

Swaziland: 2002 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Swaziland

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation with Swaziland, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **September 20, 2002**, with the officials of Swaziland on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on November 13, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **December 18, 2002** updating information on recent developments.
- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its December 19, 2002 discussion** of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Swaziland.

The document(s) listed below will be separately released.

Selected Issues and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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SWAZILAND

Staff Report for the 2002 Article IV Consultation

Prepared by Staff Representatives for the 2002 Consultation with Swaziland

Approved by Michael Nowak and Liam P. Ebrill

November 13, 2002

- The 2002 Article IV consultation discussions were held in Mbabane during September 9–20, 2002. The staff team met with the Ministers of Finance and Economic Planning and Development; the Governor of the Central Bank of Swaziland; other senior officials at the Ministries of Agriculture, Enterprise and Employment, Health, Natural Resources, and Public Services and Information; and representatives of the banking, business, labor, and international communities.
- The staff team comprised V. Arora (head), L. Erasmus, L. Ricci, M. Vocke, and G. Bagattini (all AFR). Mr. Mamba, Technical Assistant to the Executive Director for Swaziland, participated in some of the meetings.
- At the conclusion of the previous Article IV consultation on March 20, 2002, Directors noted that economic growth in Swaziland had slowed since mid-2000 and inflationary pressures had picked up. Directors stressed the importance of prudent fiscal policy for reinvigorating growth and strengthening the external position. Directors considered that the key policy challenges were to reduce the high rate of unemployment and widespread poverty, address the HIV/AIDS pandemic, and maintain external viability. They emphasized the need for reorienting public spending toward health and education, and for implementing structural reforms, particularly to enhance the efficiency of the public enterprise sector.
- Swaziland has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement and maintains an exchange system free of restrictions on payments and transfers for current international transactions. Swaziland has no outstanding use of Fund resources.
- Swaziland's relations with the Fund, including recent technical assistance, are summarized in Appendix I, and its relations with the World Bank Group in Appendix II. Statistical issues are discussed in Appendix III. Weaknesses in the economic statistics continue to hamper policymaking and effective surveillance. Swaziland's metadata are being prepared in the context of its ongoing participation in the Fund's General Data Dissemination System (GDDS) Project for Anglophone African Countries, and are expected to be posted on the Dissemination Standards Bulletin Board.

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Executive Summary

- Swaziland's socioeconomic situation remains serious, with a food shortage and the spread of HIV/AIDS exacerbating the already severe impact of high unemployment, income inequality, and poverty. Over one-fourth of the population is likely to need emergency food assistance by the end of 2002 and over a third of the adult population is infected with HIV/AIDS.
- Economic growth continued to fall in 2001, to 1¼ percent, while inflation picked up to 12 percent (12-month basis) as of July 2002. The fiscal balance deteriorated further in 2001/02 (fiscal year), mainly due to weak Southern African Customs Union (SACU) receipts and higher capital expenditure. Imports fell as a result of weak economic activity, but the impact on the current account was offset by lower foreign income and transfers. International reserves declined somewhat in relation to imports, but external debt and debt-service obligations remain relatively low.
- The main near-term problem is the humanitarian situation. The authorities have made progress in organizing food imports and strengthening the anti-HIV/AIDS effort, but they will need help in terms of foreign assistance. However, in the context of the political background and policy orientation, donor sentiment is relatively unfavorable. An urgent reorientation of policies to show a clear focus on the humanitarian situation would have both a direct effect on social outcomes and improve donor sentiment.
- The fundamental policy challenge is to address the factors that are holding down Swaziland's longer-term growth prospects and preventing a sustained, broad-based increase in living standards. In this context, there is a need to reduce the fiscal deficit (projected at nearly 4 percent of GDP, including grants, in 2002/03), in order to restore macroeconomic stability and prepare to withstand prospective medium-term pressures. At the same time, spending needs to be reoriented toward critical social sectors.
- Swaziland's banking sector is reasonably well developed, but the Swaziland Development and Savings Bank (SDSB) remains a source of concern, notwithstanding its recapitalization from the budget in 2001.
- There is a need to improve economic data for the purposes of economic policy making and effective surveillance. In this context, the authorities' participation in the IMF's General Data Dissemination System (GDDS) Project for Anglophone African Countries since 2001 is very welcome.

Swaziland: Selected Economic and Financial Indicators, 1999-2003

	1999	2000	2001	2002	2003
			Est.	Proj.	Proj.
	(Annual percentage change)				
GDP at constant prices	3.5	2.0	1.8	1.6	2.0
Consumer prices (average)	5.9	9.9	7.5	12.6	10.0
Broad money	15.6	-6.6	10.7	14.2	11.3
	(In percent of GDP, unless otherwise specified)				
Central government balance (including grants) 1/	-1.5	-1.4	-2.8	-3.9	-4.1
Central government balance (excluding grants) 1/	-2.8	-2.6	-3.8	-5.4	-5.6
External current account balance 2/	-1.6	-3.7	-4.1	-3.5	-3.5
Debt service (in percent of exports)	2.3	2.7	2.3	2.1	2.0
Net official international reserves (in months of imports)	3.0	2.8	2.5	2.5	2.1

Sources: Swazi authorities; and staff estimates and projections based on current policies.

1/ Fiscal year (April-March).

2/ Including transfers.

I. BACKGROUND

1. *The discussions took place against the background of a serious socioeconomic situation.* The drought in the southern African region has affected Swaziland, and over one-fourth of the population (280,000 people) could need emergency food assistance by the end of the year. Meanwhile, HIV/AIDS has continued to spread, and now infects one-third of the working-age population. These developments have further exacerbated social conditions. Although Swaziland is considered a lower-middle-income country, its income distribution is highly skewed, two-thirds of the population lives on less than US\$1 per day, and nearly one-third of the labor force is estimated to be unemployed.¹

2. *The political situation is broadly unchanged, and the outlook is dominated by prospects for a new draft constitution and upcoming parliamentary elections.* Political parties have been disallowed since 1973, when the constitution was also suspended, and

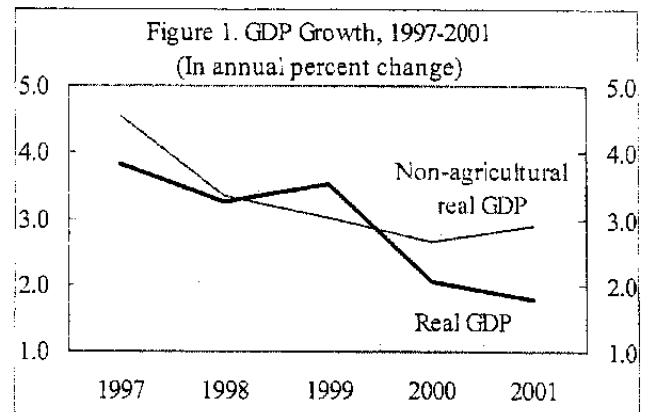
¹ Swaziland's per capita GNP is above the World Bank's US\$756 threshold used for classifying countries as lower middle income (LMI). However, at 0.61, Swaziland's Gini coefficient is the highest among LMI countries. On the basis of a human development index of 0.583, the UNDP categorizes Swaziland as a middle-tier human development country.

parliament is in part appointed by the King and in part elected through a traditional system. A new draft constitution was completed in October 2002, and is expected to be made public in 2003. The next parliamentary election is expected to take place in 2003.

II. ECONOMIC DEVELOPMENTS

3. *Swaziland's growth performance has weakened since the early 1990s, in part because the emergence of South Africa from political and economic isolation has eroded some of the country's advantage as a location for investment.* The average annual growth rate of real GDP fell from 7¾ percent in the 1980s to 3¾ percent during the 1990s. In 2001, a fall in export demand associated with the economic slowdown in South Africa contributed to a further decline in real GDP growth to 1.8 percent (Table 1 and-Figure 1).

Manufacturing output was dampened by divestments in some industries, notably the withdrawal of a large foreign refrigerator manufacturer (Fridgemaster), and poor weather contributed to a 10 percent decline in agricultural output.² Economic activity appears to have weakened further in 2002, with manufacturing output showing the effects of additional closures by foreign firms and agricultural output affected by the drought.



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and poor weather contributed to a 10 percent decline in agricultural output.² Economic activity appears to have weakened further in 2002, with manufacturing output showing the effects of additional closures by foreign firms and agricultural output affected by the drought.

4. *Along with other countries in the region, Swaziland faces a serious food shortage (Box 1).* Around 144,000 people are estimated to have been severely affected and in immediate need of food aid, and another 87,000–136,000 may need assistance by the end of 2002. The authorities are making efforts to alleviate the food shortage, including through budgetary allocations and the formation of a task force on disaster relief to organize foreign food inflows.³

5. *The HIV/AIDS pandemic continues unabated (Box 2).* The infection rate is among the highest in the world, having increased by 10 percentage points during 1999-2001 to reach over 33 percent of the working-age population. By 2010, the population could be reduced to 75 percent of what it would have been in the absence of AIDS. The authorities have shown a

² In addition to the reduced relative advantages of investing in Swaziland following South Africa's emergence, foreign investors have been leaving the country because of concerns about governance and the high incidence of HIV/AIDS.

³ The budget allocation for disaster relief was E 5 million in 2002/03 (April-March) and E 2 million in 2001/02. Maize imports in 2002 related to the drought are estimated at E 300 million, or 2½ percent of GDP, of which food aid accounts for around E 50 million and commercial imports for the remainder.

Box 1. The Food Situation

Swaziland faces a severe food shortage after two consecutive years of poor cereal harvests.¹ Cereal production in both 2000/01 and 2001/02 was only two-thirds of the average annual production during 1995/96–1999/2000.² In 2002/03, Food and Agricultural Organization (FAO)/World Food Programme (WFP) estimates suggest that total cereal production may be only 62 percent of the 1995/96–1999/2000 average, and equivalent to only 36 percent of consumption. The FAO estimated in May 2002 that at least 144,000 people (15 percent of the population) had been severely affected by the food crisis and were in immediate need of food aid, and that an additional 87,000 (9 percent of the population) had been moderately affected and may need assistance by the end of 2002. A recent official statement estimated that the total number of people requiring food assistance by end-2002 could be substantially higher, at around 280,000. Most maize, Swaziland's main staple food, is imported from South Africa, which traditionally is a surplus producer. The shortfall would need to be filled by additional imports, both on a commercial basis and in the form of aid.

Swaziland did not receive any food aid in 2001/02. The FAO/WFP and other UN agencies have launched an appeal for food aid of around 17,720 tons, including 15,200 tons of maize (equivalent to 10 percent of total cereal consumption). The government has distributed more than 1,500 tons of maize to the most vulnerable people. By end-July 2002, Swaziland had received only 23 percent of all commercial cereal imports envisaged for 2002/03.

Table 1. Swaziland: Cereal Balance Estimates, 2001/02-2002/03 1/
(Thousands of metric tons)

Marketing Season Source	2001/02	2002/03
	SADC	FAO/WFP
Opening stock	13	9
Production (est.)	73	68
Domestic requirement	209	188
Domestic balance	-123	-111
Net commercial imports (proj.)	91	96
Food aid pledge	0	15
Deficit	-32	0

Sources: FAO/WFP and the Southern Africa Development Community.

1/ FAO/WFP estimates as of May 29, 2002.

¹ Cereals account for about three fourths of the average daily calorie intake in Swaziland.

² The maize marketing year runs from April 1 until March 31.

Box 2. Assessing The Impact of HIV/AIDS

Background

Swaziland is among the African countries most affected by HIV/AIDS. The population is 6 percent smaller than it would have been without the pandemic, and the disease accounted for 12,000 deaths in 2001. Life expectancy was reduced from 58 years in 1997 to 46 years in 2000. As of 2001, over one-third of the country's adults (170,000 people) were infected. Around 40,000 children (10 percent of all children) have been orphaned as a result of HIV/AIDS. These developments have contributed to raising the dependency ratio to 1.0 in 2001.

Table 1: HIV/AIDS Infection Rate (In percent)

	Adults	Women in Antenatal	
	(Ages 15-49)	Care Clinics	
	2001	1992	2000
Swaziland	33.4	4.0	32.3
South Africa	20.1	2.5	24.3
Botswana	38.8	17.5	44.9
Zimbabwe	33.7	...	31.1
Lesotho	31.0	...	42.2

Table 2: Social Indicators

	1992	2001
Population growth rate (in percent)	2.4	1.9
Infected adults (percent of adults)	17,000	170,000
Dependency ratio	4	34
Total fertility rate	0.9	1.0
Infant mortality rate (per 1,000 births)	5.1	4.4
	75	89

Sources: *World Development Indicators*, 2002; UNAIDS; U.S. Census Bureau; and Swaziland Ministry of Health and Social Welfare, *7th HIV Sentinel Serosurveillance Report*, December 2000.

The government has shown a renewed sense of urgency in addressing the disease, notably by forming the National Emergency Response Committee on HIV/AIDS (NERCHA) in December 2001. NERCHA's operating budget for 2002/03 is E 32 million, of which E 20 million was allocated from the national budget.¹ NERCHA has spent E 10 million since becoming operational in June 2002, and there is an expectation that the committee's funds will be exhausted by the end of the year. In contrast, in 2001/02, only one-fourth of the budget allocation to HIV/AIDS was actually spent, owing to coordination problems among the agencies involved.

Outlook

On current trends, the pandemic could have a further significant impact on demographic and social patterns. By 2010, the population could start to shrink by 0.4 percent annually and could be 25 percent smaller than it would have been without AIDS, and life expectancy could fall to 27 years.² Over the same horizon, the number of orphans is projected to rise to 25 percent of children, which would further increase the dependency ratio.

Although budget spending on HIV/AIDS has doubled, it remains small, having increased from 0.1 percent of GDP in 2001/02 to 0.2 percent of GDP in 2002/03. NERCHA estimates that the cost of treating the full-blown AIDS population would be E 60 million per year, or three times the size of total budget expenditure at present. Additional costs arising from AIDS-related deaths (around 2 percent of the country's working-age population per year), such as a shrinking tax base, increasing pressure on pension funds, and lower productivity, could be over E 1 billion (cumulative) during 1999-2016 and would undermine growth prospects.³ One study estimates that the level of per capita output, relative to a baseline, could be depressed by some 7 percent over the medium term and by around 2 percent over the long term, owing in part to declines in total factor productivity arising from a decline in the average level of experience of workers.⁴

¹ The country has submitted an application to the Global HIV/AIDS Fund for E 160 million per year during 2003-07. NERCHA has not solicited funds from other international donors.

² U.S. Census Bureau forecast.

³ *Swaziland Human Development Report*, 2000.

⁴ Markus Haacker, "The Economic Consequences of HIV/AIDS in Southern Africa", IMF Working Paper /02/38 (Washington: IMF, 2002).

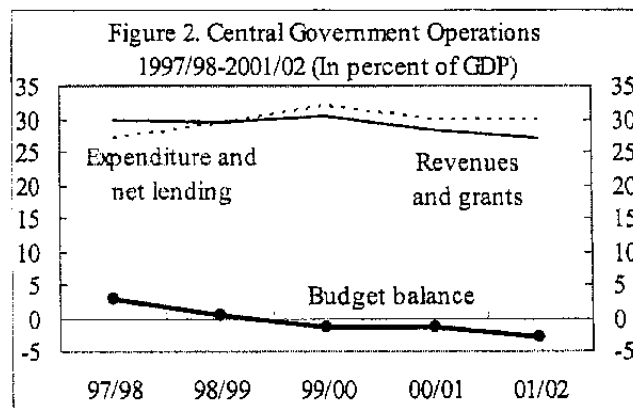
renewed commitment to fighting HIV/AIDS, notably through the establishment of a National Emergency Response Committee on HIV/AIDS (NERCHA) in December 2001, which has resulted in an improved coordination of the effort and a more effective utilization of public resources.

6. *Unemployment remains high, at an estimated 31 percent of the labor force.* The emergence of a fledgling export-oriented clothing industry, in part related to Swaziland's preferential access to U.S. markets under the U.S. African Growth and Opportunity Act (AGOA) since January 2001, has helped to create new jobs equivalent to 6 percent of total employment. However, limited investment in other labor-intensive industries, factory closures, and the sluggish growth of output on communally owned Swazi Nation Land (nearly two thirds of the country's land area) have prevented a reduction in the overall unemployment rate.

7. *The central government fiscal balance has shifted into deficit since 1999/2000 (April–March), and by 2001/02 the deficit (including grants) had widened to 2.8 percent of GDP (Table 2 and Figure 2).*⁴ The

primary deficit increased to nearly 2 percent of GDP in 2001/02. The deterioration in public finances has mainly reflected a decline in tax receipts as a share of GDP, principally Southern African Customs Union (SACU) receipts.⁵ Fiscal expenditure remained broadly unchanged as a percent of GDP, as an increase in capital expenditure was offset by a decline in the public wage bill stemming from the retrenchment of

3,000 workers in 2001/02. In recent years, the deficit has been financed entirely from domestic nonbank and foreign sources. However, in April 2002 the government issued domestic debt worth E 230 million to commercial banks.⁶ Total government debt stood at 22 percent of GDP in 2001/02.



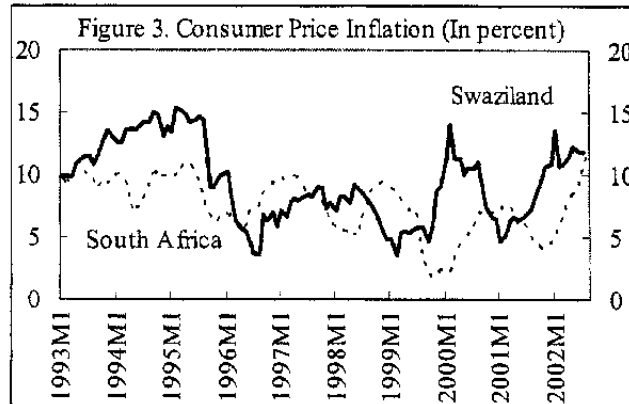
⁴ The deficit, excluding grants, rose to 3.8 percent of GDP in 2001/02.

⁵ SACU membership comprises Botswana, Lesotho, Namibia, South Africa, and Swaziland. A decline in Swaziland's imports related to slower economic activity, and a reduction in SACU's common external tariffs following implementation of the South Africa–EU Free Trade Agreement since 2000, have contributed to weaken Swaziland's receipts from the SACU revenue pool in recent years.

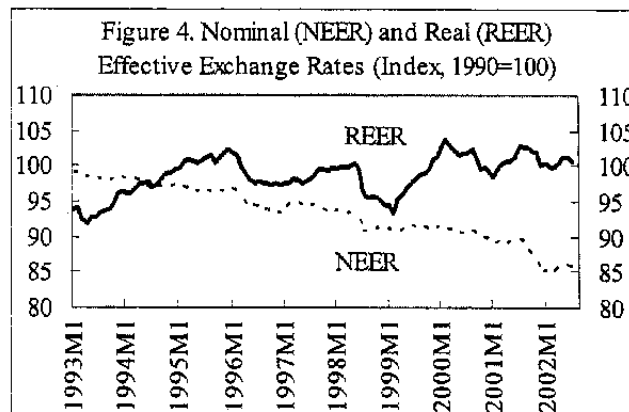
⁶ The bonds were issued at par with maturities of one, three, and eight years and coupon rates ranging from 12.6 percent to 14 percent.

8. *Developments during April–July 2002 suggest a further widening of the central government deficit to nearly 4 percent of GDP in 2002/03.⁷* The increase mainly reflects the implementation of higher wage rates for public servants, contributing to an increase in the civil service wage bill to 12 percent of GDP from 10.2 percent in 2001/02.

9. *Inflationary pressures have picked up since late 2001 (Figure 3).* In July 2002, consumer price inflation was 11.8 percent (12-month basis), which was 1.2 percentage points higher than in South Africa. Both external factors, such as inflation imported from South Africa and rising food and oil prices, and domestic factors, such as increases in wages and the cost of education, have contributed to the pickup in inflation.



10. *The rise in inflation has blunted the impact on competitiveness of a depreciation in the nominal effective exchange rate (NEER) of the lilangeni (Box 3 and Figure 4).⁸* The NEER depreciated by 5 percent in 2001 (end-year basis), largely reflecting the substantial depreciation of the South African rand vis-à-vis the U.S. dollar, but the real effective exchange rate (REER) appreciated by 1 percent. During January–July 2002, both the NEER and the REER appreciated by around ½ of 1 percent.



⁷ The envisaged deficit is lower than was projected in the original budget (5 percent of GDP). The budget was, however, predicated on a significantly higher projected deficit in 2001/02 (E 737 million, or 6½ percent of GDP) than was realized (E 315 million, or 2.8 percent of GDP), in part due to an under implementation of capital expenditure. In recent years, budget forecasts have tended to build in substantially higher capital spending than is eventually implemented, resulting in deficit outturns that are significantly below the forecasts.

⁸ Although competitiveness declined with respect to South Africa, the main trading partner, it increased with respect to countries outside the Common Monetary Area as a result of the substantial depreciation of the lilangeni vis-à-vis their currencies. The forthcoming selected issues paper discusses the trends in Swaziland's external competitiveness over the past decade.

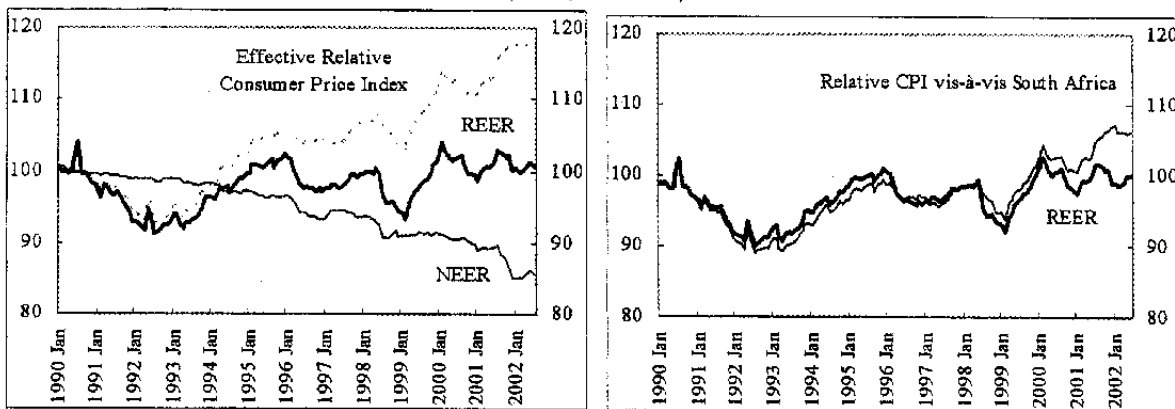
Box 3. Competitiveness and the Real Effective Exchange Rate in Swaziland

During 1990-2002, the nominal effective exchange rate of the lilangeni depreciated steadily, reflecting a substantial depreciation of the South African rand (around 70 percent) with respect to the currencies of advanced economies (Swaziland has maintained an unchanged peg of the lilangeni to the rand for over 50 years).¹ However, relatively high inflation has blunted the effect on competitiveness. Thus, despite the significant nominal depreciation, in July 2002 the real effective exchange rate of the lilangeni was close to its 1990 level (see figure below).

Consistent with the exchange rate peg, the price dynamics of Swaziland and South Africa have tended to converge over long time horizons (although they have diverged temporarily), generating a roughly neutral impact on Swaziland's real effective exchange rate. However, both countries have had higher inflation than the advanced economies, thereby offsetting the nominal exchange rate depreciation.

As movements in Swaziland's nominal effective exchange rate have tended to offset the inflation differential with advanced economies, the movements in the real effective exchange rate have mainly reflected changes in relative prices vis-à-vis South Africa. In 2001 and 2002, notwithstanding significantly higher inflation with respect to South Africa, the substantial nominal depreciation vis-à-vis other countries helped to keep the lilangeni stable in real terms. While Swaziland has lost some competitiveness with respect to South Africa, its main trading partner, it has experienced significant gains in competitiveness with respect to industrial countries.² This has been reflected in a recent increase in the share of exports going to industrial countries (which rose to 55 percent in 2001 from 40 percent in 1999).³

Swaziland: Exchange Rate Developments, 1990-2002
(Index, 1990=100)



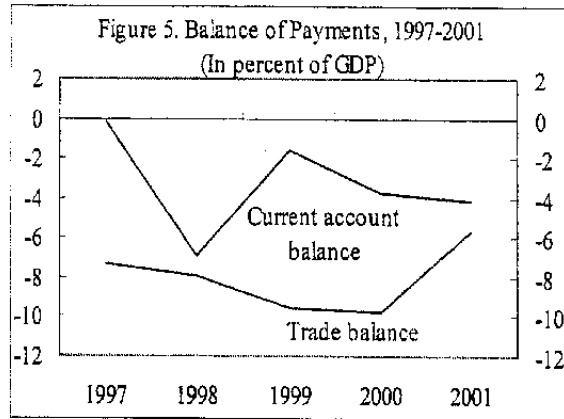
Source: IMF, Information Notice System (INS).

¹ In the Fund's Information Notice System (INS) for calculating the real effective exchange rate, the weight of the South African rand for Swaziland is 86 percent.

² The adjustment in relative inflation between the two countries could be eased by the pass-through effect from the substantial nominal exchange rate depreciation vis-à-vis advanced economies in 2001. Such a pass-through may, in fact, be larger in South Africa than in Swaziland, given the greater share of advanced economies in South Africa's imports.

³ These figures are from the Central Bank of Swaziland and may differ somewhat from data of the Department of Customs and Excise.

11. *The external current account deficit rose to 4 percent of GDP in 2001 as a reduction in the trade deficit was more than offset by lower foreign income and transfers (Table 4 and Figure 5).*⁹ The trade deficit declined due to a contraction in imports of goods and services related to weak private investment. The sharp reduction in official transfers in 2001 reflected lower SACU receipts. Net international reserves decreased slightly to US\$228 million (2½ months of imports), total external debt fell to 22 percent of GDP, and the ratio of external debt-service payments to exports declined to 2¼ percent (Table 5).



12. *Given the peg of the lilangeni to the rand and Swaziland's membership in the Common Monetary Area (CMA), the scope for the Central Bank of Swaziland (CBS) to pursue an independent monetary policy is limited.* The CBS raised short-term interest rates by 400 basis points during January–September 2002, in step with monetary tightening by the South African Reserve Bank.¹⁰ Data for the 12 months through July 2002 (the most recent month available) indicate that the pace of broad money growth moderated to 15½ percent, after having risen above 20 percent in the first quarter (Table 3).

13. *Swaziland has a well-developed banking system, although some concerns remain about the government-owned Swaziland Development and Savings Bank (SDSB).*¹¹ Nonperforming loans of the three commercial banks fell to 1½ percent of total loans and advances in June 2002 and their overall profitability increased to nearly 15 percent (pretax return on capital). Their capitalization exceeds the Basel Accord requirements, and their risk management and provisioning are considered by the banking supervisors to be sound. The SDSB, which lost its commercial banking license in 1995 owing to poor financial performance, relaunched commercial banking operations in June 2001 following recapitalization by the government, a write-off of its nonperforming loans, and the adoption

⁹ In U.S. dollar terms, the current account deficit remained unchanged at around US\$50 million.

¹⁰ However, market interest rates in Swaziland remain below rates in South Africa, partly because of a domestic liquidity requirement on Swazi banks. At end-June 2002, the interest differential for three-month treasury bill rates was minus 2½ percentage points.

¹¹ The banking system comprises three commercial banks—First National Bank, Nedbank, and Standard Bank (all with headquarters in South Africa)—and a development bank (the SDSB). The SDSB is the smallest of the four banks and, as of June 2002, it accounted for 3¾ percent and 14¾ percent of banking sector loans and deposits, respectively.

of new lending and risk management procedures.¹² The bank broke even during 2001/02, but it continues to engage in noncommercial lending.

III. REPORT ON THE DISCUSSIONS

14. *The Fund's policy advice to Swaziland in recent years has focused on the need for fiscal adjustment to restore macroeconomic stability and prepare for medium-term needs, and for structural reforms, particularly with regard to the financial sector, public enterprises, and land tenure.* The authorities have been in broad agreement with this advice and have responded in a few areas, but substantial progress remains to be made. They recognize the need for fiscal consolidation, although the central government deficit has continued to widen (as noted) and key medium-term vulnerabilities still have to be addressed. Structural reforms have progressed in some areas, notably in strengthening the financial sector, but have been slower in others, particularly public enterprise restructuring and land reform. The policy response has been hampered by governance problems, which have slowed down the passage of needed legislation, and by limitations in the institutional capacity to develop and implement the necessary changes.

15. *The staff and the authorities agreed that the central policy challenge was to address the factors that were holding down Swaziland's longer-term growth prospects and preventing a sustained and broad-based increase in the standard of living.* Looser fiscal policy is endangering macroeconomic stability, as reflected in higher inflation, and is eroding competitiveness and external viability and jeopardizing growth prospects. At the same time, a decline in capital accumulation as a percent of GDP is weakening the platform for growth, and relatively low investment in health and human capital is contributing to a worsening of social outcomes, particularly in the context of the rapid spread in HIV/AIDS. Economic performance also continues to be hindered by inefficiencies among public enterprises, low productivity on agricultural land, and impediments to higher employment.

16. *Against this background, the discussions focused on:*

- the economic dimensions of the food shortage and the HIV/AIDS pandemic, and the formulation of an adequate response;
- the macroeconomic outlook and policies that would help to raise the sustainable growth rate and spread its benefits widely;
- fiscal policy adjustments that were needed to ensure macroeconomic stability (thereby also helping to sustain competitiveness and the exchange rate peg of the lilangeni to the rand) and meet the prospective medium-term pressures on the budget arising from HIV/AIDS, other social priorities, and contingent government liabilities (such as the public pension fund);

¹² In 2001, budgetary transfers of E 120 million (1 percent of GDP) were made to the SDSB.

- the continued usefulness of the pegged exchange-rate arrangement in providing a nominal anchor;
- the health of the banking system, and particularly reform of the SDSB;
- the strategies for addressing unemployment and agricultural efficiency/land reform.

A. Humanitarian Situation

17. *It was agreed that the most immediate issue to be addressed was an adequate response to the humanitarian crisis.* Notwithstanding the authorities' ongoing efforts to alleviate the food shortage and fight HIV/AIDS, it was recognized that an effective response to the crisis would require adequate foreign assistance in the near term. The authorities expressed only limited interest in using the Fund's emergency assistance facility, mainly because of the lack of concessionality.¹³ Donor sentiment, however, was negative on account of misgivings about the policy orientation and concerns about governance, particularly the government's proposed acquisition of a new airplane for the King and the extent of its participation in the large so-called Millennium Projects (discussed below), as well as the slow pace of legislative change and lapses in the rule of law. The staff argued that a reorientation of policies with a clear, determined focus on the humanitarian situation would be beneficial both through its direct impact on the economy and by attracting donor support. The staff supported the authorities' intention to organize a donor conference, in collaboration with the UNDP, but advised that this be done at a time when they were able to present a strong policy package that showed a clear focus on key social priorities.

B. Economic Outlook

18. *The near-term economic outlook is for a further slowdown in economic activity in 2002.* Real GDP growth could slow to 1½ percent in 2002, reflecting the effects of the drought and additional factory closures. It could then pick up to 2 percent in 2003 as agricultural output returns to more normal levels and an envisaged recovery in economic activity in South Africa provides some temporary support to Swaziland's output. Inflation could be expected to remain somewhat above the level envisaged in South Africa, and the external current account deficit should narrow slightly, to 3½ percent of GDP, reflecting lagged effects of the depreciation of the lilangeni in 2001.

19. *The medium-term outlook is clouded by the deteriorating fiscal picture, HIV/AIDS, and the need for structural reforms.* The staff presented two alternative scenarios (see Appendix IV), with which the authorities broadly agreed:

¹³ In this context, the authorities questioned the usefulness of the PRGF and IDA-eligibility rules, which they said did not take account of income inequality. In Swaziland, two-thirds of the population live on less than US\$1 per day but, because per capita GNP is above the IDA threshold, the country is not eligible for concessional multilateral financing.

- With no change in policies, the real GDP growth rate could remain at around 1½ percent. Fiscal and external sustainability would deteriorate sharply, and inflation would remain somewhat higher than in South Africa.
- With fiscal policy set on a sustainable trend and structural reforms being implemented in a range of areas, the real GDP growth rate could rise to around 2½ percent, representing somewhat higher per capita growth than was experienced during the 1990s.¹⁴ The fiscal and external positions would become more viable, and inflation could converge to the South African level.

The outlook is susceptible to significant downside risks. It could be substantially worsened by a lack of strengthening in policies and by a further loosening in fiscal policy, such as spending on large capital projects not related to the humanitarian situation. In addition, key medium-term risks include Swaziland's vulnerability to regional and global trade shocks as well as uncertainties about the economic impact of the HIV/AIDS pandemic.

20. *Over the longer term, Swaziland's economic prospects depend importantly on its attractiveness as an investment destination relative to its neighbors, particularly South Africa.* Having in place policies and institutions that help to raise the country's risk-adjusted rate of return is critical in this regard. Swaziland already possesses several of the key elements that are necessary for improving its longer-term economic prospects, notably a physical infrastructure that compares reasonably well with that in neighboring countries, relatively low crime, and corporate income tax rates that are comparable with those in South Africa. However, during the discussions, business representatives pointed out that investment was deterred by concerns about governance and the high incidence of HIV/AIDS. Addressing these issues, as well as continued integration into the global economy, including in the context of regional arrangements such as the Southern African Development Community (SADC) and SACU, the continued adoption of international standards and regulations, and sound macroeconomic policies, all would help strengthen longer-term growth prospects.

C. Macroeconomic Policies

Fiscal policy

21. *The authorities recognized that greater fiscal discipline was needed to regain macroeconomic stability and to address social priorities and improve growth prospects while maintaining a sustainable public debt position.* A failure to reduce the fiscal deficit would worsen macroeconomic stability, reduce competitiveness, and harm debt sustainability. In addition, the current stance of fiscal policy would not prepare the budget for

¹⁴ The assumptions encompass an overall improvement in the policy and institutional environment stemming from a further broadening of the tax base, a higher rate of implementation of public capital expenditure, civil service reform, public enterprise restructuring and privatization, and land reform that addresses tenure and efficiency issues.

the looming medium-term pressures (from HIV/AIDS, other social priorities, and contingent liabilities). The authorities broadly agreed with this assessment and indicated that they intended to target a reduction in the deficit to 1–2 percent of GDP over the medium term. Against this background, the mission recommended, as a realistic and feasible target, that the overall deficit (including grants) be reduced to around 3 percent of GDP in 2003/04;¹⁵ it also recommended that further fiscal adjustment be undertaken over the medium term that aimed to achieve a primary surplus. The mission welcomed the authorities' efforts to move toward a medium-term fiscal framework in conjunction with an EU-sponsored fiscal restructuring project initiated in 2002.

22. *The authorities noted progress with implementing the measures initiated in 2001/02 to broaden the tax base.*¹⁶ The base-broadening measures would help to compensate for an envisaged decline in SACU-related trade taxes over the medium term.¹⁷ The mission encouraged further measures in this direction, given the need for fiscal adjustment in subsequent years and from the standpoint of efficiency.¹⁸ The mission and the authorities agreed that there was a continued need to strengthen tax administration, particularly in terms of audit and enforcement, and to step up efforts to collect tax arrears, which were sizable.¹⁹

¹⁵ This would entail a reduction in the overall deficit of 1 percent of GDP in 2003/04, which is comparable to the anticipated increase in the deficit in 2002/03.

¹⁶ Amendments to the Income Tax Act in 2001 included the introduction of withholding taxes on management fees, royalties, and interest income; the elimination of income tax exemptions for public enterprises (although this could not be widely implemented because it conflicted with the statutes governing certain public enterprises); and an increase in the sales tax rate from 12 percent to 14 percent. At the same time, the amendments included a reduction in the corporate and personal income tax burden.

¹⁷ Receipts from SACU, which accounted for nearly half of total revenue in 2001/02, are expected to fall over time as tariffs are reduced under WTO commitments and the South Africa–EU and SADC trade agreements.

¹⁸ Such measures could include bringing benefits in kind into the tax net; reducing the use of tax concessions for developmental purposes; and eliminating several remaining tax exemptions, including those for commercial activities on Swazi Nation Land, public enterprises whose governing statutes conflict with the 2001 income tax amendments, and any that may apply to the activities of Tibiyo Taka Ngwane (a national trust under the auspices of the King).

¹⁹ The Commissioner of Taxes estimated that outstanding tax arrears, including accrued interest, were around E 300 million (2½ percent of GDP) in 2001/02. The authorities are focusing on efforts to prosecute businesses and individuals owing more than E 1 million and E 100,000, respectively, in overdue taxes. In addition, it was agreed that the introduction of unique taxpayer identification numbers would help in improving tax collection. The ongoing
(continued)

23. ***On the expenditure side, the mission and the authorities agreed on the need to reorient spending toward critical social sectors while restraining overall expenditure.*** In particular, the mission recommended a reorientation of current and capital spending toward education and health, the allocations for which had been relatively stagnant since 1990 and were smaller than in neighboring countries,²⁰ and restraint over the wage bill and transfers to public enterprises (which together accounted for two-thirds of current expenditure in 2001/02).

24. ***The mission also recommended reconsideration of some of the prospective expenditure items that were being discussed.*** A government proposal to acquire a new airplane for the King could crowd out current social needs and was a deterrent to donor support.²¹ The mission urged that the authorities' concerns about an appropriate form of transport for the King be met through less costly alternatives that did not require significant additional budgetary resources, and it suggested that the timing of the transaction be reconsidered. After the mission, on October 18, parliament voted against the government's proposal on the new airplane.

25. ***A careful sequencing of civil service reform would help to improve the efficiency of public services while avoiding an increase in the public wage bill.*** The mission and the authorities agreed that wider wage dispersion in the public sector could help to attract and retain skilled employees (as the Salary Review Commission had concluded), but the mission urged that this should only be done alongside a reduction in the overall size of the civil service. The Public Sector Management Program needed to be speeded up to identify alternative approaches to right sizing the civil service while ensuring adequate staffing in key social sectors.²² The authorities expected that a proposal would be submitted to the cabinet by May 2003 to determine the sustainable size and cost of the civil service, which, if passed,

EU-sponsored fiscal restructuring project is examining further measures to improve tax administration.

²⁰ In 2001, government expenditure on health and education was equivalent to 2 percent and 6 percent of GDP, respectively (approximately the same as in 1990), compared with averages of 3 percent and 8 percent, respectively, in other SACU countries.

²¹ The authorities noted that press reports that they had finalized the outright purchase of a US\$45 million aircraft were premature. The government was considering a seven-year lease-to-own arrangement involving a down payment of US\$8 million, of which it had already paid US\$2½ million. Under the arrangement, the aircraft would also be subleased to other users for a fee that could cover the leasing costs. The assumptions with regard to the fee were somewhat optimistic, however, and the staff warned that the government would be taking on a potentially sizable contingent liability. The authorities noted that the transaction had not been finalized and that, at the time of the mission, it was awaiting a vote in parliament.

²² The authorities noted that these sectors, particularly education and health, tended to be relatively labor intensive.

would be implemented in 2004. Meanwhile, they were advised to avoid public wage increases of the scale seen in recent years as these, in addition to worsening the public finances, influenced private sector wages (including unions' wage negotiations) and raised economy-wide labor costs.

26. *It is important for the authorities to regain effective control over transfers to public enterprises.*²³ The restructuring of public-enterprises and implementation of a sound privatization policy (discussed below) would be essential in this regard. The mission took note of the authorities' view that some of the Millennium Projects (such as factory shells for foreign investors) had been helpful in generating growth and employment, but encouraged the authorities to move ahead with the intended devolution of the majority of the Millennium Projects to the private sector and to ensure the economic viability of the few projects where government participation was warranted.²⁴

Monetary policy and the exchange rate

27. *The authorities and the mission agreed that the pegged exchange rate system of the lilangeni to the rand continued to serve Swaziland well, given the financial discipline that it entailed and in view of the close economic integration between Swaziland and South Africa (Box 4).*²⁵ However, a strengthening of public finances, an appropriately prudent monetary policy stance to secure an adequate level of international reserves, and continued structural reforms were important for ensuring the credibility of the peg. There was also agreement that Swaziland was well served by its membership in the CMA and would benefit from a continued increase in financial integration with other member countries.²⁶

²³ In 2001/02, while public enterprises accounted for 6 percent of GDP, they received budgetary transfers equivalent to 4½ percent of GDP, nearly half of which represented subsidies. The largest recipients included Swazi Railways and Royal Swazi National Airways (0.9 percent of GDP each), and the SDSB (0.8 percent of GDP).

²⁴ The Millennium Projects include factory shells for foreign investors, an airport, a convention center, a hotel complex, a theme park, and a new parliament building. The budget allocated E 200 million (1.8 percent of GDP) for the first phase of the projects in 2001/02, and an additional E 150 million (1.2 percent of GDP) in 2002/03.

²⁵ The rand circulates widely in Swaziland, and the authorities are considering reintroducing it as legal tender, similar to the system that existed until 1986.

²⁶ In 2001, exchange controls were further relaxed on travel, study, and other allowances, and on investment limits for private individuals. In addition, the approval requirement was removed for interest payments and for capital investments by nonresidents in domestic companies through the stock market; the exchange limit on casino gambling and lottery winnings was eliminated; and the coverage of import permits was reduced to a small negative list of items.

Box 4. Economic Integration Between Swaziland and South Africa

Two key characteristics of Swaziland's economy are its high degree of openness and very close integration with South Africa. The latter was a key factor behind the authorities' decision to adopt a fixed exchange rate between the lilangeni and the South African rand. In 2000, the degree of openness (as measured by the ratio of external trade of goods and services to GDP) in Swaziland was 161 percent, which is considerably higher than for most other small, open economies. Swaziland's merchandise trade with South Africa is equivalent to 70 percent of its total trade and to over 110 percent of its GDP. In contrast, Swaziland's trade with other SACU countries is equivalent to less than 1 percent of its total trade.

External Trade Within Regions, 2001
(In percent)

	Regional Trade/ Total Trade	Regional Trade/ GDP
European Union (EU)	With other EU countries	
Belgium	67	101
Denmark	63	35
Ireland	60	77
Netherlands	61	70
EU average	59	34
North American Free Trade Association (NAFTA)	With the United States	
Canada	76	52
Mexico	78	38
Southern African Customs Union (SACU) 1/	With South Africa	
Botswana	40	42
Lesotho	85	104
Namibia	55	47
Swaziland	70	112

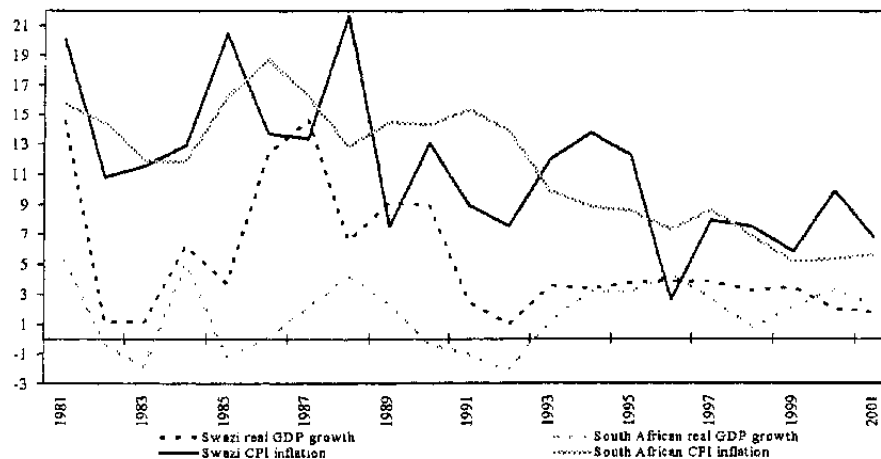
Sources: SACU, and IMF *Direction of Trade Statistics*.
Data refer to aggregate merchandise trade (X+M).

1/ Data are from 1997.

In Swaziland, like in other SACU countries, South Africa is proportionately more important as a source of imports (80 percent) than a destination for exports (50 percent). The differential in part reflects the fact that a substantial share of exports (about 15 percent) is governed by preferential trade agreements with industrial countries. A high degree of labor mobility and a close integration via the capital account exist between Swaziland and South Africa. Swazi contract mining workers in South Africa account for 1-2 percent of the population of Swaziland. Although statistics on foreign direct investment (FDI) are not reliable, South African companies appear to account for the largest share of FDI in Swaziland.

The economic integration between Swaziland and South Africa has contributed to a positive correlation of macroeconomic trends. The correlation between Swaziland and South Africa during 1981-2001 was 0.3 for real GDP growth and 0.5 for consumer price inflation.

Economic Growth and Inflation in Swaziland and South Africa, 1981-2001
(Annual percentage change)



28. *The mission welcomed the reduction in the statutory reserve requirement on banks in August 2002, from 4 percent to 3 percent.* This should help bring about deeper financial integration within the CMA, by bringing the requirement closer in line with that in South Africa (2½ percent), and reduce the effective tax on financial intermediation.²⁷ At the same time, the mission noted that the list of assets eligible for the domestic liquidity requirement (15 percent) could be expanded to include South African securities, thereby raising the relative yield on comparable assets in Swaziland, and that the requirement could eventually be eliminated.

D. Structural Issues

Public sector

29. *Public enterprise restructuring and privatization need to be accelerated.* The mission encouraged early action to finalize the draft privatization policy that the authorities were preparing with support from the UNDP.²⁸ The authorities expect to submit the policy to parliament in time for its approval by March 2003, and to start implementing the policy by 2004. Incorporating the views of labor representatives, the mission suggested that the process be transparent and collaborative in order to ensure broad social acceptance of the policy. The mission supported the cabinet's approval in 1999 of the decision to restructure the Central Transport Authority (CTA), and urged that the decision now start to be implemented.²⁹ Further measures could include requiring public enterprises to comply with existing reporting regulation, and introducing performance contracts for each enterprise.³⁰ The mission encouraged the authorities to liberalize the importation of maize by reconsidering the monopoly of the National Maize Corporation over imports.

²⁷ The measure is not expected to have a significant monetary impact since commercial banks have tended to hold excess reserves.

²⁸ The draft policy specifies a range of options for restructuring public enterprises, from service and management contracts to full privatization. It envisages the establishment of an institutional framework to manage the restructuring process, including an agency to coordinate and implement restructuring plans. The process is intended to be transparent and consultative, although the privatization of individual enterprises would continue to be approved by the cabinet on a case-by-case basis.

²⁹ This would entail establishing the CTA, which currently operates under the Ministry of Transport, as a separate entity with a formal management structure and subject to a performance contract. In addition some functions of the CTA would be privatized.

³⁰ The Minister of Finance has authorized the establishment of a tribunal to address instances of noncompliance with the Public Enterprises Act (1989), including with regard to a provision requiring public enterprises to submit quarterly financial reports.

30. ***The Swaziland Public Service Pensions Fund (PSPF) could pose a significant future liability to the government if its finances are not addressed (Box 5).***³¹ The latest evaluation (April 2001) estimated the actuarial deficit of the fund to be E 1.7 billion (16 percent of annual GDP).³² The mission encouraged the authorities to initiate measures to put the fund on a sustainable path, including the Actuary's previous recommendations to increase statutory contribution rates and the retirement age. The mission also suggested that proposed amendments to the pending Retirement Fund Act that would recall investments held abroad by domestic pension funds could jeopardize the return or raise the risk profile of the PSPF's asset portfolio. However, the authorities noted that the amendments were proposed partly because the pension fund's earnings in South Africa had started being taxed, and they expressed the view that the repatriation of investments would also contribute to developing the domestic capital market in Swaziland.

Financial sector

31. ***The authorities noted recent progress in strengthening banking supervision.*** Proposed and gazetted changes in bank legislation would reduce the concentration of banks' loans to single borrowers, introduce audit committees, and strengthen lending rules (including with regard to insider lending).³³ Some banking sector representatives indicated that the reduction in loan concentration could adversely affect their profitability and might have implications for key economic sectors.³⁴ The mission advised the authorities to remain alert, when implementing the legislation, to the implications for financial and business institutions, and encouraged them to request any technical assistance from the Fund that may be useful.

32. ***The mission noted that the commercial viability of the SDSB remained a source of concern.***³⁵ Notwithstanding its recapitalization from the budget and the full provisioning of its nonperforming loans, the bank's viability would depend on a rigorous application of its

³¹ The forthcoming selected issues paper includes a chapter on the finances of the pension fund.

³² The evaluation did not take into account the potential impact of HIV/AIDS on the fund's net liabilities, although the authorities have requested the Actuary to provide an updated evaluation that accounts for the HIV/AIDS impact.

³³ The amendments are to the Financial Institutions Act and the Central Bank Order.

³⁴ The new regulations would limit a bank's exposure to a single borrower to no more than 25 percent of its share capital. The banks' main concern was that the loan requirement of a key borrower, the Swaziland Sugar Association, exceeded the reduced amount that they would be allowed to lend.

³⁵ However, the SDSB's systemic implications are limited by its relatively small size and the fact that the other commercial banks all have headquarters in South Africa.

Box 5. Swaziland Public Service Pensions Fund

The Swaziland Public Service Pensions Fund (PSPF) is one of three pillars of Swaziland's pension system.¹ Swaziland also has a diversified social safety net, although it is limited in scale and accounts for only 0.2 percent of total government expenditure in 2002/03.² The PSPF was established in 1993 as a defined benefit scheme and, as of April 2001, covered 35,710 people (9 percent of the labor force). The PSPF is administered by the Public Service Pensions Board, an autonomous statutory body.

Members and the government contribute at rates of 5–10 percent and 15 percent, respectively, of pensionable salary. Benefits accrue at a rate of 2 percent of pensionable salary for each year of service. The minimum contribution period is ten years, and the fund contains strong disincentives for early retirement (a member's pension is reduced by 0.33 percent for each month of early retirement). The PSPF also extends disability and death benefits (see below).

The PSPF's finances are vulnerable and represent a potentially significant liability for the government. At end-March 2001 (the latest available information), the ratio of the actuarial value of assets to pension liabilities was estimated by the Actuary (Alexander Forbes Financial Services) at around 46 percent, resulting in a shortfall of around E 1.7 billion (16 percent of annual GDP).³ Moreover, in the absence of a response from the government, the contributions required to eliminate the shortfall have been rising rapidly, most recently from 34.9 percent at end-March 2000 to 39.4 percent at end-March 2001.

Over the medium term, HIV/AIDS is expected to have an adverse impact on the PSPF. Disability benefits entail early retirement with no penalty and an additional pension of up to 50 percent of the actual salary at the date of injury, depending on the severity and circumstances of the injury. Death benefits include a payment of twice the annual pensionable salary, a spouse's pension equal to 50 percent of the accrued pension, and a pension of 10 percent of the accrued pension for each child, with a maximum of 50 percent. Benefits are paid irrespective of the number of years of service. The actuarial evaluation made no explicit allowance for the potential impact of AIDS, although it did raise the assumptions on mortality by 50 percent relative to those in South Africa to take account of Swaziland's evolving demographic profile. The payment of death benefits rose significantly during the second half of the 1990s, and particularly sharply again in 2001.

In order for the PSPF to attain financial soundness, the Actuary estimated it would be necessary to raise the contribution rate to 39 percent, raise the retirement age (currently 60 years), or restructure the benefits and rules of the fund. The main strategy at present to improve the financial position of the fund entails meeting an objective of the Board of Trustees to maintain a rate of return on the offshore investment portfolio that is at least equal to the benchmark set by the South African financial markets, as well as a real rate of return of at least 3 percent per year on the domestic portfolio.

¹ The other two are private pension funds and the Swaziland National Provident Fund (SNPF). The government's legal obligation is limited to the PSPF.

² Safety net expenditure consists of pensions for the aged, free medical services for the elderly and children younger than 5, public assistance for the disabled and destitute elderly, disability payments, and support for handicapped children, children in hospitals, children in foster care, and orphans.

³ According to the Actuary, the PSPF was grossly underfunded at its establishment in 1993, which explains in part how such a large unfunded liability has emerged for such a young system.

new enhanced risk management procedures and on the profitability of its banking services. The mission emphasized that an action plan to prevent bad loans should be a precondition for any budgetary support.³⁶ The mission urged early action to restructure or privatize the institution and reiterated that, as a first step, commercial and developmental activities could be made more distinct and be taken up by different entities in order to increase transparency and accountability in the bank's financial operations.

33. ***The mission welcomed the passage of legislation in August 2002 to strengthen the framework to combat money laundering.*** The authorities responded in full to the Fund's questionnaire on anti-money laundering and combating the financing of terrorism (AML/CFT), and are now engaged in implementing this legislation. They have established a task force to prepare and carry out an action plan in such areas as drafting detailed regulations and building the necessary institutional capacity and expertise. Swaziland is cooperating with other members of the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG) to improve AML systems in the region, and to introduce measures to combat the financing of terrorism.

Social issues

34. ***The mission emphasized the need for a strategy to reduce unemployment.*** Analysis of the labor market in Swaziland is hampered by serious data deficiencies. However, it would appear that the investment environment, skills shortages, and labor market rigidities have contributed to raising labor costs. There is some urgency to formulating and implementing policies to address these factors. A skills development study that is expected later in 2002 may represent a first step in this direction.

35. ***In view of the relatively low productivity of Swazi Nation Land, measures to improve the efficiency of land use could yield substantial efficiency gains and help to improve income distribution and alleviate poverty.*** An important measure in this regard could be reform of the land tenure system.³⁷ The mission recommended early enactment into law of the Land Policy Act (approved by the cabinet in 1999), which would institute long-term leases for agricultural and peri-urban land. Allowing landholders on Swazi Nation Land to use their holdings as collateral (not allowed under the current system of land tenure) could

³⁶ Budgetary transfers to the SDSB are envisaged to be E 160 million (¼ of 1 percent of GDP) during 2002/03–2004/05 (cumulative), and to cease thereafter.

³⁷ Land tenure in Swaziland consists broadly of two types, title deed land and Swazi Nation Land, which account for around 40 percent and 60 percent of total land area, respectively. Title deed land is held by freehold tenure, which recognizes exclusive access rights. The land is irrigated and is used for commercial farming. Tenure over Swazi Nation Land is more complex and is not defined by legislation, since the land is controlled and held in trust by the King and allocated by tribal chiefs according to traditional arrangements. The land is rain fed and is mainly used for subsistence farming, and yields are much lower than on title deed land.

enhance farmers' access to commercial credit and contribute to investment and productivity gains. The authorities noted that improvements in the irrigation of agricultural land, including through the recently-implemented Maguga dam and prospective Lower Usuthu Smallholder Irrigation Project (LUSIP), would also help to improve agricultural productivity.

External trade

36. *Swaziland's external trade policy is largely determined by its membership in SACU and the SADC.*³⁸ The mission encouraged the authorities to remove remaining nontariff barriers, which applied mainly to permits for the importation of some agricultural products. The authorities were also encouraged to reconcile Swaziland's membership in COMESA and SACU in a timely manner.³⁹ As a practical matter, they noted that eliminating the tariffs on Swaziland's imports from other COMESA countries may not have a significant impact on its trade given the small size of these imports.

E. Statistical and Other Issues

37. *A lack of timely and comprehensive data continues to hamper effective policymaking and surveillance.* Significant inadequacies remain in the economic statistics, particularly in the national income, balance of payments, and government accounts. The mission emphasized the need to improve data quality and communication. There is also a need to improve the timeliness of data reporting to the Fund. In this context, the mission welcomed the authorities' decision to participate in the General Data Dissemination System (GDDS) Project for Anglophone African Countries in 2001 and urged them to pay close attention to the initial GDDS assessment of statistical practices, which had been initiated in July 2002, and would form a sound basis for future technical assistance.

38. *The authorities were encouraged to allow publication of the Board documents for this year's Article IV consultation.*

IV. STAFF APPRAISAL

39. *Swaziland faces a serious economic situation, with the food shortage and the continued spread of HIV/AIDS exacerbating the already severe impact of persistent high unemployment, income inequality, and poverty.* The main economic challenges are to address the humanitarian crisis, regain macroeconomic stability, and raise the economy's sustainable longer-term growth rate, while ensuring that the benefits are spread widely.

³⁸ Swaziland maintains a relatively open trade regime with a rating of 4 on the Fund's trade restrictiveness index (on a range of 1–10, with 10 being the most restrictive). Tariff rates range between 3 percent and 55 percent, with a simple average of 6½ percent.

³⁹ Trade among COMESA (Common Market for Eastern and Southern Africa) countries is tariff free, although COMESA countries that are also members of SACU (Swaziland and Namibia) have been given a derogation, which ends in May 2003.

Meeting these challenges requires a return to fiscal discipline, the implementation of structural reforms to increase economic efficiency, including through restructuring public enterprises and further strengthening the financial sector, and an urgent and well-coordinated response to the HIV/AIDS pandemic.

40. ***The most immediate issue is the need for an adequate response to the humanitarian crisis.*** The staff welcomes the authorities' efforts to alleviate the food shortage, including through budgetary allocations and the work of the task force on disaster relief, as well as their renewed commitment to fight HIV/AIDS, notably through establishment of the National Emergency Response Committee on HIV/AIDS (NERCHA) in December 2001. However, an effective response to the crisis will require adequate inflows of foreign assistance in the near term. A reorientation of policies with a clear, determined focus on the humanitarian situation would thus be beneficial both through its direct impact and by influencing international sentiment. Over time, it will be critical for the authorities to address the underlying factors behind the successive run of poor harvests and the continued spread of HIV/AIDS.

41. ***Against the background of a fragile medium-term outlook, the staff considers that the central policy challenge is to address the factors that are holding down Swaziland's longer-term growth prospects and preventing improvements in the standard of living.*** Greater fiscal discipline is needed to regain macroeconomic stability, strengthen competitiveness and external viability, address social priorities, and secure longer-term growth prospects. On the basis of current policies, the central government deficit (including grants) could increase to nearly 4 percent of GDP in 2002/03. Sustained deficits of this magnitude would further undermine macroeconomic stability and would not prepare the budget to withstand prospective medium-term pressures (such as those related to HIV/AIDS and the Swaziland Public Service Pensions Fund). The staff recommends that the deficit be reduced to around 3 percent of GDP in 2003/04, and that further reductions be undertaken over the medium term with a view to achieving a primary surplus. The staff also urges early adoption of a medium-term framework for the formulation of fiscal policy.

42. ***The staff welcomes the measures initiated in 2001/02 to broaden the tax base, which would help compensate for an envisaged decline in SACU receipts, and urges further measures in this direction.*** Such measures could include bringing benefits-in-kind into the tax net; reducing the use of tax concessions for developmental purposes; and eliminating several remaining income-tax exemptions. There is also a need to strengthen tax administration, particularly audit and enforcement, and enforce prompt collection of the sizable outstanding tax arrears.

43. ***On the expenditure side, the staff emphasizes the need to reorient spending toward critical social sectors, such as health and education, while restraining overall expenditure.*** In particular, there is a need to restrain the public wage bill and transfers to public enterprises. A careful sequencing of civil service reform that increases wage dispersion while reducing staffing would help to increase efficiency while avoiding an increase in the wage bill. The restructuring of public enterprises and implementation of the

new privatization policy would help to reduce budgetary transfers. The staff welcomes parliament's October 2002 decision against the proposed acquisition of a new airplane for the King. The staff supports the authorities' intended devolution of the majority of the Millennium Projects to the private sector and urges them to ensure the economic viability of the few projects where government participation may be warranted.

44. ***Membership in the Common Monetary Area, which involves a pegged exchange rate with the South African rand, continues to serve Swaziland well, given the financial discipline that it entails and the close economic integration between Swaziland and South Africa.*** A strengthening of public finances, a prudent monetary policy stance that secures an adequate level of international reserves, and continued structural reforms will be important for ensuring the credibility of the peg.

45. ***Swaziland has a well-developed banking system.*** The banks' capitalization, risk management, and provisioning appear to be sound, and their nonperforming loans are relatively low. However, the future commercial viability of the Swaziland Development and Savings Bank remains a source of concern. The staff recommends that an action plan to prevent bad loans be a precondition for continued budgetary support to the bank, and urges early action to restructure or privatize the institution.

46. ***The staff commends the authorities for the passage of legislation, in August 2002, to combat money laundering.*** The authorities are encouraged to move ahead with their plans to implement the legislation, and to develop institutional capacity in the areas of both anti-money laundering and combating the financing of terrorism.

47. ***The Swaziland Public Service Pensions Fund could pose a significant future liability to the government if its finances are not addressed.*** The staff encourages the authorities to initiate measures to put the fund on a sustainable path, including the Actuary's previous recommendations to increase statutory contribution rates and the retirement age.

48. ***Reform of the land tenure system would be helpful in raising agricultural productivity and alleviating poverty.*** The staff welcomes the cabinet's approval of the Land Policy Act, which would institute long-term leases for agricultural and peri-urban land, and recommends its early enactment into law.

49. ***The staff considers that the effectiveness of policymaking would be greatly enhanced by improvements in the economic data.*** The authorities are encouraged to address the shortcomings that remain in the economic statistics, particularly in the national income, balance of payments, and government accounts. The authorities are also encouraged to improve the timeliness of data reporting to the Fund. In this context, their decision to participate in the GDDS Project for Anglophone African Countries is very welcome, and the initial GDDS assessment should form a sound basis for future technical assistance.

50. It is expected that the next Article IV consultation will be held on the standard 12-month cycle.

Table 1. Swaziland: Selected Economic and Financial Indicators, 1998-2003

	1998	1999	2000	2001	2002	2003
				Est.	Projections 1/	
	(Annual percentage change, unless stated otherwise)					
National Income and Prices						
GDP at constant prices	3.3	3.5	2.0	1.8	1.6	2.0
GDP per capita at constant prices	0.5	1.0	-0.1	0.4	0.4	1.0
GDP deflator	9.1	9.0	12.4	11.8	13.6	11.0
CPI (period average)	7.5	5.9	9.9	7.5	12.6	10.0
CPI (end of period)	4.9	9.1	6.4	10.8	11.0	8.3
Unemployment rate (in percent)	30.0	31.4	31.3	31.3	31.5	31.8
External sector						
Current account balance (in millions of U.S. dollars)	-94.1	-21.7	-51.7	-53.4	-41.6	-43.2
Trade balance (in millions of U.S. dollars)	-106.9	-131.3	-136.5	-73.7	-66.8	-70.1
Exports, f.o.b. 2/	14.8	-2.8	4.1	-1.2	4.0	2.1
Imports, f.o.b. 2/	17.5	-2.8	-6.3	-8.1	5.8	2.0
Nominal effective exchange rate 3/	-2.8	0.4	-1.9	-5.1	-4.6	...
Real effective exchange rate 3/	-5.3	7.2	-1.9	0.9	-2.3	...
Money and credit						
Broad money	12.9	15.6	-6.6	10.7	14.2	11.3
Prime lending rate (in percent; end of period) 4/	21.0	15.0	14.0	12.5	16.5	...
Interest rates on 12-month time deposits (in percent; end of period) 4/	14.1	8.0	7.0	6.3	9.5	...
	(In percent of GDP)					
Gross national savings	15.4	17.2	16.2	14.0	14.2	13.8
Of which: government	7.6	5.8	4.8	4.9	3.2	2.5
Gross domestic investment	22.4	18.8	19.9	18.1	17.7	17.2
Of which: government	5.9	6.7	6.2	7.3	6.7	6.4
Central government finance (fiscal year) 5/						
Total revenue and grants	29.6	30.4	28.3	27.2	26.6	26.4
Of which: South African Customs Union (SACU) receipts	14.0	14.0	14.1	13.2	12.4	12.3
Total expenditure and net lending	29.1	31.9	29.8	29.9	30.5	30.6
Current expenditure and net lending	22.0	25.2	23.7	22.3	23.9	24.0
Central government balance (including grants)	0.5	-1.5	-1.4	-2.8	-3.9	-4.1
Primary balance (including grants)	1.1	-0.6	-0.8	-1.9	-2.9	-3.2
Government debt	19.3	20.3	22.7	26.3	26.8	28.1
External sector						
Current account balance	-6.9	-1.6	-3.7	-4.1	-3.5	-3.5
Trade balance (merchandise goods)	-7.9	-9.5	-9.8	-5.7	-5.7	-5.6
Capital and financial account balance	10.4	2.8	2.6	-1.3	2.1	1.7
Overall balance 6/	3.7	1.5	-0.5	-4.4	-1.5	-1.7
External debt	21.2	23.2	25.7	22.3	34.0	31.2
Memorandum items:						
GDP in current prices (in millions of emalangeni)	7,449	8,408	9,639	10,971	12,652	14,326
Overall balance of payments (in millions of U.S. dollars)	51	21	-6	-57	-17	-22
Net official international reserves (in millions of U.S. dollars)	329	314	293	228	221	194
(in months of imports of goods and nonfactor services)	2.9	3.0	2.8	2.5	2.5	2.1
Total external debt (in millions of U.S. dollars)	288	319	358	288	400	389

Sources: Swazi authorities; and staff projections.

1/ Staff projections, assuming unchanged policies.

2/ Based on values in U.S. dollars.

3/ IMF Information Notice System trade-weighted; end of period. For 2002, data relates to 12-month change as of July.

4/ Data for 2002 relates to September.

5/ The fiscal year runs from April 1 to March 31.

6/ Excluding net errors and omissions.

Table 2. Swaziland: Summary of Central Government Operations, 1998/99-2002/03 1/

	1998/99	1999/00	2000/01	2001/02		2002/03		
				Revised Budget 2/	Actual Outturn	Budget	Budget Estimate 3/	Proj.
(In millions of emalangeni)								
Total revenue and grants	2,275	2,646	2,825	3,065	3,094	3,322	3,407	3,480
Tax revenue	2,042	2,369	2,574	2,731	2,779	2,972	3,049	3,110
<i>Of which:</i>								
Southern African Customs Union (SACU) receipts	1,076	1,222	1,407	1,504	1,504	1,618	1,618	1,518
Non-SACU revenue	966	1,148	1,168	1,228	1,276	1,354	1,431	1,492
Nontax revenue	188	167	139	174	194	155	163	175
Grants	45	110	112	157	121	195	195	195
Total expenditure and net lending	2,239	2,776	2,968	3,799	3,409	3,887	3,885	3,985
Current expenditure	1,689	2,194	2,364	2,677	2,537	2,884	3,035	3,127
Wages and salaries	833	1,077	1,071	1,320	1,162	1,519	1,570	1,570
Goods and services	463	542	679	642	781	666	766	828
Interest payments	51	76	63	79	96	121	121	121
Subsidies and transfers	342	499	550	636	497	578	578	608
<i>Of which: nonfinancial public enterprises</i>	132	142	148	...	140	...	...	...
Capital expenditure	483	585	604	1,092	866	967	835	842
Net lending	67	-3	0	31	7	37	15	15
Primary balance	87	-54	-80	-657	-219	-443	-357	-384
Overall balance (including grants)	36	-130	-143	-737	-315	-564	-478	-505
Overall balance (excluding grants)	-9	-240	-255	-894	-436	-760	-673	-700
Financing	-36	130	143	737	315	564	478	505
Government debt	1,487	1,767	2,259	...	2,994	...	...	3,499
Foreign	1,417	1,697	2,189	...	2,867	...	...	...
Domestic	70	70	70	...	128	...	...	...
(In percent of GDP, unless otherwise specified)								
Total revenue and grants	29.6	30.4	28.3	26.9	27.2	29.2	28.0	26.6
Tax revenue	26.6	27.2	25.8	24.0	24.4	26.2	25.0	23.8
<i>Of which:</i>								
SACU receipts	14.0	14.0	14.1	13.2	13.2	14.2	13.3	12.4
Non-SACU revenue	12.6	2.5	11.7	10.8	11.2	11.9	11.7	11.4
Nontax revenue	2.4	1.9	1.4	1.5	1.7	1.4	1.3	1.3
Grants	0.6	1.3	1.1	1.4	1.1	1.7	1.6	1.5
Total expenditure and net lending	29.1	31.9	29.8	33.4	29.9	34.2	31.9	30.5
Current expenditure	22.0	25.2	23.7	23.5	22.3	25.4	24.9	23.9
<i>Of which:</i>								
Wages and salaries	10.8	12.4	10.7	11.6	10.2	13.4	12.9	12.0
Goods and services	6.0	6.2	6.8	5.6	6.9	5.9	6.3	6.3
Interest payments	0.7	0.9	0.6	0.7	0.8	1.1	1.0	0.9
Subsidies and transfers	4.4	5.7	5.5	5.6	4.4	5.1	4.7	4.7
Capital expenditure	6.3	6.7	6.1	9.6	7.6	8.5	6.9	6.4
Primary balance	1.1	-0.6	-0.8	-5.8	-1.9	-3.9	-2.9	-2.9
Overall balance (including grants)	0.5	-1.5	-1.4	-6.5	-2.8	-5.0	-3.9	-3.9
Overall balance (excluding grants)	-0.1	-2.8	-2.6	-7.8	-3.8	-6.7	-5.5	-5.4
Financing	-0.5	1.5	1.4	6.5	2.8	5.0	3.9	3.9
Government debt	19.3	20.3	22.7	...	26.3	...	...	26.8
Foreign	18.4	19.5	22.0	...	25.2	...	...	...
Domestic	0.9	0.8	0.7	...	1.1	...	...	...
Memorandum item:								
GDP at current market prices (in millions of emalangeni) 4/	7,689	8,716	9,972	11,391	11,391	11,364	12,179	13,071

Sources: Ministry of Finance; and Fund staff projections.

1/ The fiscal year runs from April 1 to March 31.

2/ Reflects supplementary budget of January 2001.

3/ Estimates by Ministry of Finance as of September 2002.

4/ Fiscal-year basis.

Table 3. Swaziland: Monetary Accounts, 1998-2002 1/

	1998	1999	2000	2001	2002 Jul.
	(In millions of emalangeni)				
Monetary authorities					
Net foreign assets	1,928	1,935	2,217	2,771	2,485
Central Bank of Swaziland (CBS)	1,452	1,356	1,600	2,389	2,206
<i>Of which: Capital Investment Fund (CIF), managed by CBS.</i>	705	752	941	1,537	1,384
Government	476	579	617	382	278
Net domestic assets	-1,664	-1,639	-1,940	-2,523	-2,188
Central government (net) 2/	-1,480	-1,552	-1,765	-2,112	-1,912
Private sector	-36	-35	-52	-70	-35
Commercial banks (net)	43	44	42	42	0
Other items (net)	-190	-97	-165	-382	-241
Reserve money	265	296	277	254	296
Commercial banks					
Net foreign assets	530	783	546	866	786
Reserves	173	175	139	122	179
Domestic credit	1,198	1,259	1,368	1,443	1,719
Central government (net)	38	36	59	60	186
Private sector	1,159	1,223	1,308	1,384	1,533
Other items (net)	-133	-179	-191	-345	-458
Private sector deposits	1,769	2,038	1,862	2,086	2,225
Monetary survey					
Net foreign assets	2,459	2,718	2,762	3,636	3,270
Domestic credit	-318	-328	-449	-739	-229
Central government (net)	-1,441	-1,516	-1,706	-2,053	-1,726
Private sector 3/	1,123	1,188	1,256	1,313	1,497
Other items (net)	-216	-165	-235	-596	-612
Broad money					
Currency in circulation 4/	107	137	148	135	154
Deposits	1,817	2,088	1,930	2,166	2,275
	(Annual change in percent of beginning-of-period broad money, unless otherwise specified) 5/				
Broad money	12.9	15.6	-6.6	10.7	15.4
Net foreign assets	43.8	13.5	2.0	42.1	10.8
Domestic credit	-23.2	-0.5	-5.5	-14.0	17.2
Central government (net)	-28.6	-3.9	-8.5	-16.7	3.5
Private sector	5.5	3.4	3.0	2.7	13.7
Other items (net)	-7.8	2.7	-3.1	-17.4	-12.6
Memorandum items:					
Currency/broad money (percent)	5.6	6.2	7.1	5.9	6.3
Reserve money/deposits (percent)	14.6	14.2	14.3	11.7	13.0
Money multiplier (broad money/reserve money)	7.3	7.5	7.5	9.1	8.2
Velocity (GDP/period average broad money)	4.1	4.1	4.5	5.1	4.8

Sources: Central Bank of Swaziland (CBS); and Fund staff estimates.

1/ End-of-year data, except 2002.

2/ Comprises government domestic deposits with the central bank and the counterpart of government (including CIF) external assets in rand.

3/ Includes public sector entities other than the government.

4/ Excludes rand in circulation.

5/ For 2002, percent change of July 2002 over July 2001.

Table 4. Swaziland: Balance of Payments, 1998-2003
(In millions of U.S. dollars, unless otherwise specified)

	1998	1999	2000	2001 Prel.	2002 Projections	2003
Current account balance	-94	-22	-52	-53	-42	-43
Trade balance	-107	-131	-137	-74	-67	-70
Exports, f.o.b.	976	937	910	820	800	837
Imports, f.o.b.	-1,083	-1,068	-1,046	-894	-867	-907
Services (net)	-178	-109	-106	-95	-92	-97
Exports of services	92	95	108	86	83	87
Imports of services	-270	-205	-213	-182	-174	-184
Goods and services balance	-285	-241	-242	-169	-159	-167
Income (net)	57	88	67	35	33	34
Income (credits)	169	164	126	120	113	119
Income (debits)	-112	-76	-59	-85	-80	-85
<i>Of which</i> : interest	-16	-23	-28	-23	-19	-19
Transfers (net)	134	131	124	81	84	90
Official sector (nonduty Southern African Customs Union receipts)	131	130	124	81	84	89
Private sector	3	1	0	0	1	1
Capital and financial account balance	141	38	36	-16	24	22
Capital account balance	0	0	0	1	0	0
Financial account balance (excluding reserve assets)	141	38	36	-17	24	22
Direct investment	130	87	20	27	29	31
Portfolio investment	1	6	-3	0	-1	-1
Other investment	10	-55	18	-44	-4	-9
Errors and omissions	4	5	10	12	0	0
Overall balance	51	21	-6	-57	-17	-22
Memorandum items:						
Current account/GDP (in percent)	-6.9	-1.6	-3.7	-4.1	-3.5	-3.5
Goods and services balance/GDP (in percent)	-20.9	-17.5	-17.3	-13.1	-13.5	-13.4
Net official reserves (end of period)	329	314	293	228	221	194
In months of imports of goods and services	2.9	3.0	2.8	2.5	2.5	2.1
External debt service (in percent of exports of goods and services)	1.5	2.3	2.7	2.3	2.1	2.0
Total external debt	288	319	358	288	400	389
Public	244	267	274	234	328	314
Private	45	52	85	55	72	75
Total external debt/GDP (in percent)	21	23	26	22	34	31
GDP at current prices (at market exchange rates)	1,359	1,376	1,396	1,292	1,177	1,246
Emalangeni per U.S. dollar (end of period)	5.86	6.15	7.57	12.13	...	...
Emalangeni per U.S. dollar (period average)	5.48	6.11	6.91	8.49	...	...
Exports fob, volume growth	14.8	-2.8	4.1	-1.2	4.0	2.1
Imports fob, volume growth	17.5	-2.8	-6.3	-8.1	5.8	2.0

Sources: Central Bank of Swaziland; and staff projections.

Table 5. Swaziland: Indicators of External Vulnerability, 1998-2002
(in percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	2002	Date
Financial indicators						
Public sector debt 1/	19.3	20.3	22.7	26.3	...	
Broad money (M2; percent change, 12-month basis)	12.9	15.6	-6.6	10.7	15.4	July-02
Private sector credit (percent change, 12-month basis)	9.0	5.8	5.7	30.9	23.9	July-02
Ratio of domestic credit to GDP	16.4	15.3	14.4	13.3	13.9	July-02
Treasury-bill yield 2/	13.1	11.2	8.3	7.2	8.5	June-02
Treasury-bill yield (real) 3/	5.6	5.3	-1.6	-0.3	-1.9	June-02
External indicators						
Exports (percent change, 12-month basis in U.S. dollars) 4/	1.4	-4.0	-2.9	-9.8	...	
Imports (percent change, 12-month basis in U.S. dollars) 4/	1.6	-1.4	-2.1	-14.5	...	
Terms of trade (percent change, 12-month basis)	1.9	-0.7	-4.9	0.7	...	
Current account balance	-6.9	-1.6	-3.7	-4.1	...	
Capital and financial account balance	10.4	2.8	2.6	-1.3	...	
<i>Of which</i> : inward portfolio investment (debt securities, etc.)	0.2	0.2	0.1	0.0	...	
other investment (loans, trade credits, etc.)	0.6	2.3	3.0	-0.3	...	
inward foreign direct investment	11.3	7.3	2.5	1.6	...	
Net foreign assets of commercial banks (in millions of U.S. dollars)	90.5	127.2	72.1	71.4	77.6	July-02
Gross official reserves (in millions of U.S. dollars)	351.1	363.6	338.5	267.4	269.6	July-02
Net central bank foreign currency position (in millions of U.S. dollars) 5/	127.6	98.2	87.1	70.2	81.1	July-02
Short-term foreign assets of the financial sector (in millions of U.S. dollars)	101.0	137.3	86.4	73.6	83.4	July-02
Short-term foreign liabilities of the financial sector (in millions of U.S. dollars)	10.4	10.1	14.3	2.2	5.8	July-02
Net foreign currency position of the financial sector (in millions of U.S. dollars) 6/	90.5	127.2	72.1	71.4	77.5	July-02
Gross official reserves in months of imports of goods and services	3.1	3.4	3.2	3.0	3.1	July-02
Ratio of reserve money to reserves (in percent)	12.9	13.2	10.8	6.2	10.9	July-02
Ratio of broad money to reserves (in percent)	93.5	99.4	81.1	56.0	88.9	July-02
Total external debt 6/	21.2	23.2	25.7	22.3	...	
Ratio of total external debt to exports of goods and services (in percent) 7/	27.0	30.9	35.2	31.8	...	
Nominal exchange rate (emalangeni per U.S. dollar; period average)	5.5	6.1	6.9	8.5	10.8	Jan - Sep 2002
REER depreciation (-) (period average; CPI-based)	-0.8	0.0	4.0	-0.3	0.0	Jan - Jul 2002 7/
Financial market indicator						
Stock market index (e.o.p.)	70.5	147.0	138.0	205.7	178.6	March-02
Memorandum items:						
GDP (in millions of U.S. dollars)	1,359.2	1,376.4	1,395.8	1,291.7	...	
Nominal exchange rate (emalangeni/U.S. dollar, end-of-period)	5.9	6.2	7.6	12.1	10.5	September-02

1/ National government debt.

2/ End of period.

3/ Backward-looking with actual CPI.

4/ Customs-based data, in current U.S. dollar prices.

5/ Net foreign assets plus foreign exchange credit to government and banks less foreign exchange deposits at CBS. Does not include foreign exchange position arising from off-balance sheet operations.

6/ Net foreign assets less net foreign liabilities. Does not include foreign exchange position arising from off-balance-sheet operations.

7/ Including intercompany loans.

Swaziland: Relations with the Fund
(As of September 30, 2002)

I. <u>Membership Status:</u> Joined September 22, 1969; Article VIII		
II. <u>General Resources Account:</u>	<u>SDR Million</u>	<u>% Quota</u>
Quota	50.70	100.0
Fund holdings of currency	44.15	87.1
Reserve position in Fund	6.55	12.9
III. <u>SDR Department:</u>	<u>SDR Million</u>	<u>% Allocation</u>
Net cumulative allocation	6.43	100.0
Holdings	2.46	38.2
IV. <u>Outstanding Purchases and Loans:</u>	None	
V. <u>Financial Arrangements:</u>	None	
VI. <u>Projected Obligations to the Fund:</u>	None	

VII. Exchange Rate Arrangement

The lilangeni (plural: emalangeni) continues to be pegged to the South African rand at E 1 = R 1. The intervention currency is the U.S. dollar; exchange rates for the U.S. dollar are based on the floating middle rate of the South African rand against the U.S. dollar. The rate on September 30, 2002 was E 1 = US\$0.0946.

VIII. Article IV Consultation

Swaziland is on the standard 12-month cycle. The last Article IV consultation discussions were held in Mbabane in December 2001. The staff report (SM/02/64; 2/21/02) was considered by the Executive Board on March 20, 2002.

IX. Technical Assistance

FAD provided technical assistance in 1997 to Swaziland on tax reform. A technical assistance mission visited Swaziland in 1999 to advise on a new income tax bill.

In 1998, LEG assisted Swaziland in drafting a new income tax bill and amendments to the Sales Tax Act.

A technical assistance mission from MAE visited Swaziland in 1997 to assist in the drafting of the Financial Institutions Act, and, in 1998, MAE provided an advisor to strengthen bank supervision at the Central Bank of Swaziland (CBS). Until January 2000, MAE had provided

a long-term general advisor to the CBS. In 1999, MAE also conducted several staff visits to assist in improving the payments system and to advise on the introduction of electronic payments systems. MAE plan to conduct a multitopic TA needs assessment mission in early 2003.

STA sent a mission to Swaziland in 1998 with the objectives of identifying weaknesses in the statistical system and assisting in capacity building, particularly relating to the national accounts and other real sector data. An STA mission visited Swaziland in April 1999 to assist with balance of payments statistics. Another STA mission also visited Swaziland in April 1999 to establish an action plan for improving government finance statistics. An initial mission in July 2002 made progress with the implementation of GDDS, and once the metadata (including plans for improvement and associated TA needs) process is completed, TA missions will be scheduled.

X. Resident Representative

None

**Swaziland: Relations with the World Bank Group
as of September 30, 2002**

Since 1962, the World Bank Group has approved 17 IBRD loans, two IDA credits, and seven IFC investments (loans and equity) for a total of US\$136.8 million. Total IDA commitments amounted to US\$8.4 million; IBRD commitments amounted to US\$104.6 million (of which US\$81.4 million was disbursed, US\$4.4 million was cancelled, and US\$18.9 million remains undisbursed); and IFC commitments amounted to US\$23.7 million. The most recent of these operations are an IBRD loan for an Urban Development Project (US\$29 million) in 1994, and an IFC loan and equity input of US\$3.3 million to Swaziland First Merchant Bank in 1999. Only the IBRD loan for Urban Development is currently disbursing. The IDA/IBRD assistance has been for a broad range of sectors: roads, education, power, water supply/sewerage, rural and urban development, and development finance. The IFC's investments have been in support of a development finance corporation, agro-industrial enterprises producing sugar and cotton, paper pulp production, and textile/garment production.

**World Bank Loan/Credit Summary for Swaziland
(in millions of U.S. dollars; as of September 30, 2002)**

	IBRD	IDA	TOTAL
Original principal	104.8	8.4	113.1
Cancellations	4.4	0.03	4.4
Disbursed	81.4	8.3	89.8
Undisbursed	18.9	0.0	18.9
Repaid	70.3	4.1	74.4
Due	9.01	4.2	13.2
IFC commitments	Loans 21.7	Equity 2.0	Total 23.7

Swaziland: Statistical Issues

Deficiencies in the quality of Swaziland's economic data are pervasive and hamper internal policymaking and effective surveillance. The authorities provide available data to the Fund with a lag of 1–2 months, except for the national accounts and international trade data, which are reported with irregular periodicity and with substantial lags.

As one of fourteen countries participating in the Fund's General Data Dissemination System (GDDS) Project for Anglophone African Countries, Swaziland has undertaken to use the GDDS as a framework for the development of national statistical systems. GDDS metadata for Swaziland are being prepared currently, and, on completion, will be posted to the Fund's Dissemination Standards Bulletin Board. The Anglophone Africa project (funded by the U.K. Department for International Development (DFID)) aims to assist participating countries to implement plans for improvement identified in the metadata, to meet GDDS recommended statistical practices.

Real sector data

National accounts suffer from serious shortcomings. For example, data on GDP by expenditure category at constant prices are not available; and there is no reporting of unemployment data on a regular basis. For national accounts data, missions rely on estimates provided by the Central Statistical Office.

Prices

The consumer price index (CPI) was significantly revised in 1998. Monthly consumer price data are published by the Central Statistical Office (CSO) with a one-month lag. For IFS purposes, the CPI is reported for the all-income group.

Government finance statistics

Fiscal data are provided to AFR staff only during missions and/or following budget announcements. The CBS reports to STA fiscal data for publication in *IFS* on an irregular basis. After several years, in 2001 the authorities reported data for publication in the GFS Yearbook. A 1999 government finance statistics (GFS) mission delineated the institutional coverage of the public sector and central government for compiling GFS, and recommended that the same institutional table be used by the Ministry of Finance (MOF) to compile fiscal data and by the CBS to compile monetary data. By correcting the difference in institutional coverage, the discrepancy between fiscal and monetary data was largely resolved. The mission prepared detailed GFS tables for budgetary central government directly from the MOF's existing receipts and payments spreadsheet, and recommended that the coverage be expanded to include extrabudgetary funds and local government.

Monetary statistics

The CBS provides to the Fund, with a lag of 1–2 months, its own balance sheet and a composite balance sheet of the commercial banks, as well as the monetary survey. The data are generally good. However, problems with nonperforming loans and the capitalization of interest may distort credit data, and the circulation of large amounts of unverifiable South African rand make data on money difficult to interpret.

Balance of payments statistics

The Central Statistical Office publishes data on foreign trade on a quarterly basis, but the lack of sufficient computer resources continues to result in long lags in the production of trade—especially import—data. Missions use trade data provided by the CBS. The CBS now adheres to a methodology consistent with the Fund's *Balance of Payments Manual* (fifth edition). However, errors and omissions are large and suggest a need to examine the quality and coverage of data for all components of the balance of payments.

Swaziland: Core Statistical Indicators
(As of October 29, 2002)

	Exchange Rates	International Reserves	Reserve/Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt	Debt Service
Date of latest observation	Sep. 2002	Aug. 2002	Jul. 2002	Jul. 2002	Jul. 2002	Jun. 2002	Jul. 2002	2001	2001	2001/02	2001	2001	2001
Date received	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002	Sep. 2002
Frequency of data 1/	D	M	M	M	M	M	M	Q	A	A	A	A	A
Frequency of reporting 1/	D	M	M	M	M	M	M	A	A	Mainly during missions	A 2/ 3/	A	A
Source of data 4/	P	A	A	A	A	A	A	N	N	A	A	A	A
Mode of reporting 5/	O	C	C	C	C	C	C	V/C	V/C	V/C	V	C	C
Confidentiality 6/	C	D	D	D	D	D	D	D	D	D	D	C	C
Frequency of publication 1/	D	M	M	M	M	D	M	A	A	A	A	A	A

1/ D = daily, M = monthly, Q = quarterly, and A = annually.

2/ Mainly on missions, and when data are received.

3/ From 1992 onward, authorities' and staff estimates.

4/ A = direct report by the authorities; P = commercial publication; and N = official publications.

5/ C = facsimile; V = staff visit; and O = other.

6/ C = unrestricted use; and D = restricted until officially published.

Swaziland: Medium-Term Scenarios

1. Two scenarios were conducted to analyze the medium-term economic outlook: a “baseline” scenario that assumes unchanged policies (that is, policies that have already been announced), and a “reform” scenario that assumes the implementation of reform policies that include achieving a primary fiscal surplus by 2007 and implementing structural reforms to raise economic efficiency.
2. Both scenarios are susceptible to significant negative risks. In particular, projected capital expenditures do not take into account spending on large capital projects that have not yet been budgeted. In addition, neither scenario takes into account the costs of contingent liabilities, such as those related to the public pension fund, and the potentially higher-than-envisaged economic costs of HIV/AIDS. If these costs were to materialize, the needed fiscal adjustment would be correspondingly larger.

Baseline Scenario

3. The “baseline” medium-term scenario assumes a continuation of current policies and developments, in particular:
 - a continued expansionary fiscal policy;
 - revenue sharing under the new SACU agreement coming into effect by 2004/05 and a reduction in SACU revenue on account of continued trade liberalization;
 - a continued slowdown in population growth, largely due to the impact of HIV/AIDS on mortality.

Reform Scenario

4. The “reform” scenario assumes a fiscal policy consistent with achieving a primary surplus by 2007. It also assumes reform policies in a number of areas, including:
 - reducing the share of salaries and wages in recurrent expenditure by implementing the civil service restructuring program;
 - a broadening of the tax base;
 - a higher implementation capacity for public capital investment;
 - public enterprise restructuring and privatization that results in a decline in budgetary subsidies and increases overall economic efficiency;
 - land reform that addresses tenure and efficiency issues.

Table I. Swaziland: Medium-Term Scenario, 2001-2007

	2001 Prel.	2002	2003	2004	2005	2006	2007
Unchanged Policies Scenario:							
	(Annual percentage change, unless otherwise indicated)						
National Income and Prices							
GDP at constant prices	1.8	1.6	2.0	1.7	1.6	1.6	1.5
GDP per capita at constant prices	0.4	0.4	1.0	0.9	0.8	0.8	0.8
GDP deflator	11.8	13.6	11.0	7.7	6.6	5.9	5.9
CPI (period average)	7.5	12.6	10.0	6.7	5.6	4.9	4.9
External sector							
Exports, f.o.b. (in millions of U.S. dollars)	820	800	837	876	926	982	1,036
Imports, f.o.b. (in millions of U.S. dollars)	-894	-867	-907	-949	-1,006	-1,067	-1,127
Exports, f.o.b. (volume change in percent)	-1.2	4.0	2.1	2.1	2.2	2.3	2.3
Imports, f.o.b. (volume change in percent)	-8.1	5.8	2.0	2.1	2.1	2.0	2.0
Money and credit							
Broad money	1.8	13.1	14.2	11.3	8.9	8.0	7.5
Credit to the private sector	2.9	-4.5	-24.5	-10.7	-6.1	0.0	9.1
	(In percent of GDP, unless otherwise indicated)						
Investment and savings							
Gross domestic investment	18.1	17.7	17.2	16.9	16.7	16.4	16.5
Private sector	10.8	11.0	10.8	10.5	10.3	10.0	10.0
Public sector	7.3	6.7	6.4	6.4	6.4	6.4	6.5
Gross national savings	14.0	14.2	13.8	13.3	12.8	12.4	12.4
Private sector	9.1	11.0	11.3	11.0	10.7	10.5	10.6
Public sector	4.9	3.2	2.5	2.4	2.2	1.9	1.7
Central government finance (fiscal year)							
Total revenue and grants	27.2	26.6	26.4	26.3	26.2	26.2	26.1
Total expenditure and net lending	29.9	30.5	30.6	30.6	30.7	30.9	30.9
Central government balance (including grants)	-2.8	-3.9	-4.1	-4.2	-4.4	-4.7	-4.8
Primary balance	-1.9	-2.9	-3.2	-3.3	-3.4	-3.5	-3.6
External sector							
Current account balance	-4.1	-3.5	-3.5	-3.6	-3.9	-4.1	-4.1
Net official international reserves (in millions of U.S. dollars)	228	221	194	167	135	98	57
Total external debt (in millions of U.S. dollars)	288	400	389	406	420	434	452
Reform Scenario:							
	(Annual percentage change, unless otherwise indicated)						
National Income and Prices							
GDP at constant prices	1.8	1.6	2.2	2.3	2.4	2.5	2.5
GDP per capita at constant prices	0.4	0.4	1.2	1.3	1.4	1.5	1.5
GDP deflator	11.8	13.6	10.0	6.7	5.6	4.9	4.9
CPI (period average)	7.5	12.6	9.0	5.7	4.6	3.9	3.9
External sector							
Exports, f.o.b. (in millions of U.S. dollars)	820	800	847	896	950	1,008	1,063
Imports, f.o.b. (in millions of U.S. dollars)	-894	-867	-904	-948	-1,001	-1,060	-1,119
Exports, f.o.b. (volume change in percent)	-1.2	4.0	3.7	3.3	3.5	3.5	3.5
Imports, f.o.b. (volume change in percent)	-8.1	5.8	2.4	2.9	2.8	2.7	2.5
Money and credit							
Broad money	1.8	13.1	14.6	12.2	10.1	9.4	9.0
Credit to the private sector	2.9	-4.5	4.4	3.1	2.5	2.1	2.0
	(In percent of GDP, unless otherwise indicated)						
Investment and savings							
Gross domestic investment	18.1	17.6	17.9	18.5	19.0	19.5	20.0
Private sector	10.8	11.0	11.5	12.0	12.5	13.0	13.5
Public sector	7.3	6.6	6.4	6.5	6.5	6.5	6.5
Gross national savings	14.0	14.1	15.5	16.4	17.1	17.7	18.1
Private sector	9.1	11.0	12.1	12.6	12.6	12.7	12.7
Public sector	4.9	3.1	3.4	3.8	4.5	5.0	5.5
Central government finance (fiscal year)							
Total revenue and grants	27.2	26.8	27.4	27.4	27.6	27.8	27.9
Total expenditure and net lending	29.9	30.7	30.4	30.1	29.5	29.3	28.9
Central government balance (including grants)	-2.8	-3.9	-3.0	-2.7	-1.9	-1.5	-1.0
Primary balance	-1.9	-2.8	-2.1	-1.8	-0.9	-0.5	0.1
External sector							
Current account balance	-4.1	-3.5	-2.5	-2.1	-1.9	-1.8	-1.8
Net official international reserves (in millions of U.S. dollars)	228	221	225	247	275	305	338
Total external debt (in millions of U.S. dollars)	288	400	391	405	417	429	445

Source: Swazi authorities, and staff estimates and projections.

Swaziland: Social and Demographic Indicators¹

Area	Population (2001)	Density	
17,364 sq. km.	997,964	57.5 per sq. km.	
Population		Health	
Population growth rate (2001)	1.9	Population per physician	12,283
Life expectancy at birth	45.6	Public health expenditure (2001, percent of GDP)	2.1
Infant mortality rate (per thousand)	88.7	HIV-incidence, ages 15-49 (percent of population)	33.4
Urban population (percent total)	26.4		
Population younger than 35 years of age (1996, percent of total)	80.0		
GDP per capita	US\$1,294	Education	
Access to safe water (1999)		Adult literacy rate	79.6
Percent of population	43.0	Primary school enrollment (1998, percent of school-age group)	117.37
Urban	41.0		
Rural	44.0		
Labor statistics (in thousands, unless otherwise indicated)		Poverty indicators	
		Poorest 40 percent Share of income	14 percent
Labor force (2001)	388		
<i>Of which:</i> agriculture (1990, in percent)	39.5		
Formal employment (2001)	94		
Private sector	60		
Public sector	33		

Sources: Ministry of Health; International Monetary Fund, *International Financial Statistics*; World Bank, *World Development Indicators, 2002*; *African Development Indicators, 2002*; and *Swaziland—Reducing poverty Through Shared Growth*; Central Bank of Swaziland, *Annual Report, 1997-98*; United Nations, *Demographic Yearbook, 1997*; and staff estimates.

¹ Data refer to 2000, unless otherwise indicated.

**Statement by the IMF Staff Representative
December 18, 2002**

1. This statement reports on information that has been made available since the staff report (SM/02/351, November 14, 2002) was issued. It does not change the thrust of the staff appraisal.
2. Inflation has continued to increase. CPI inflation rose steadily to 12.9 percent (12-month rate) in October, from 11.8 percent in July, largely reflecting rising inflation in South Africa (14.5 percent in October) and higher food prices.
3. On December 2, 2002, Parliament approved supplementary expenditures worth E 282 million (2¼ percent of GDP) for the current fiscal year (April 2002–March 2003). Three-fifths of the supplementary expenditure represents current spending (nearly half of it on grants and subsidies, education, and housing and urban development) and the remainder spending on capital projects (principally a major road project). The Ministry of Finance anticipates that the impact on the central government deficit will be contained by improved fiscal management and tax collection, reductions in nonessential spending, and, as in the past, underspending on investment projects. It expects the deficit in 2002/03 to be 4–4½ percent of GDP, compared with 3.9 percent reported in the staff report. It is hard to make an assessment of the impact of the supplementary expenditures on fiscal prospects, since details were not released on developments in the other elements of the expenditure plan and in revenues, but the effort to bring the budget deficit down to a sustainable level in the medium term will likely be more difficult. This reinforces the need for fiscal discipline in order to restore macroeconomic stability.
4. A final decision has not yet been taken regarding the government's proposed acquisition of a new airplane for King Mswati III. After parliament voted against the original proposal in October, the government revisited the issue at a parliamentary caucus on November 18. The caucus suspended the acquisition, but asked for more detailed information on the transaction in order to make a final decision. A select committee was appointed and charged with providing the necessary information.
5. Governance issues have come to the forefront recently, particularly in the areas of the law and the independence of the judiciary. The majority of the judges in the High Court resigned on December 1 after the government refused to accept a ruling on the grounds that it undermined the King's ability to rule by decree. The planned airplane acquisition and the circumstances surrounding the judges' resignation have triggered protests by the business community and labor unions, who have called for a general strike and mass protests during December 19–20, 2002.



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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2002 Article IV Consultation with Swaziland

On December 19, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Swaziland.¹

Background

Swaziland's growth performance has weakened since the early 1990s as the emergence of South Africa from economic isolation has eroded some of the country's advantage as a location for investment. Real GDP growth fell from 7¾ percent annually during the 1980s to 3¾ percent during the 1990s. In 2001, growth declined further to 1.8 percent, reflecting a fall in export demand associated with the economic slowdown in South Africa, foreign disinvestment in some industries, and poor weather. Economic activity appears to have weakened further in 2002, with manufacturing output showing the effects of additional closures by foreign firms and agricultural output being affected by the drought in the region.

Swaziland faces a serious humanitarian situation, with a food shortage and the spread of HIV/AIDS exacerbating the already severe impact of high unemployment (nearly one third of the labor force), income inequality, and poverty. Over a quarter of the population could be in need of emergency food assistance and over a third of the adult population is infected with HIV/AIDS. The authorities are making efforts to alleviate the food shortage, including through budgetary allocations and the formation of a task force on disaster relief to organize foreign food inflows.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

allocations and the formation of a task force on disaster relief to organize foreign food inflows. They have renewed their commitment to fighting HIV/AIDS, notably through the establishment of a National Emergency Response Committee (NERCHA) in December 2001.

The central government fiscal balance has shifted into deficit since 1999/2000 (April-March), and by 2001/02 the deficit (including grants) had widened to 2¾ percent of GDP. The deterioration in public finances has mainly reflected a decline in Southern African Customs Union (SACU) receipts. In 2002/03, the authorities expect that the deficit could widen to 4-4½ percent of GDP, largely due to an increase in the civil service wage bill and, in early December, supplementary expenditures equivalent to around 2 percent of GDP.

Inflationary pressures have picked up since late 2001, and CPI inflation rose to 12.9 percent (12-month basis) in October 2002. The rise in inflation has blunted the impact on competitiveness of a depreciation in the nominal effective exchange rate of the lilangeni, which fell by 5 percent (end-year basis) in 2001, largely reflecting the depreciation vis-à-vis the U.S. dollar of the South African rand (to which the lilangeni is pegged). The real effective exchange rate, however, appreciated by 1 percent.

The external current account deficit widened to 4 percent of GDP in 2001. A reduction in the trade deficit, due to an import contraction related to weak investment, was offset by lower SACU receipts. Gross international reserves declined slightly to 3 months of imports. Total external debt fell to 22 percent of GDP, and external debt service as a percent of exports fell to 2¼ percent.

Given the peg of the lilangeni to the rand, and Swaziland's membership in the Common Monetary Area (CMA), the scope for an independent monetary policy is limited. The Central Bank of Swaziland raised short-term policy interest rates by 400 basis points during January-September 2002, in step with monetary tightening by the South African Reserve Bank.

Executive Board Assessment

Directors expressed concern about the serious economic situation in Swaziland, with the food shortage and continued spread of HIV/AIDS exacerbating the already severe impact of persistent high unemployment, income inequality, and poverty. They saw the main economic policy challenges as addressing the humanitarian crisis, regaining macroeconomic stability, and raising the economy's sustainable longer-term growth rate, while ensuring that the benefits were spread widely. Meeting these challenges would require a return to fiscal discipline, while reorienting spending toward critical social sectors and humanitarian priorities; implementation of structural reforms to increase economic efficiency, including through restructuring public enterprises and further strengthening the financial sector; and an urgent and well-coordinated response to the HIV/AIDS pandemic; as well as strengthening of governance.

Directors considered the most immediate issue would be to find an adequate response to the humanitarian crisis. They welcomed the authorities' efforts to alleviate the food shortage, including through budgetary allocations and the work of the task force on disaster relief. Equally, Directors welcomed the authorities' renewed commitment to fight HIV/AIDS, notably through the

establishment of the NERCHA. Directors stressed that an effective response to the growing humanitarian crisis would urgently require greater foreign inflows and concessional assistance. In this regard, a reorientation of policies, with a clear, determined focus on the humanitarian situation, would be beneficial both through its direct impact and confidence-building effects among the donor community. Directors noted that, over time, it would be critical for the authorities to address the underlying factors behind the successive run of poor harvests and the continued spread of HIV/AIDS.

Against the background of a fragile medium-term outlook, Directors considered that the central longer-term challenge was to address the factors that were holding down Swaziland's growth prospects and preventing improvements in the standard of living. They felt that greater fiscal discipline was needed to restore macroeconomic stability, address social priorities, prepare the budget to withstand prospective medium-term pressures, and regain longer-term growth prospects. Directors also recommended the early adoption of a medium-term framework for the formulation of fiscal policy as a means of strengthening budgetary planning.

Directors welcomed the measures initiated in 2001/02 to broaden the tax base, which would help compensate for an envisaged decline in SACU receipts, and they urged further measures in this direction. Directors also saw a need to strengthen tax administration, particularly audit and enforcement, and to enforce prompt collection of sizable outstanding tax arrears.

On the expenditure side, Directors emphasized the need to reorient spending toward critical social sectors, such as health and education, while restraining overall expenditure. In particular, they considered it important to contain the public wage bill and transfers to public enterprises. Directors expressed concern about the substantial additional expenditures announced by the authorities in early December, which they felt were likely to further weaken the fiscal situation. Directors strongly urged reconsideration of the government's proposed acquisition of a new airplane for the King. This expenditure could crowd out social needs and deter donor support while depleting foreign exchange reserves. They suggested that the authorities' concerns about an appropriate form of transport for the King be met through less costly alternatives that did not require significant additional budgetary and foreign-exchange resources. Directors supported the authorities' intention to devolve the majority of the Millennium Projects to the private sector, and urged them to ensure the economic viability of the few projects in which government participation might be warranted. More generally, they stressed the need to address governance concerns and encouraged further strengthening of the rule of law, including through the current constitutional review process, with a view to improving the environment for private investment.

Directors noted that membership in the Common Monetary Area, which involved pegging the exchange rate of the lilangeni to the South African rand, continued to serve Swaziland well, given the monetary discipline that it entailed and the close economic integration between Swaziland and South Africa. They emphasized that a strengthening of public finances, a prudent monetary policy stance that secured an adequate level of international reserves, and continued structural reforms would be important for ensuring the credibility of the peg.

Directors noted that Swaziland has a well-developed banking system. Banks' capitalization, risk management, and provisioning appeared to be sound and their nonperforming loans were

relatively low. However, Directors observed that the future commercial viability of the Swaziland Development and Savings Bank remained a source of concern. They recommended that continued budgetary support to the bank be dependent upon the prevention of a build-up in bad loans, and urged early action to restructure or privatize the institution.

Directors commended the authorities for the passage of anti-money-laundering legislation in August 2002, and encouraged them to move ahead with plans to implement the legislation and develop institutional capacity to combat both money laundering and the financing of terrorism.

Directors cautioned that the Swaziland Public Service Pensions Fund could pose a significant future liability to the government if its financial difficulties were not adequately addressed, and they encouraged the authorities to initiate measures to put the fund on a sustainable path.

Directors felt that reform of the land tenure system would be helpful in raising agricultural productivity and alleviating poverty. They welcomed the cabinet's approval of the Land Policy Act, which would institute long-term leases for agricultural and peri-urban land, and recommended its early enactment into law.

Directors considered that the effectiveness of policymaking in Swaziland would be greatly enhanced by improvements in the economic data. They encouraged the authorities to address the shortcomings in the economic statistics, particularly with respect to the national income, balance of payments, and government accounts. They also encouraged the authorities to improve the timeliness of data reporting to the Fund. In this context, they welcomed the authorities' decision to participate in the General Data Dissemination System (GDDS) Project for Anglophone African Countries, and considered that the initial GDDS assessment should form a sound basis for future technical assistance.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Swaziland: Selected Economic and Financial Indicators, 1998-2001

	1998	1999	2000	2001
Domestic economy	(Annual percentage change)			
Real GDP	3.3	3.5	2.0	1.8
Consumer price inflation (period average)	7.5	5.9	9.9	7.5
External economy	(In millions of U.S. dollars) 1/			
Exports, f.o.b.	976	937	910	820
Imports, f.o.b.	-1,083	-1,068	-1,046	-894
Current account balance 2/ (In percent of GDP)	-94 -6.9	-22 -1.6	-52 -3.7	-53 -4.1
Capital and financial account balance	141	38	36	-16
Gross official international reserves (In months of imports of goods and nonfactor services)	351 3.1	364 3.4	339 3.2	267 3.0
Debt service (in percent of exports of goods and nonfactor services)	1.5	2.3	2.7	2.3
Change in real effective exchange rate (in percent) 3/	-5.3	7.2	-1.9	0.9
Financial variables	(In percent of GDP) 1/			
Total government revenue and grants 4/	29.6	30.4	28.3	27.2
Total government expenditure and net lending 4/	29.1	31.9	29.8	29.9
Overall government balance 4/	0.5	-1.5	-1.4	-2.8
Change in broad money (in percent)	12.9	15.6	-6.6	10.7
Interest rates (in percent) 5/	14.1	8.0	7.0	6.3

Sources: Swazi authorities; and IMF staff estimates.

1/ Unless otherwise indicated.

2/ Including transfers.

3/ Trade-weighted; end of period.

4/ Fiscal years (April 1-March 31).

5/ For 12-month time deposits.

**Statement by Ismaila Usman, Executive Director for Swaziland
December 18, 2002**

Key Points

- Swaziland is facing a serious humanitarian crisis affecting the entire Southern African region with a food shortage affecting a growing number of the population aggravated by poverty, HIV/AIDS high unemployment and income inequality.
- Economic growth continues to fall exacerbated by deteriorating fiscal and external sector outlook.
- Need to reorient and restrain government expenditure towards the worsening humanitarian crisis and social sectors whilst attempting to gunner for macroeconomic stability and sustained economic growth.

Introduction

1. My Swaziland authorities would like to convey their appreciation to the staff for their constructive views, recommendations and advice during the last Article IV Consultation staff mission. They are broadly in agreement with the report which is candid and gives a fair and balanced view of the recent economic developments in the country highlighting also the numerous challenges.

2. Recent performance indicate a slump in economic growth which stood at 1.75 percent in 2001 compared to 2.0 percent the year before. Inflation pressure continued to mount and reached an annualized 12.9 percent by October 2002. Economic growth has been falling over the years, largely as a result of a continued low inflows of foreign direct investments and increased competition from neighboring states. The country also suffered from the closure and downsizing of some of its major manufacturing entities, such as the fridge manufacturing firm which employed a sizeable number of the work force in the manufacturing sector. A 10 percent decline in agricultural performance as a result of the poor weather conditions resulting in successive poor harvests also contributed to the poor performance. The same trend continued in 2002 as a result of the weak performance of the agricultural sector due largely to the continued drought conditions.

3. Unemployment remained at unacceptably high levels estimated at 31 percent of the labour force in 2001 despite the significant number of jobs that have been created mainly in the textile sector since 2001, amounting to 6 percent of total employment. The authorities are however, committed to help ameliorate the situation through the attraction of more textile manufacturing concerns that seek to take advantage of the United States' Africa Growth and Opportunities Act (AGOA).

4. The international reserve position fell marginally to two months of imports as the external sector recorded fewer inflows of foreign direct investments into the country. The country's competitiveness was also undermined by the steady surge in the country's inflation

rate. The depreciation of the local currency vis-à-vis its major trading partners in the latter half of 2001 to mid-2002, subsequently improved the country's export competitive edge. Exports to most industrial countries surged as a result of this development accounting for 55 percent of total exports in 2001 from 40 percent in 1999.

Humanitarian Situation

5. The HIV/AIDS pandemic has continued to ravage the economy, with indications of an increase in infection rates which stand amongst the highest in the world. To address this concern my authorities established the National Emergency Response Committee on HIV/AIDS (NERCHA) in December 2001. NERCHA seeks to coordinate the fight against AIDS and effectively utilize the limited public resources to fight the pandemic.

6. Although the full economic impact of the HIV/AIDS pandemic is yet to be assessed, the spate of factory closures and departure of foreign investors largely due to the high incidence of the disease, underscores the seriousness of the humanitarian situation which is compounded by the food shortage as a result of the prolonged drought. The authorities have allocated extra budgetary resources towards the food crisis and donor assistance has also been sought to deal with the issue. The HIV/AIDS crisis is affecting one out of every three people in the working age group of the population. The pandemic is not only threatening the country's most productive human resource base but stands to undermine longer-term economic growth prospects of the country. Taking into consideration that nearly one third of the population is unemployed and two-thirds of the population is living under US\$1 per day, the country needs adequate foreign assistance to deal with the crisis.

7. My authorities are concerned by the classification which denies the country access to concessional multilateral financing under the PRGF and IDA. The classification fails to address the income inequality that currently exists in the country. They therefore urge the IMF and World Bank to re-examine the rationality of the eligibility criterion with a view to granting the country waiver to enable it to access concessional resources to effectively address the pandemic.

8. In this connection my authorities intend, in collaboration with the UNDP, to organize a donor conference in due course and they hope that they could count on the goodwill, understanding and support of the international community in this endeavor.

Fiscal Policy

9. My authorities are committed to improved fiscal discipline. They would develop a medium-term fiscal strategy in conjunction with an EU-sponsored fiscal restructuring project initiated in 2002 that aims at achieving macroeconomic stability and promoting economic growth. They are cognizant of the challenges posed by the HIV/AIDS threat and the need to reorient spending to increase social sector expenditures without worsening the medium-term budgetary position. Spending in health and education is to be increased whilst transfers to parastatals would be restrained and the size of the wage bill contained.

10. My authorities are currently embarking on a comprehensive tax reform exercise under the Fiscal Restructuring Project, targeting diversification and broadening the revenue base. They are also committed to a further broadening of the tax base to compensate for the declines in the Southern African Customs Union (SACU) receipts, which currently account for approximately 50 percent of government revenues. SACU receipts are expected to decline as a result of the countries' WTO commitments and the South Africa-European Union Free Trade Area and the SADC trade arrangements. All remaining income tax exemptions will be abolished and the tax base will be broadened by amending the Sales Tax Act and incorporating previously uncovered commercial activities on the Swazi Nation Land. Tax collection will be improved and tax administration further strengthened. Tax officials will also receive training.

Monetary Policy

11. Swaziland belongs to a monetary union with Lesotho, Namibia and South Africa, where the currencies of these economies are pegged on a one-to-one basis with the South African rand. The rand circulates widely in Swaziland along with the local currency, the lilangeni. This has meant that it cannot exercise an independent monetary policy. Authorities agree with the recommendation of staff to maintain the peg and they believe that the gains outweigh the costs. This also serves to increase trade and foster further and deeper economic integration with its neighbour and biggest trading partner, South Africa. Monetary and exchange rate policies are therefore closely tied to those of South Africa and this informs the authorities commitment to continued increase in financial integration with members of the CMA.

Structural Reforms

12. Civil service reforms will continue and will help reduce the size and improve efficiency of the public service. The UNDP, working jointly with the authorities, are currently developing a comprehensive strategy to privatize and restructure public enterprises including the Central Transportation Authority (CTA). On the developments surrounding the Swaziland Public Service Pension Fund, the authorities accept recommendations of staff and would rectify the anomalies and initiate measures to increase its efficiency by increasing contributions and retirement age.

13. Reform of the Swaziland Development and Savings Bank is on-going, with the appointment of a new management team, recapitalization of the bank and provisioning for nonperforming loans. The Bank is now operating under new enhanced risk management procedures. My authorities support the need to delineate the commercial and development aspects of the bank to increase transparency and accountability of its financial operations whilst fulfilling its responsibility of improving the living standards of the people and contributing to the country's poverty reduction efforts.

14. Swaziland's trade policy is largely influenced by the Southern African Customs Union (SACU) which has been recently renegotiated. The new SACU will be a democratic

institution which will also have Secretariat which will be responsible the day- to-day running of the affairs of the institution. Recognizing the small size, and relative openness of the Swazi economy and its susceptibility to external shocks the authorities will work closely with other regional economic integration groupings to promote an export sector-led economic growth.

15. My authorities remain committed to improve agricultural production on Swazi Nation Land through improved agricultural irrigation of land as shown by the recent implementation of the Lower Usuthu Smallholder Irrigation Project (LUSIP). The Land Policy Act is expected to further empower the smallholder rural farming communities to access credit to improve investment and productivity.

16. They agree with the staff recommendation to improve economic data to strengthen policy formulation and have already joined the GDDS project and would welcome technical assistance in this regard.

Other Reforms

17. A constitutional review process is currently underway with the formation of a Constitutional Review Commission (CRC). The commission is expected to complete its work soon and present its report and recommendations to the authorities and this is expected to bring into the country a new political dispensation once the commission's recommendations are considered and adopted.

Conclusion

18. My authorities remain committed to pursuing prudent macroeconomic policy and creating an environment conducive to attracting foreign direct investment. They however remain concerned with the slow response of the multilateral institutions and the international community to help them to address the humanitarian crisis facing the country in particular the HIV/AIDS pandemic and the food shortage crisis aggravating the already pervading poverty situation.