD. Major bilateral creditors were the Governments of Germany, Japan, Kuwait, RSA and Republic of China (Taiwan), and the private creditors, which formed the minority of lenders, are DBSA, Gensec, Hambros and RMB. Table 9 shows the institutional composition of external debt.

Table 8 Swaziland's public debt indicators

	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12
		(E' Million)							
Total debt						3,992.6	3,203.4	4,250.7	4,480.2
External Debt		2,581.9	2,747.8	3,202.8	3,969.3	3,604.9	2,812.5	2,552.9	2,558.9
Domestic debt						387.7	391.0	1,697.8	1,921.3
		As percent of total debt							
External Debt						90.3	87.8	60.1	57.1
Domestic debt						9.7	12.2	39.9	42.9
		As percent of GDP							
Total debt	20.1	17.9	15.9	17.4	18.8	16.0	12.1	15.0	14.8
External Debt	17.6	14.6	13.4	14.7	16.7	14.5	10.6	9.0	8.5
Domestic debt	2.6	3.2	2.5	2.7	2.1	1.5	1.5	6.0	6.3
Debt Service:									
(1) as percent of GDP		1.1	2.2	1.5	1.4	3.3	2.3	1.9	1.5
(2) as % of export of goods & services		1.4	3.2	2.4	2.2	5.0	3.5	3.0	2.4
Exchange rates:									
SZL/USD				7.2645	8.1438	9.6400	7.3500	6.7838	7.6925

Source: *Ministry of Finance and Central Bank of Swaziland*

In 2009/10, the Swaziland Government signed for three new loans totalling E358.9 million with Kuwait, the OPEC Fund and the Arab Bank for Economic Development in Africa (BADEA) for the construction of the Nhlangano-Sicunusa and Mbadlane-Sikhuphe roads, which increased the government's debt stock that by in June 2009 stood at 15.7 percent of GDP.

Table 9 Institutional composition of external debt stock (E' Million)

	2004/5	**2005/6**	**2006/7**	**2007/8**	**2008/9**	**2009/10**	**2010/11**	**2011/12**
International Organizations	1,241.7	1,387.8	1,676.7	2,059.1	2,184.9	1,663.0	1,461.9	1,419.3
Foreign Governments	703.7	560.3	649.8	996.6	1,035.2	811.9	806.8	875.2
Private Lenders	236.3	353.6	415.7	444.5	384.8	337.6	284.2	264.4
Total Public External Debt	2,181.7	2,301.7	2,742.3	3,500.1	3,604.9	2,812.5	**2,552.9**	**2,558.9**
o/w: Central Government	1,815.5	1,998.8	2,533.3	3,265.2	3,443.2	2,693.7	2,440.2	2,458.2
Statutory Bodies	366.2	302.9	208.9	234.9	161.7	118.7	112.7	100.7
Private non-guaranteed debt	400.2	446.1	460.5	469.2	390.1	351.3		

4.1.2 Domestic debt

From April 1, 2009 to March 31, 2010 upto 52 auctions of treasury bills amounting to E1.560 billion were put on offer—soliciting upto E2.774 billion in applications against a total of E1.4253 billion issued. Of these (total bills issued), E1.2271 billion went to local commercial banks, E83.1 million to other financial institutions and E115.1 million to individuals and private organizations. Total amount that was outstanding as at 31 March 2010 was E341 million.

Table 10. Public domestic debt, E'million

	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10
Government stocks and bills	455.61	507.34	426.87	509.38	439.99	387.71	390.98
Central Bank of Swaziland	60.00	50.00	80.00	59.19	0.08	8.02	0.00
Banks	331.71	387.36	288.78	406.02	413.83	347.36	335.02
Other	63.90	69.98	58.09	44.17	26.08	32.33	55.96

Source: *Ministry of Finance and Central Bank of Swaziland*

Table 11 Swaziland's public domestic debt

	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12
	(E' Million)							
Total public domestic debt:					387.7	391.0	1,697.8	1,921.3
Government stocks & bills	507.34	426.87	509.38	439.99	387.71	390.98		
Central Bank of Swaziland	50.00	80.00	59.19	0.08	8.0	0.0	59.2	59.3
Banks	387.36	288.78	406.02	413.83	347.4	355.0	1,109.5	1,239.6
Other	69.98	58.09	44.17	26.08	8.0	56.0	529.0	622.4
Public domestic debt:								
As percent of total debt					9.7	12.2	39.9	42.9
As percent of GDP	3.2	2.5	2.7	2.1	1.5	1.5	6.0	6.3

4.2 External debt service and practices

During the financial year 2009/10, total public external debt service amounted to E407.2 million, which is 19.1 percent below the 2008/09 figure. The decrease in debt service was driven by the appreciation of the local currency against the US dollar and other major currencies in which most of the external debt is denominated. The debt service constituted principal repayments amounting to E237.5 million whilst E169.7 million was directed to interest payments plus commitment fees on undisbursed funds.

4.2.1 External debt sustainability indicators

Swaziland's debt burden indicators remain below their policy-dependent thresholds according to IMF projections.[6] The NPV of debt-to-GDP ratio stood at 18.9 percent in

[6] Swazi policies and institutions rank as a "strong performer" according to the latest World Bank's Country Policy and Institutional Assessment (CPIA). Its policy-dependent debt burden thresholds are NPV of debt to GDP ratio of 50 percent, NPV of debt-to-exports ratio of 200 percent, NPV of debt to revenue ratio of 300 percent, debt service to exports ratio of 25 percent and debt service to revenue ratio of 35 percent.

2010, lying well below its policy-dependent threshold of 50 percent. It is projected to decline continuously thereafter, dropping below 12 percent by 2016.[7] Debt-service payments are still manageable, reflecting the delivery of HIPC assistance as well as the fact that most of Swaziland's debt has been contracted on concessional terms. Swaziland's debt service-to-exports ratio was 3 percent in 2010/11 and is projected to decline to 2 percent by 2015/16.

However, persistent shocks would worsen Swaziland's NPV of debt-to-exports ratio significantly. If exports were to grow less by one standard deviation in 2011/12, Swaziland's NPV of debt-to-exports ratio would jump up to over 19 percent in 2011/12. An export shock would have long lasting negative effects on Swaziland's debt dynamics, keeping the NPV of debt-to-exports ratio above 19 percent until 2016/17. However, Swaziland's NPV of debt-to-exports ratio would remain below its policy-dependent threshold when key macroeconomic variables are set at their historical average.

Imprudent debt management would worsen the country's NPV of debt-to-exports ratio significantly. If new borrowing were to be contracted on less concessional terms during the medium term, Swaziland's NPV of debt-to-exports ratio would increase substantially.

With regard to the prevailing debt ratios, the debt stock to exports of goods and services decreased to 21.4 percent from 27 percent the previous financial year. The debt stock to GDP ratio also fell to 14.2 percent from 17.9 percent recorded the previous financial year. The ratio of public debt service to exports of goods and services was estimated at 3.5 percent from 5 percent the previous financial year. All these ratios are still within acceptable levels. Although the external debt service ratio as a percentage of exports and of domestic revenues (about 3.5 percent) remains at levels well below critical benchmarks, the government is committed to maintaining public debt within levels that it can comfortably manage.

4.2.2 Soverign borrowing and debt management practices

The increase in public debt in recent years is a clear indication of the need for responsible sovereign borrowing and effective debt management practices to ensure future sustainability of public debt. How public debt is to be managed is enshrined in the Swazi constitution, with the detail in the Public Finance Act. There is also in place, a Public

[7] Similarly, the NPV of debt-to-revenue of 187 percent in 2004/05 is well below its policy-dependent threshold.

Debt Policy that is supposed to guide in the matters related to acquisition and management of public debt.

We examined the procedural practices associated three new loans that were contracted for specific projects during the financial year 2009/10 regarding their adherence to international best practices of internal approval, project due diligence, purpose. One loan amounting to USD8 million (equivalent E58.8 million) was contracted from BADEA for the construction of Nhlangano-Sicunusa Road. The loan was contracted on concessional terms attracting 2.5 percent interest and payable over a period of 22 years. The second loan, also contracted for the construction of Nhlangano-Sicunusa Road totalled to USD25 million, equivalent to E183.8 million. The loan was sourced from the OPEC Fund and is to be repaid over a period of 33 years attracting 3.5 percent interest. The last loan, amounting to KWD3.65 million (equivalent to E91.1 million) was contracted from the Government of Kuwait for the construction of Mbadlane-Sikhuphe Road. The loan was also contracted on concessional terms at an interest rate of 2.5 percent and payable over 21 years.

Evidence suggests that all the three loans were contracted with cabinet and legislative approval. The law of most countries requires legislative approval, sometimes given in advance in the form of "debt ceilings", for government borrowings although such ceilings can always be adjusted. In 2010, the Swaziland Government decided to increase the weekly borrowing limit from SZL 10 million to SZL 40 million to enable it to generate up to SZL 520 million during the 2010/11 fiscal year. The government also sought to review the legislation governing domestic borrowing that would see it increase the annual limit to more than the current SZL 1 billion. That perhaps explains the rapid buildup of stock of domestic debt in recent years. And with a weak 'firewall' it can only be expected that domestic borrowing will continue to grow.

Project due diligence investigations are undertaken before disbursing funds for a specific project especially on the lender's side, and the post-disbursement monitoring of the use of funds, are perceived to be happening. If project due diligence and post-disbursement monitoring of the use of funds were taken seriously by government, it should be able to curb the problem of corruption and ensure efficiency in use of public funds.

5 Fiscal adjustment strategies

There are two ways to deal with the real Swaziland fiscal crisis: ignore it, which would be a mistake; or really find ways to limit future increases in wage bills and fiscal deficits. The government wage bill (is estimated at E2.6 billion, approx. 18 percent of GDP in FY2010/11), accounts for about 62.95% (51%) of the recurrent budget, which is way above the international recommended level of 35 percent, and remains one of the largest wage bill in sub-Saharan Africa. Ignoring it would be a sure recipe for deeper crisis. At the same time, fiscal adjustment entails risks. Further fiscal contraction in an already fragile macroeconomic and growth environment can fuel further instability and perhaps new economic downturn. Fiscal adjustment—implies a combination of lower spending and higher revenue.

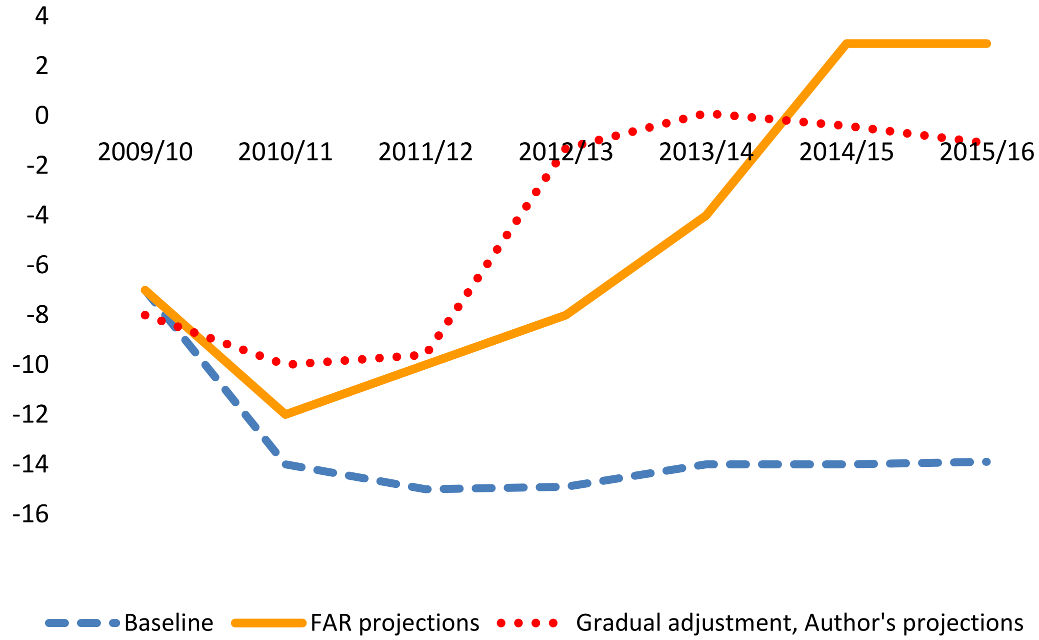
5.1 The baseline scenario

Under baseline scenario, no fiscal adjustment will be needed. The baseline scenario assumes that the fiscal crisis will last longer and that Swaziland will need to continue with expansionary fiscal policy as it did in 2009/2010. The same government spending is continued for additional five years. The results in Figure 10 show that under the baseline scenario, the overall fiscal balance would rise to 15 percent of GDP in 2011. The deficit would fall to 14 pecent in 2013/14 and remain at that level over the medium term. The the debt to GDP ratio would rise to unsustainable levels over the medium term (Figure 11).

5.2 Gradual fiscal adjustment

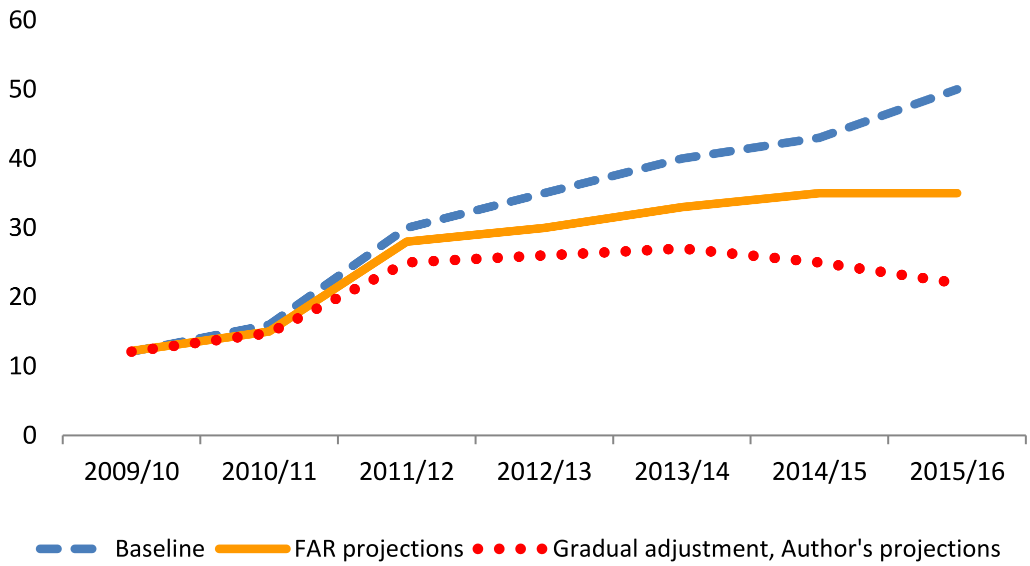
Swaziland is assumed to take a more gradual approach to adjusting its primary balance in order to reach the policy target of less than 3 percent of GDP in 2014/15 and in the medium term. Specifically, annual fiscal adjustment is limited to 2 percentage point of GDP. Under this scenario, the primary deficit—which measures the budget taking out interest payments, thus reflecting the underlying fiscal policy stance—is projected to improve from a deficit of about 10 percent in 2009/10 to a deficit of 1.1 percent in 2015/16, with a small primary surplus of 0.1 percent in 2013/14 (Figure 10).

Figure 10. Overall fiscal balance as percent of GDP, 2009/10 – 2015/16



Note: Under FAR/fiscal adjustment scenario Government would cut public spending, increase government revenue, or both. Much will depend on the pace of recovery of fiscal revenue, which in turn will depend, in part, on GDP growth, the pressure that the funding of social programme are already putting on government budget, and the political feasibility of cutting key recurrent spending items in the budget.

Figure 11. Central Government debt, percent of GDP under different scenarios



Under the second scenario in which primary balance is set at the historical level, public debt would decline. Public debt would remain sustainable over the medium term. Based on the debt sustainability analysis, the debt to GDP ratio would peak at 27 percent in 2014/15 and start coming down thereafter. Debt service projections show interest payments gradually doubling to 1.5 percent of GDP by 2014/15.

6 Conclusions and implications for policy

This paper set out to to examine the stance of fiscal policy in Swaziland since the 1980s, including the attempts that have been made to restrain fiscal deficits and sovereign debt that have built up over the past 15 years, and possible options (sustainable solutions) to the fiscal question, taking into account the speed of fiscal adjustment (i.e. how fast government should aim to make fiscal adjustment in Swaziland). Results suggest that the fiscal policy management in Swaziland is not sufficiently robust. Evidence points to two major drivers of fiscal deficit in Swaziland: the collapse of the fiscal discipline and and external dependency (over reliance on SACU revenue and primary commodity exports). Evidence further shows that if the fiscal adjustment road map is successfully implemented, the economy should be able to generate a surplus within three years (of FAR) and government debt should remain sustainable over the medium term. However, policy inaction would be a sure recipe for deeper crisis as the overall fiscal balance would stay above 14.5 percent over the medium term and debt to GDP ratio would rise to unsustainable levels over the medium term.

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