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September 15, 1987

To: Members of the Executive Board

From: The Acting Secretary

Subject: Swaziland - Staff Report for the 1987 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1987 Article IV consultation with Swaziland, which has been tentatively scheduled for discussion on Wednesday, October 7, 1987.

Ms. Dillon (ext. 8313) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

SWAZILAND

Staff Report for the 1987 Article IV Consultation

Prepared by the Staff Representatives for the
1987 Article IV Consultation with Swaziland

Approved by A.D. Ouattara and H.B. Junz

September 15, 1987

I. Introduction

The 1987 Article IV consultation discussions with Swaziland were held in Mbabane from July 10 to July 23, 1987. The representatives of Swaziland included Mr. B.S. Dlamini, Minister of Finance; Mr. H.B.B. Oliver, Governor of the Central Bank of Swaziland; Mr. K. Mbuli, Principal Secretary of the Ministry of Finance; other senior officials from the public sector; and representatives of the private sector. The staff representatives were Ms. K. Burke Dillon (head-ETR), Messrs. Timothy R. Muzondo, Philip M. Young (both AFR), Ranjit Teja (FAD), and Ms. Nadia Khattak (secretary-ETR).

Swaziland continues to avail itself of the transitional arrangements under Article XIV. Swaziland received a Trust Fund loan in 1979, purchased its reserve tranche in 1982, and made purchases under the buffer stock and compensatory financing facilities in January and June 1983, respectively. Repurchases in respect of the buffer stock facility were made in early 1985, following the dissolution of the International Sugar Agreement at the end of 1984. As of end-July 1987, the Fund's holdings of Swaziland's currency subject to repurchase amounted to 18.2 percent of quota, all of which were in respect of the compensatory financing facility.

The last Article IV consultation with Swaziland was concluded by the Executive Board on September 9, 1986 (SUR/86/91). At the meeting, Executive Directors expressed concern over the deterioration in Swaziland's economic and financial situation. They observed that in 1985 GDP was estimated to have declined and the rate of inflation had accelerated; the fiscal position had weakened in 1985/86 and was expected to deteriorate further in 1986/87. Directors noted that underlying these developments were certain factors beyond the control of the authorities, but policy weaknesses had also affected performance. In light of the deterioration in the fiscal position and the continuing overdependence on customs union revenues, they stressed the need to broaden the tax base and contain expenditures. Executive Directors were

particularly concerned by the staff's projections indicating growing deficits in the balance of payments over the medium term and urged the authorities to implement comprehensive adjustment policies.

Summaries of Swaziland's relations with the Fund and the World Bank Group are provided in Appendices I and II, respectively. Basic economic and financial data are presented in Appendix III; statistical issues are discussed in Appendix IV; social indicators are provided in Appendix V; a medium-term balance of payments scenario is presented in Appendix VI; and Appendix VII summarizes the interlinkages between Swaziland and South Africa.

II. Developments through 1986

Swaziland is a small, very open economy. Exports account for about half of GDP, and imports for two thirds of aggregate expenditure. Because of its geographical position and strong institutional and other linkages with South Africa, economic developments in Swaziland are heavily influenced by those in South Africa. Under the Southern African Customs Union (SACU) agreement, trade and payments flows between Swaziland and South Africa are generally unrestricted. 1/ Since April 1986, Swaziland has been free to pursue an independent exchange rate policy under the renegotiated Common Monetary Area (CMA) agreement, but in practice the lilangeni (plural: emalangeni) remains pegged at par to the South African rand. 2/

1. Production, prices, and employment

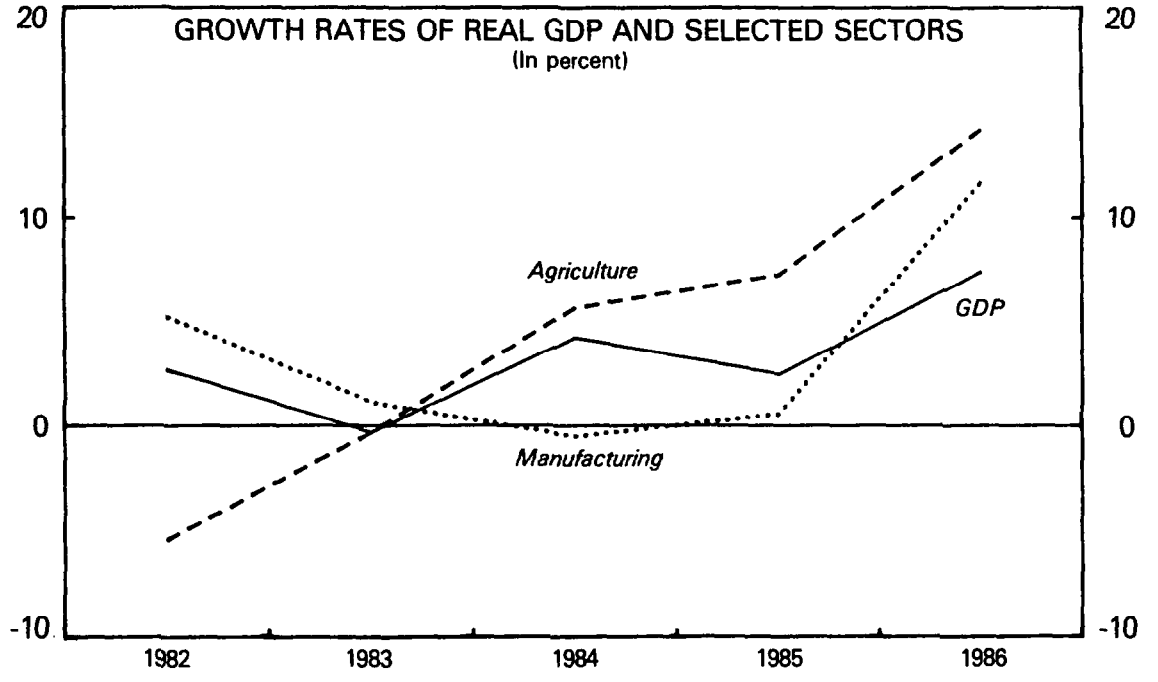
Over the four years through 1985, the economy grew at an average annual rate of 2.2 percent against a population growth rate of 3.1 percent and an even more rapid expansion of the labor force (Table 1 and Chart 1). Several factors contributed to this overall performance and to year-to-year variability: drought conditions in 1982-83; a cyclone in 1984; weak world prices for Swaziland's export commodities; and the recession in South Africa from mid-1984 to mid-1986. Due in part to the closure of two major enterprises, private sector employment in Swaziland declined by 12 percent over the four years through 1985 and total paid employment fell by 9 percent. As employment opportunities in Swaziland contracted over this period, the number of Swazi migrant workers in South Africa doubled, raising the ratio of Swazi migrant workers to total paid employment in Swaziland from about 14 percent in 1981 to over 30 percent in 1985.

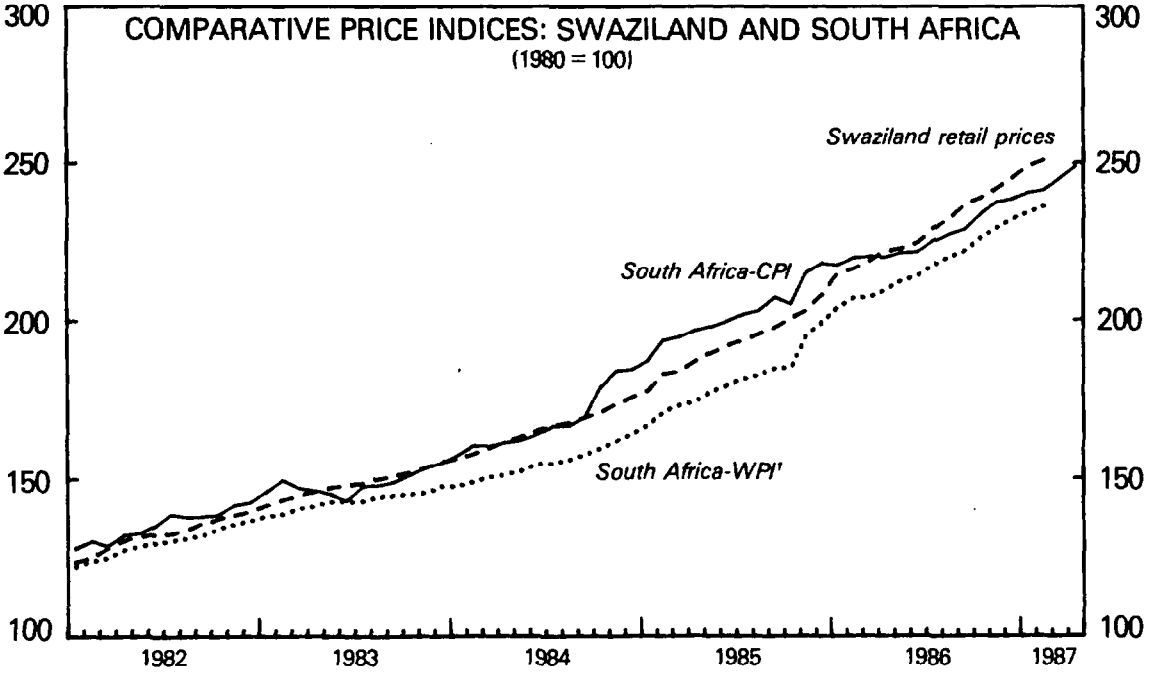
1/ There is, however, a provision permitting, upon mutual agreement, the temporary imposition of quantitative restrictions on agricultural imports.

2/ Other members of SACU are Botswana and Lesotho, and the other member of the CMA is Lesotho.

CHART 1

SWAZILAND





Sources: Central Bank of Swaziland, *Quarterly Review*, various issues; Central Statistical Office; and staff estimates.

[1] Home and imported goods.

Table 1. Swaziland: Selected Economic and Financial Indicators, 1982-86

	1982	1983	1984	1985	1986 Est.
			(Annual percentage changes)		
GDP and prices					
GDP at constant prices	2.6	-0.3	4.2	2.4	7.4
GDP deflator	7.9	7.0	10.4	9.7	18.2
Consumer retail prices					
Annual average	13.2	11.4	13.5	20.8	10.4
December to December	15.3	10.6	19.0	16.2	9.4
			(In millions of SDRs)		
External sector					
Exports, f.o.b.	295	285	231	173	227
Imports, f.o.b.	-398	-434	-370	-277	-275
Overall balance of payments transactions surplus or deficit (-)	-8	19	21	19	4
			(Annual percentage changes)		
Nominal effective exchange rate 1/	-0.7	-1.6	-11.6	-15.3	4.9
Real effective exchange rate 1/	-1.2	--	-23.0	-30.2	24.4
Government finances 2/					
Total revenue and grants	35.7	1.8	20.9	8.9	2.0
Total expenditure and net lending	9.4	2.9	9.8	17.5	11.8
			(Annual change as a percent of M3 at beginning of period)		
Money and credit					
Money and quasi-money	14.0	22.7	20.4	22.9	11.1
Net foreign assets 3/	-5.9	14.1	17.1	23.1	-2.5
Domestic credit	21.0	12.8	1.0	2.3	13.8
Government (net)	(14.9)	(9.1)	(-3.8)	(1.0)	(11.7)
Nongovernment	(6.1)	(3.7)	(4.8)	(1.3)	(2.1)
Other items (net) 3/	-1.1	-4.1	2.4	-2.4	-0.2
			(In percent)		
Interest rates (end of year)					
Prime lending rate	18.0	18.0	22-25.0	17.0	12.5
Six-month time deposit rate	11.5	14.5	14-14.8	9.5-12.0	5.0-6.0
Savings deposit rate	7.0	7.0	10.0	7.1	4.0-6.0
			(In percent of GDP)		
Central government overall surplus or deficit (-) 2/	-3.1	-3.3	-0.5	-3.3	-5.4
Domestic financing	3.0	3.0	1.3	2.9	2.0
Of which: bank	(3.0)	(2.9)	(1.0)	(0.8)	(0.9)
Foreign financing	0.1	0.2	-0.8	0.3	3.4
External current account balance	-16.4	-17.2	-10.8	-9.4	-4.7
External debt 4/	31.4	35.6	45.9	53.9	44.5
			(Units indicated)		
Debt service ratio (in percent of exports of goods and services)	4.9	4.8	6.1	9.2	8 7
Gross official reserves (in months of imports of goods and nonfactor services; end of year)	1.7	2.1	2.2	2.8	2.9

Sources: Data provided by the Swazi authorities; and staff estimates.

1/ December to December.
2/ Data for fiscal years; thus 1985 implies April 1985 to March 1986.
3/ Excludes valuation effect of changes in exchange rates.
4/ End-March stock of debt against GDP for the same year.

Preliminary estimates indicate that the economy rebounded in 1986, achieving at least 7 percent real growth, primarily because of exceptionally favorable weather conditions. Agricultural output rose by 14 percent, with sugar and maize production reaching record levels. In sharp contrast to the stagnation of recent years, manufacturing output expanded by 12 percent, partly as the result of the recent establishment in Swaziland of a number of new export-oriented enterprises.

The price level in Swaziland tends to follow that in South Africa, but with some divergence on a year-to-year basis (Chart 1). The rate of increase in consumer prices in Swaziland averaged about 13 percent over the three years through 1984, but then rose steeply to 21 percent in 1985, as the rand and lilangeni depreciated and after the introduction of a 5 percent sales tax in late 1984. In 1986, however, with South African inflation at almost 19 percent, consumer prices in Swaziland rose by only 10 percent, despite a midyear doubling of the Swazi general sales tax. This recent divergence in price developments between Swaziland and South Africa is in part explained by the impact of drought in South Africa on food prices. It may also reflect differences in wage trends and unit labor costs.

2. Fiscal policy

The Government's primary source of revenue is receipts from the Southern African Customs Union, which are paid with a two-year lag and are determined by a formula that takes into account both Swaziland's imports and total duty receipts in the customs area. As imports into both Swaziland and South Africa declined in real terms, Swaziland's receipts from SACU dropped steadily from 21 percent of GDP in fiscal year 1982/83 to 17 percent in 1985/86 (Chart 2). 1/ Against this background of weakness in SACU receipts, the Swazi authorities took action on both the revenue and expenditure fronts. The most important revenue measure was the introduction in September 1984 of a 5 percent general sales tax, which by 1985/86 was generating revenues equal to about 1 1/2 percent of GDP. This, combined with a reduction in expenditure and net lending equal to 2 1/2 percent of GDP, fully offset the decline in SACU revenues over the three years through 1985/86, and the overall deficit of the Government was maintained at about 3 percent of GDP (Table 2). 2/

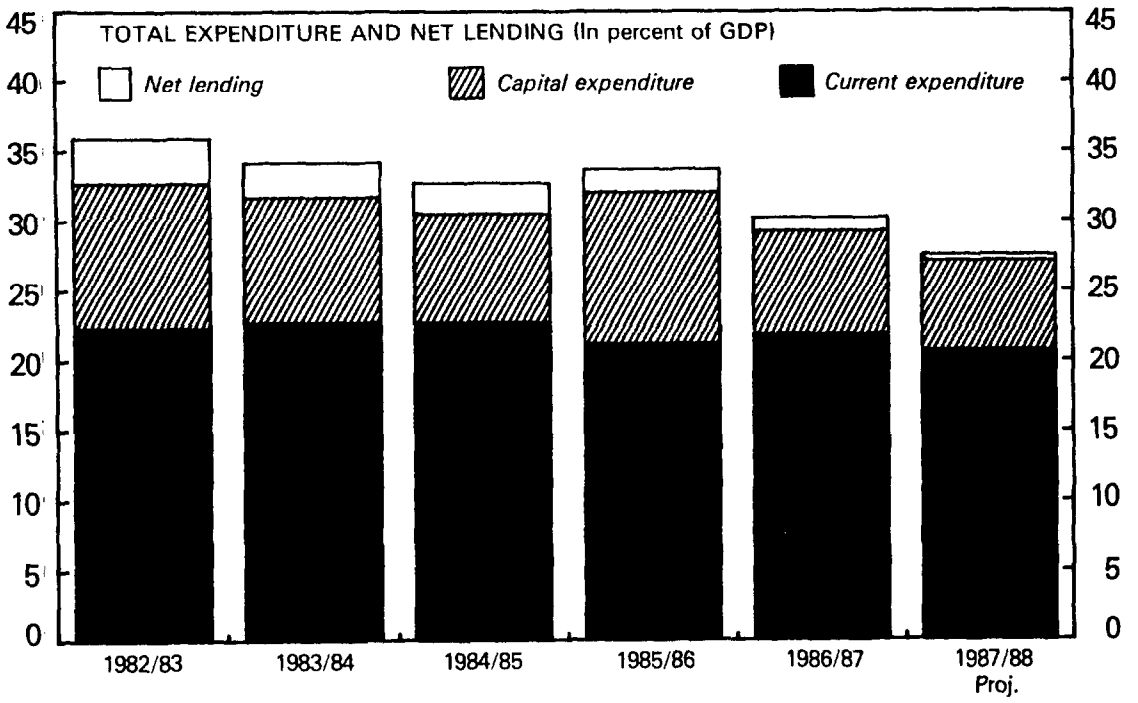
1/ The fiscal year in Swaziland begins April 1. For more detailed information on the SACU formula and its impact on Swaziland's SACU receipts, see the forthcoming report on Swaziland--Recent Economic Developments.

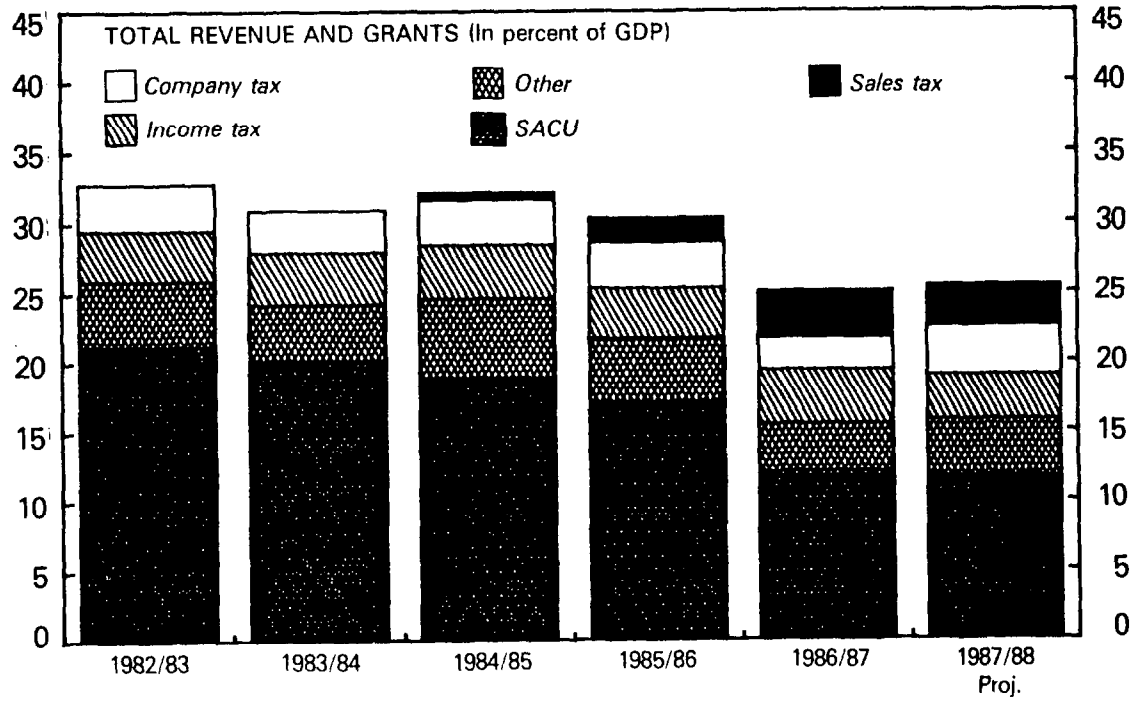
2/ There was an important but unquantified deferral of SACU receipts from 1981/82 to 1982/83 due to an earlier error in the reporting of imports; this also reduced the overall deficit in 1982/83. Nevertheless, in the interest of brevity, the same 1982/83 base year is used here as a reference point for all fiscal account items. As can be seen from Table 2, rebasing the discussion of SACU receipts and of the overall deficit to 1983/84 would not change the conclusions materially.

CHART 2

SWAZILAND

COMPOSITION OF CENTRAL GOVERNMENT REVENUE AND EXPENDITURE 1982/83-1987/88





Sources: Ministry of Finance; and Fund staff estimates.

Table 2. Swaziland: Summary of Central Government Operations, 1982/83-1987/88 1/

	1982/83	1983/84	1984/85	1985/86	1986/87 Prel. outturn	1987/88 Revised estimate
			(In millions of emalangeni)			
Total revenue and grants	182.1	185.6	221.5	243.9	249.8	293.6
Tax revenue	163.3	166.9	189.7	212.8	223.6	262.5
Nontax revenue	13.4	12.8	21.1	20.9	15.7	20.5
Grants	5.4	5.9	10.7	10.2	10.5	10.6
Total expenditure and net lending	199.4	205.2	225.1	270.1	303.8	320.6
Current expenditure	124.0	136.7	142.5	170.6	216.4	238.0
Capital expenditure	57.7	53.9	53.8	87.3	73.3	78.6
Net lending	17.7	14.6	15.3	12.2	14.1	4.0
Change in expenditure-related arrears	...	...	13.5	--	--	--
Overall surplus/deficit (-)	-17.3	-19.6	-3.6	-26.2	-54.0	-26.9
Financing	17.3	19.6	3.6	26.2	54.0	26.9
Foreign (net)	0.8	1.4	-5.6	2.8	33.9	25.9
Gross borrowing	10.5	13.5	5.5	27.0	49.6	46.1
Amortization	9.7	9.3	13.8	24.2	15.7	20.2
Change in cash balances	--	-2.7	2.7	--	--	--
Domestic (net)	16.5	18.2	9.2	23.4	20.1	1.0
Domestic bank	16.5	17.3	6.9	6.5	9.3	...
Central Bank	6.4	11.4	6.7	-4.4	5.9	...
Deposits	6.3	10.5	-4.6	-1.1	5.9	...
Borrowing	0.1	0.9	11.3	-3.3	--	...
Commercial banks	10.1	5.9	0.2	10.9	3.4	...
Deposits	4.0	8.0	0.8	-2.0	2.0	...
Borrowing	6.1	-2.1	-0.6	12.9	1.4	...
Other domestic	--	0.9	2.3	16.9	10.8	...
Borrowing	2.3	2.7	4.1	6.0	10.3	...
Other 2/	-2.3	-1.8	-1.8	10.9	0.5	...
			(In percent of GDP)			
Total revenue and grants	32.8	30.9	32.2	30.3	25.1	25.5
Tax revenue	29.4	27.8	27.6	26.4	22.5	22.8
SACU	(21.2)	(20.1)	(18.9)	(17.0)	(12.1)	(11.7)
Company tax	(3.3)	(2.9)	(3.1)	(3.3)	(2.4)	(3.6)
Income tax	(3.6)	(3.8)	(3.9)	(3.6)	(3.9)	(3.2)
Sales tax	(--)	(--)	(0.6)	(1.7)	(3.1)	(3.0)
Nontax revenue	2.4	2.1	3.1	2.6	1.6	1.8
Grants	1.0	1.0	1.6	1.3	1.1	0.9
Total expenditure and net lending	35.9	34.1	32.7	33.6	30.6	27.9
Current expenditure	22.3	22.7	20.7	21.2	21.8	20.7
Capital expenditure	10.4	9.0	7.8	10.8	7.4	6.8
Net lending	3.2	2.4	2.2	1.5	1.4	0.3
Payment of arrears	--	--	2.0	--	--	--
Overall surplus/deficit	-3.1	-3.3	-0.5	-3.3	-5.4	-2.3
Financing	3.1	3.3	0.5	3.3	5.4	2.3
Foreign (net)	0.1	0.2	-0.8	0.3	3.4	2.2
Domestic (net)	3.0	3.0	1.3	2.9	2.0	0.1
Bank	3.0	2.9	1.0	0.8	0.9	...
Nonbank	--	0.1	0.3	2.1	1.1	...

Sources: Ministry of Finance; and staff estimates.

1/ The fiscal year runs from April 1 through March 31. Data presented on a cash basis.
2/ Includes changes in unpresented checks in accounts payable, changes in funds held in trust, cash in transit, and errors and omissions.

In fiscal year 1986/87, SACU receipts dropped by a full 5 percentage points of GDP and, despite additional measures on both the revenue and expenditure sides, the overall government deficit increased to 5.4 percent of GDP. Sales tax receipts more than doubled, rising to about 3 percent of GDP, as the sales tax applicable to most commodities was doubled to 10 percent in May 1986 and the tax on alcohol and tobacco was increased fourfold to 20 percent. Also, following the introduction in late 1985 of a system of income tax clearance certificates, personal income tax receipts increased by one third in 1986/87, apparently outpacing by a substantial margin the growth in wage incomes. At the same time, however, receipts from the company tax declined by about 1 percent of GDP, reflecting the lagged effects of the weak economic outturn in 1985. (While personal income taxes are paid contemporaneously, company taxes are paid with a lag.) Nontax revenues and grants also did not keep pace with the growth of the economy last year. As a result, total revenue and grants fell by the same amount as SACU receipts, dropping from 30 percent of GDP in 1985/86 to 25 percent of GDP in 1986/87.

Faced with this large decline in revenues, the authorities cut spending by a further 3 percent of GDP last year, bringing total expenditure and net lending down to below 31 percent of GDP, compared with 36 percent in 1982/83. Capital expenditure and net lending accounted for most of the reduction over these four years. While the authorities succeeded in reducing the main components of current spending relative to GDP, these efforts were offset by the effects of the exchange rate depreciation on the interest cost of the Government's own foreign debt and by the Government's assumption, either directly or through loans and transfers, of part of the debt service of certain parastatals. 1/ Effective April 1986, government employees were granted a 14 percent wage increase, which included a catch-up for past wage erosion. At the same time, it was decided to increase salaries of very senior officials by up to 56 percent to maintain competitiveness with the private sector. This latter increase is to be phased in over three years beginning in fiscal 1986/87. Nevertheless, the government wage bill declined from 12.0 percent of GDP in 1982/83 to 10.7 percent in 1986/87, reflecting restraint both in hiring and, for the period as a whole, in the granting of wage increases. Current spending on goods and services has also been held in check, although it turned upward somewhat during the past two fiscal years, reflecting in part exceptional expenditures associated with the coronation of King Mswati III in late April 1986.

1/ The Government has throughout effectively borne, through transfers, the cost of servicing the external debt of the Royal Swazi Airways Corporation. More recently it has been servicing the debt of the National Industrial Development Corporation of Swaziland, which is being restructured, and it has also agreed to an arrangement whereby it lends to the Swaziland Electricity Board (SEB) the additional servicing costs on SEB's debt over and above what those costs would be at the exchange rates of March 31, 1985.

The sharp increase in the government deficit in 1986/87 did not lead to a significant increase in net recourse to domestic bank financing, as nearly two thirds of the deficit was financed by foreign borrowing, mostly on concessional terms. This was in marked contrast to the four years through fiscal 1985/86, when there had been a small net repayment of foreign debt and the Government had financed its deficits by a reduction in its net creditor position with the banking system, as well as by domestic nonbank borrowing. A major factor behind the substantial increase in foreign borrowing in 1986/87 was the Government's success in accelerating the processing of a large backlog of claims for reimbursement of expenditure on foreign-financed projects. Past delays in submitting such claims had contributed to the low level of disbursements in earlier years.

3. Money, credit, and the balance of payments

The banks in Swaziland are free to set both lending and deposit rates and, given the unrestricted movement of resident capital within the Common Monetary Area, interest rate movements in Swaziland tend to be closely synchronized with those in South Africa. Rates in both countries moved steeply upward over 1983 and 1984 but then, reflecting the monetary policy stance adopted by South Africa, fell steadily over 1985 and 1986 (Chart 3). However, while the level of lending rates in Swaziland has remained close to that prevailing in South Africa, Swazi deposit rates have, since 1980, been consistently below those in South Africa and the difference has widened over time. This widening differential would appear to reflect not only political factors but also increasing investor concern that South Africa might impose further exchange controls. In the first quarter of 1987 the rate on one-year time deposits was about 5.5 percent in Swaziland compared with 10 percent in South Africa, while the prime lending rate was 12 percent in Swaziland, compared with 12.5 percent in South Africa.

Over the three years through 1984, the broad money stock (M3) in Swaziland increased considerably faster than nominal GDP. Deposit rates have been substantially negative in real terms since late 1984, and during 1985 and 1986 broad money rose at a compound rate of 18 percent; this was somewhat less than nominal GDP but about in line with prices. 1/ In the 12 months to June 1987 the pace of increase in broad money accelerated to almost 30 percent.

While the recent M3 figures would seem to indicate that negative real interest rates had not yet had a dampening effect on the demand for money, the composition of that growth gives cause for concern. In particular, most of the recent growth has been concentrated in short-term time deposits held by businesses and may reflect the very liquid position of some large exporting firms that experienced windfalls as the

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1/ The temporary placement at end-1985 of a large time deposit at the Central Bank distorts annual data for 1985 and 1986 taken separately.

lilangeni prices of their output increased sharply during the last two years. Personal deposits, on the other hand, have generally been declining in real terms since late 1985.

Bank loans and advances have increased much more slowly than bank deposits over recent years, and the counterpart of this difference has been a steep increase in net commercial bank balances with the Central Bank, which by end-1986 were almost equal to bank loans and advances (Chart 3). The growth in bank credit picked up somewhat in 1986 but, as was the case with deposits last year, the pattern was very different for business and personal loans and advances. While credit to business stagnated, personal loans jumped by 40 percent from a low base. Given the liquidity of the banking system, the call money rate, i.e., the rate that the Central Bank pays on the banks' balances with it, would appear to be setting a floor on the downward slide of deposit rates; the bankers' call rate was reduced from 5.5 percent in the first quarter of 1987 to 5 percent in the second.

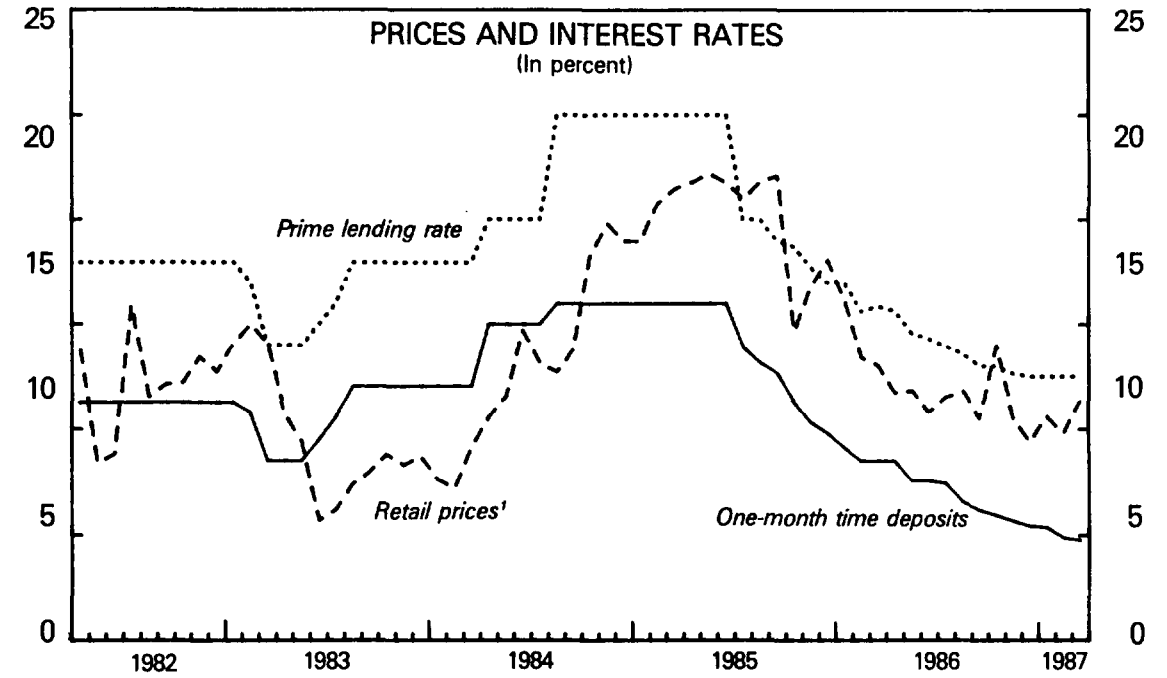
With lending to the private sector remaining fairly weak throughout, the overall balance of payments result has depended primarily on the relationship between money demand and the Government's recourse to bank financing (Table 1). In 1982 and 1986, net bank financing of the Government was large compared with the increase in the money supply, and there was a small external payments deficit in 1982 and approximate balance in 1986. In the intervening years, the Government's bank financing requirement was equal to less than 10 percent of the increase in the money supply, and there were strong balance of payments surpluses in all three years. For the five-year period as a whole, there was a cumulative surplus on balance of payments transactions of SDR 55 million (Table 3). Net international reserves, however, declined by SDR 4 million as the result of valuation losses, primarily on rand reserves.

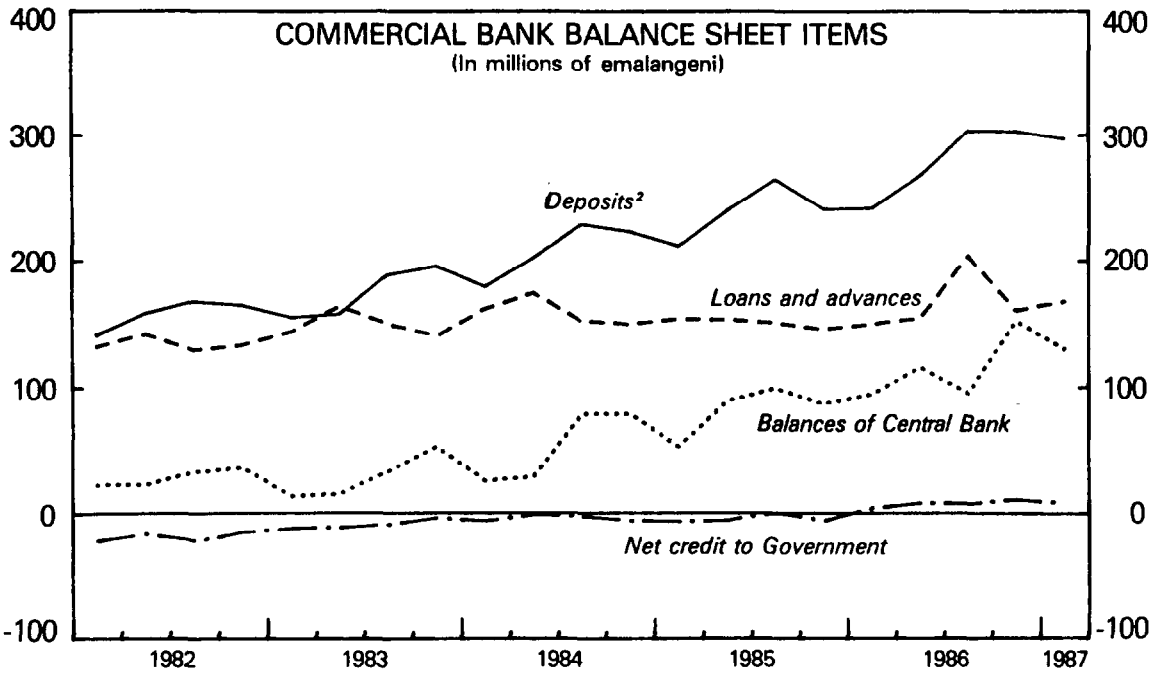
About 85 percent of Swaziland's imports come from South Africa, while only about one third of Swaziland's exports are sold in that market. Movements in the exchange rate for the rand and lilangeni have, therefore, little effect on the relative price of imports versus domestically produced goods in Swaziland, and for Swaziland the impact of exchange rate movements must come primarily through exports. These differential effects can be seen in Chart 4. The export-weighted real effective exchange rate for Swaziland fell by about 40 percent from mid-1983 to end-1985 and then moved up erratically to reach a level at mid-1987 that was 25 percent below that of mid-1983. Over these four years the net downward movement in Swaziland's import-weighted real effective rate was only 7 percent and the trade-weighted rate fell by 15 percent, or by about half the trade-weighted real effective depreciation of the rand.

From 1982 to 1985, Swaziland's exports and imports declined by 40 percent and 30 percent, respectively, in SDR terms. Such numbers, however, imply a much greater contraction of imports and a greater impact on the Swazi economy than actually occurred. Given the real effective depreciation of the rand, each SDR of export earnings bought

CHART 3

SWAZILAND





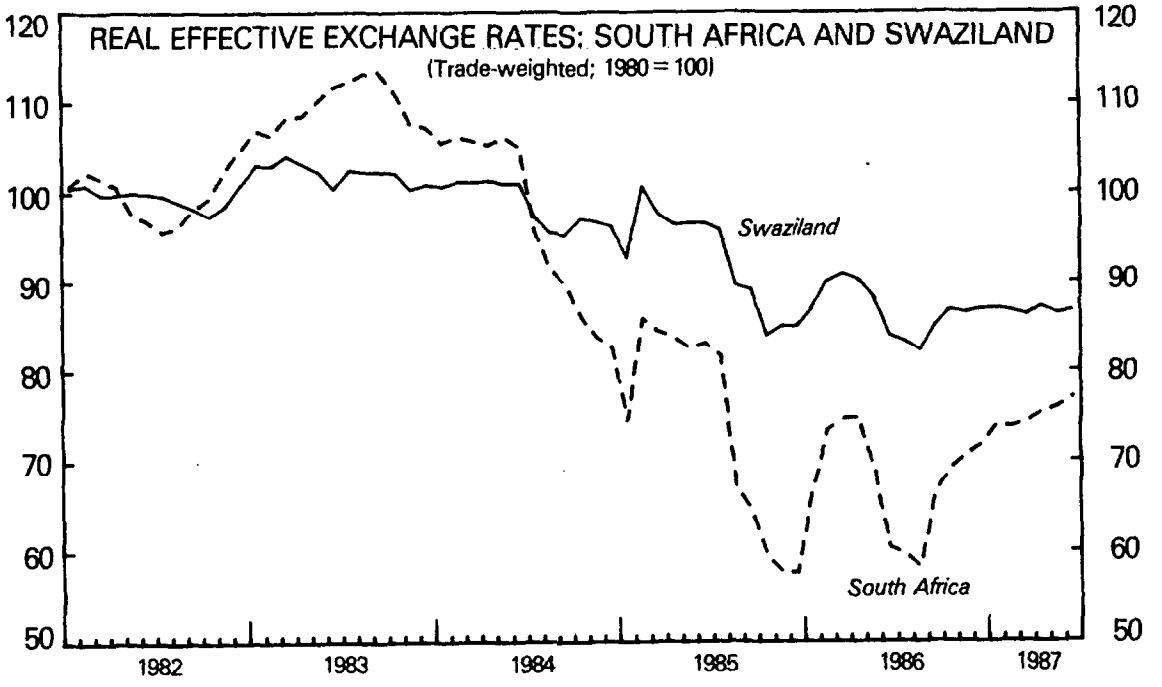
Sources: Central Bank of Swaziland, *Quarterly Review*, various issues.

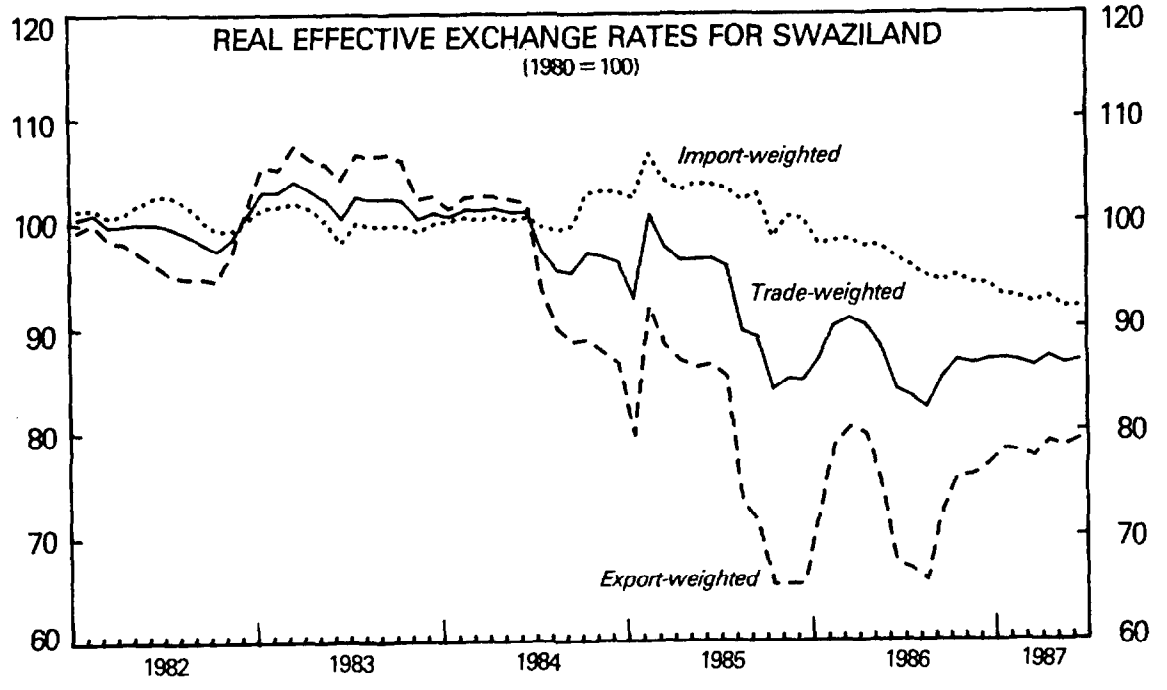
[1] Percentage change from the corresponding period in the previous year.

[2] Excludes deposits of the Government.

CHART 4

SWAZILAND





Source: IMF, Information Notice System.

Table 3. Swaziland: Balance of Payments, 1982-87

	1982	1983	1984	1985	1986 Est.	1987 Proj.
			(In millions of SDRs)			
Exports, f.o.b.	295	285	231	173	227	262
Sugar	(91)	(103)	(95)	(63)	(92)	(91)
Imports, f.o.b.	-398	-434	-370	-277	-275	-300
Trade balance	-103	-149	-139	-104	-48	-37
Services (net)	-34	-5	11	19	-5	-9
Nonfactor services (net)	-55	-28	-24	-16	-17	-15
Factor incomes (net)	21	22	35	35	12	5
Investment income (net)	(-8)	(-20)	(-9)	(-4)	(-26)	(-37)
Labor income (net)	(29)	(42)	(44)	(39)	(39)	(42)
Goods and services balance	-137	-155	-128	-85	-53	-47
Unrequited transfers (net)	27	25	34	20	18	19
Nonduty SACU receipts	35	46	45	33	18	16
Current account balance	-75	-84	-49	-32	-17	-11
Direct investment (net)	5	-13	2	26	16	31
Other long-term capital (net)	22	29	9	10	21	-3
Public sector	(17)	(26)	(13)	(-1)	(16)	(1) 1/
Private sector	(5)	(3)	(-4)	(11)	(5)	(-4)
Other short-term capital (net)	10	21	8	14	-5	-5
Errors and omissions	30	66	51	1	-11	...
Transactions balance	-8	19	21	19	4	13
Valuation adjustment	-1	-8	-29	-24	2	...
Change in net reserves	-9	11	-8	-4	6	...
Memorandum items:			(In units indicated)			
Gross official reserves						
(In millions of SDRs)	70	91	83	77	79	92
(In months of imports of goods and nonfactor services)	1.7	2.1	2.2	2.8	2.9	3.0
Debt service (in percent of exports of goods and services)	4.9	4.8	6.1	9.2	8.7	7.9 1/
Current account/GDP (in percent)	-16.4	-17.2	-10.8	-9.4	-4.7	-2.6
Emalangeni/SDR (period average)	1.1942	1.1890	1.4740	2.2247	2.6678	2.6138

Sources: Data provided by the Swazi authorities; and staff estimates and projections.

1/ Capital account includes, but debt service ratio excludes, a DM 15 million debt prepayment by Swaziland Railways.

more real imports from South Africa, and the real decline in Swaziland's imports over this period is estimated by the staff to have been less than 10 percent. Moreover, almost one half of the contraction in exports between 1982 and 1985 resulted from the closure of two firms, a chemical fertilizer plant and an electrical equipment manufacturer, for which imported inputs represented a large part of export value. As a result, the decline in exported value added was much less than the decline in exports, and imports--apart from these firms' inputs--were probably about the same in real terms in 1985 as in 1982. Quite apart from the foregoing factors, there was a sharp drop in export earnings in 1985 as a result of both lower volumes and weak world prices for Swaziland's main agricultural exports.

As exports and imports fell by the same amount in SDR terms over these four years, the trade deficit remained unchanged at about SDR 100 million. The current account deficit, however, declined from SDR 75 million (16 percent of GDP) in 1982 to SDR 32 million (9 percent of GDP) in 1985 as a result of higher worker remittances and a substantial increase in net receipts from travel. 1/ Of the SDR 143 million in cumulative identified net inflows of short- and longer-term capital during these four years, public sector borrowing accounted for only about one third. The most important source of foreign financing was private sector short-term borrowing, primarily by the sugar industry. Also, errors and omissions cumulated to a positive SDR 148 million.

In 1986 Swaziland's export earnings rose by one third as a result of very good weather conditions, a 50 percent increase in the price of sugar in the free market (where more than half of Swazi export volume is sold), and the entry into production of a number of new export-oriented manufacturing firms. Imports remained at the 1985 level, both in SDRs and in real terms, and the current account deficit fell further to SDR 17 million, or 5 percent of GDP. While public sector borrowing increased, owing to the speedup in claims processing noted above, there were net outflows both on the private short-term capital account and on errors and omissions. Overall the external accounts were about in balance in 1986, and the Swazi authorities ended the year with reserves that were equal to about three months' imports or to one third of the total public sector external debt. The debt service ratio last year was 9 percent.

III. Economic Prospects and Discussion of Policies

1. Policies and prospects in 1987

Real growth is expected to slow in 1987. A decline in agricultural output is anticipated as sugar production falls back to more normal

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1/ As with imports from South Africa, the SDR numbers understate the real growth of worker remittances. Also, Swaziland's GDP expressed in SDRs fell by one fourth from 1982 to 1985.

levels. Output from unirrigated lands may also decline on account of poor rains earlier this year. Growth in the rest of the economy is, however, expected to remain strong. Despite some decline in agricultural processing, manufacturing output should continue to expand, partly as the result of rising production from new firms. A major soft drink manufacturer has recently shifted its concentrate plant for the southern African region to Swaziland, and other new industries include chipboard and garment factories and a textile mill. Mining activity should also help maintain growth, with fairly strong increases anticipated in coal and diamond production. Overall the staff estimates that real growth may be about 2 to 3 percent this year.

Growth in manufacturing and mining should lead to an increase in paid employment. However, with employment data available only through 1985, it is too early to assess whether the recent economic recovery has reversed the downward trend in paid employment over the first half of the decade. Inflation is expected to accelerate in 1987, reflecting both the weaker performance of agriculture and the upward pull of continued high inflation in South Africa; in the first quarter of this year prices in Swaziland were rising at an annual rate of 13 percent.

Exports are projected to rise by about 15 percent in SDR terms as a decline in agricultural exports is more than offset by an increase in exports of manufactured goods, particularly soft drink concentrate, and of minerals. As imports are expected to rise by somewhat less than exports in SDR terms, the current account deficit is projected to decline further from SDR 17 million (5 percent of GDP) in 1986 to SDR 11 million (3 percent of GDP). Despite the continued speedup in processing of reimbursement claims on foreign-financed projects, net public sector foreign borrowing will be about zero in 1987 due to a decision by Swaziland Railways to borrow from a local bank to prepay a foreign loan contracted in deutsche mark.

Valuation adjusted data on the change in net foreign assets are not available for the first half of 1987, but the monetary data would imply a continued balance of payments surplus. As noted above, money growth accelerated during this period; at the same time, there was a decline in net credit to the Government and private sector credit remained sluggish. 1/

a. Fiscal policy

The Swazi authorities were of the view that the increase in the government deficit in 1986/87 resulted from exceptional circumstances, particularly the precipitous decline in SACU revenues, and represented neither a loosening of the stance of fiscal policy nor a fundamental deterioration in the fiscal position. They intend to reduce the deficit

1/ Government recourse to bank financing for fiscal year 1986/87 was only about one third of that for calendar year 1986.

sharply in 1987/88, primarily through further cuts in expenditure. Moreover, recent developments now point to an improved revenue outlook for the medium term.

The revised estimates for 1987/88, which take into account recent and anticipated supplementary appropriations as well as developments on the revenue side, envisage a halving of the overall budget deficit to E 27 million, or 2.3 percent of GDP compared with 5.4 percent in 1986/87. 1/ Reflecting in part the continued catch-up on the processing of reimbursement claims on foreign-financed projects, the deficit is expected to be financed almost entirely through net foreign borrowing.

Total revenue and grants are projected to increase about in line with nominal GDP. A substantial growth in company tax receipts is anticipated on account of the delayed impact of last year's boom in the sugar industry as well as the recent establishment of the soft drink concentrate plant. Income tax receipts, however, are projected to decline sharply in real terms, and performance of other revenues is expected to be sluggish. SACU receipts will register a small further decline relative to GDP, while sales tax receipts are forecast to rise by somewhat less than GDP despite the fact that 1987/88 is the first full year of the new higher rates. A new road levy was introduced in mid-1987, but the yield is expected to be small in the current fiscal year.

Given the overall outlook for revenues, the targeted improvement in the fiscal position is to be achieved by holding total expenditure and net lending to 28 percent of GDP, a 3 percentage point reduction from the previous year that is to fall on both current and capital spending (including net lending). The cut in current expenditure is to come primarily from a reduction in purchases of goods and services as spending returns to more normal levels following the coronation in 1986. Capital expenditure is expected to decline somewhat further relative to GDP, while net lending is to be cut by a full percentage point of GDP, primarily as the result of an exceptional redemption of preference shares purchased earlier to provide start-up support for a large sugar mill.

The staff representatives commended the authorities on the overall stance of fiscal policy, particularly the prompt and determined response to a decline in SACU revenues that had been equal to almost 10 percent of GDP since 1982/83. The revenue effort had been considerable, with tax revenues other than SACU receipts rising by 3 percent of GDP over this period. Nevertheless, expenditure--particularly capital spending--had borne the brunt of the adjustment. The authorities did not see the reduction in capital spending as a major constraint on development, as

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1/ The revisions to revenue and to expenditure projections are offsetting and leave the overall deficit at the level envisioned in the original budget for 1987/88.

growth was expected to come primarily from new private sector investment. The authorities were, moreover, of the view that at present there was probably a greater return to increased expenditure on maintaining and improving existing capital stock than to major new investments in infrastructure.

The staff representatives expressed concern about the expected sluggishness of sales tax receipts in 1987/88. It was the staff's impression that sales tax evasion, particularly through the underreporting of imports, had increased after the doubling of the general sales tax in May 1986. 1/ If so, the underreporting of imports was particularly worrisome as it would undermine not only sales tax revenues but also Swaziland's SACU receipts.

The authorities shared the staff's assessment and concern regarding the apparent increase in underreporting of imports. The key problem was enforcement at a large number of relatively isolated border posts. This was a new development that the authorities would have to find ways to address.

The authorities explained that the projected weakness in income tax receipts could in part be explained by their decision to grant for 1987/88 a 7 percent across-the-board income tax reduction to offset past "bracket creep." Overall, however, their estimates were probably quite conservative. They had reorganized the Income Tax Department in July 1987 and established a new investigations unit. They expected the new unit to result in improved collections; however, as a general rule, they do not take improvements in tax administration into account in their revenue projections until the results of such measures begin to show up in actual receipts. Also, their projections made allowance for the possibility that last year's very strong growth of income tax receipts might in part have represented a one-time windfall as a result of the introduction of the system of tax clearance certificates to document income tax compliance.

The staff representatives noted that the lack of timely and centralized information on the parastatals prevented an analysis of the overall financial performance of the public sector. While the available data did not indicate major problems in this area, e.g., dependence on the budget had been limited and the parastatals had a net creditor position vis-à-vis the banking system, there was a need for an improved flow of information in order to facilitate orderly debt management and to enable the authorities to foresee and control parastatal recourse to the budget. The authorities said they were aware of this problem and were studying a proposal to establish a public enterprise monitoring unit.

1/ To take into account this underreporting of imports, the staff's balance of payments estimates for 1986 incorporate an estimate of imports SDR 17 million higher than that derived from customs figures. This adjustment was made in consultation with the authorities.

b. Money and credit

The staff representatives considered that, despite recent history, the Swazi authorities had to be prepared for the possibility that money demand could weaken considerably. Personal deposits had already slowed and might continue to decline in real terms if real interest rates remained negative. At the same time, the staff considered that there was a possibility of a rundown in the large business time deposits that had sustained total money growth over the past 18 months. The staff noted that such deposits, which probably resulted from windfall gains to exporters, were being kept in a very liquid form and that a steady downward movement in the rand and lilangeni, as would appear warranted by inflation differentials, would increase substantially the relative return to shifting these funds overseas unless deposit rates rose accordingly. Given the liquidity of the banking system, a rundown of these deposits would not necessarily result in an immediate narrowing of the deposit rate differential between Swaziland and South Africa, and it was unlikely that South African interest rates would rise sufficiently to produce a competitive rate of return on Swazi deposits. The staff noted that such a shift of funds could take place through the repayment of debt. The sugar industry in particular had undertaken large cumulative net short-term borrowing over recent years.

The Swazi authorities were also uncertain about the stability of these funds. They pointed out, however, that interest rates were set by the banks and that interest and exchange rate developments reflected the policies adopted by South Africa. They thought that at least part of these liquid deposits would be retained in Swaziland for essentially political reasons. In any case, the Central Bank of Swaziland had sufficient reserves to weather such outflows.

The staff representatives considered that the possibility of weakened money demand made the reserve level look considerably less comfortable. The authorities should, therefore, be prepared to use bank reserve requirements and call rate and discount rate policies actively to encourage an upward movement in deposit rates if money growth does begin to slow. In particular, it would be important to monitor business time deposits closely.

The staff representatives also expressed concern regarding the recent establishment by the Central Bank of a facility to provide exchange rate guarantees on medium- and long-term foreign borrowing by the public sector. In the event of a depreciation, such guarantees would result in the effective transfer to the books of the Central Bank of part of the deficit of the public sector, thus obscuring analysis of the overall fiscal situation and making control more difficult. The Swazi authorities explained that the exchange rate guarantee provisions had originally been developed to facilitate the establishment of the Swaziland Industrial Development Corporation (SIDC), as one of the

partner multilateral agencies had required such guarantees. The authorities said they were aware of the dangers of such a scheme and intended to use it very selectively.

2. The medium-term outlook and structural issues

Throughout the discussion the Swazi authorities stressed that reliance on market forces was the cornerstone of their economic policies and of their development strategy. Only a very few prices are controlled, and even for those commodities prices are adjusted in line with market developments and no budgetary subsidies result. Public enterprise activity is essentially limited to the railway, the airline, and public utilities, although the Government has recently made some investments in tourism. The Government is also a minority partner in some firms, including the newly created Swaziland Industrial Development Corporation, a private company in which multilateral and bilateral agencies hold controlling interest.

In line with this philosophy, private sector investment is expected to provide the main engine of growth over the medium term and the planning process focuses primarily on the public sector's provision of services and infrastructural support. Since the last consultation discussions, evidence has mounted that regional developments are leading to stepped-up investor interest in Swaziland, in view of Swaziland's access to both South African and other regional markets, as well as to other key markets, including through its membership in the Lomé Agreement. The increased competitiveness of the Swazi economy appears also to have been a factor, as some of the new investment has been undertaken by firms from outside the region and directed to overseas markets. Newly established firms are already making an important contribution to the balance of payments, the budget, and growth; and an important number of other investors have indicated their interest in opening manufacturing operations in Swaziland. The Swazi authorities recognize that, to maintain this momentum, it is important to ensure the "made in Swaziland" label means exactly that, and they have, therefore, issued and are enforcing strict guidelines regarding the domestic content of exports labeled as products of Swaziland.

The most pressing problem confronting the Swazi economy over the medium term is the need to absorb the rapidly growing labor force. Employment opportunities in South Africa cannot necessarily be assumed to continue to provide the escape valve that they did over the first half of the decade. A continued influx of refugees from Mozambique and elsewhere could also add to employment pressures. The staff emphasized that the employment problem underscored the need to maintain the competitiveness of the Swazi economy, particularly wage competitiveness. Analysis in that regard would be greatly facilitated by the collection of timely data on private sector wages and unit labor costs. At the same time, the staff representatives thought that the poor recent record with respect to employment generation may have reflected the fact that development has centered on large, foreign-owned firms that tend to use

relatively more capital-intensive techniques. Efforts to expand small-scale agriculture and small enterprises might bring greater rewards in terms of employment generation.

The authorities said that, while they did not intervene in private sector wage decisions, restraint had been exercised in the granting of public sector wage increases and in adjusting the minimum wage; in some industries the minimum wage had not been increased since 1983. The authorities agreed that small-scale agriculture would have to play a role in absorbing the expanding labor force. They were currently making efforts to improve marketing facilities for smallholders, and the improvement of extension services was a medium-term objective. The Small Enterprise Development Corporation (SEDCO) provided technical assistance and rented out workshop space, but SEDCO's credit program had been discontinued after large losses.

The staff representatives noted that, in their meetings with both public and private sector representatives, the unavailability of credit had frequently been cited as a prime constraint on the development of small business and agriculture. On the other hand, not only SEDCO but also the two smaller banks in Swaziland had taken heavy losses on such lending, while the two big foreign banks that dominated banking in Swaziland were likely to continue to gear their operations to the banking and international trade needs of their larger customers. While this was a difficult area, the staff thought that the authorities might usefully seek assistance from bilateral and multilateral agencies that had experience with successful credit programs for small business and agriculture, particularly in the context of traditional land tenure systems. The staff noted, moreover, that the recent growth in personal loans might be a welcome development in this regard, as "personal" loans were often in fact used for investment in small farms and firms.

The staff representatives also observed that the banks seemed to have been the major beneficiaries of depositors' increasing preference for keeping their funds in Swaziland rather than in South Africa. While the banks had kept lending rates pegged in line with those in South Africa, deposit rates had been progressively lowered and the spread between deposit and lending rates was now double what it had been in the late 1970s. At present the average cost of funds to the banks was about 3 1/2 percent, while the prime rate was 12 1/2 percent and borrowers other than the largest firms paid several percentage points above prime. Such large spreads, as well as the limited role the banks were playing in intermediating funds in the Swazi economy, also seemed to point to the need for institutional innovation and increased competition in the financial sector.

Regarding the fiscal outlook, the authorities expected to see continued strong growth in company tax revenues over the medium term. Tax receipts from the new soft drink concentrate plant will reach E 7.5 million (0.7 percent of GDP) already in 1987/88, the first year of operation, and are scheduled to rise threefold in the following year. More generally, the anticipated continued expansion in manufactured

exports could also be expected to buoy company tax receipts, although in some cases that impact would be delayed as a result of the five-year tax holiday Swaziland offers the first firm in a new industry. Also, SACU revenues should respond to the expected recovery in imports. Overall, then, the authorities considered that, provided the problem of sales tax evasion and underreporting of imports was successfully addressed, the medium-term outlook was for an upturn in revenues. They were, however, concerned about the impact of income tax bracket creep over recent years and were considering an offsetting revision of the tax schedule. The schedule had not been revised since 1982, while consumer prices had almost doubled in the meantime, and the highest marginal tax bracket in Swaziland is now reached well before the corresponding rate in South Africa. The staff representatives agreed with the authorities that an adjustment of tax brackets would be desirable, but urged the authorities, consistent with their general practice, to act only when the strength in other revenues was an established fact.

The staff and the authorities agreed that the medium-term outlook for the balance of payments had improved considerably since the time of the last consultation discussions, as relatively strong export growth now appeared likely as the result of substantial new foreign investment in both manufacturing and mining. Even on conservative assumptions regarding the prices and volumes of agricultural exports, the staff's projections now indicated sufficiently strong export growth over the next four years to permit, for example, an expansion of imports of about 4 percent a year in real terms while keeping the current account deficit below 5 percent of GDP. (This medium-term scenario is presented in Appendix VI.) New investment--and, therefore, the relatively favorable outlook projected by the staff--will depend critically on maintaining Swaziland's competitiveness, which will require in turn that South Africa follow a policy of depreciating the rand so as to maintain the competitiveness of its own nongold exports.

The Swazi authorities considered it likely that South Africa would follow such a policy; nevertheless, they would need to consider whether or not to abandon the peg between the rand and lilangeni if the rand should appreciate further in real terms. The staff noted that the costs of a devaluation against the rand could be high, both in terms of inflation and in terms of the effect on confidence and, hence, capital movements and/or interest rates. Given the integration of the two economies, a devaluation could not be expected to produce a significant shift in the level or structure of prices of goods as between Swaziland and South Africa. The benefits of a devaluation would, therefore, have to come primarily through its effect on wage competitiveness, real incomes, and absorption; those effects might be better achieved through pre-emptive use of other policy instruments to prevent a decline in competitiveness and a deterioration in the balance of payments position. In particular, the staff warned against attempting to use the exchange rate as a substitute for fiscal policy measures. Not only would this be more disruptive to the economy than a tax increase, but also the initial benefit to the budget would be rapidly eroded by inflation.

IV. Staff Appraisal

Following four years of slow growth and declining per capita incomes, the economy of Swaziland rebounded in 1986, achieving an estimated real growth of at least 7 percent. While this growth was partly the result of exceptional factors, including weather conditions that yielded record levels of sugar and maize production, the medium-term outlook has also improved since the last consultation discussions, primarily as the result of the substantially stepped-up foreign investor interest in both the manufacturing and mining sectors in Swaziland. Nevertheless, the Swazi economy remains vulnerable, not only to the vagaries of weather but also to economic and political developments in the region. At the present time, Swaziland faces a growing refugee problem as well as intermittent but severe difficulties with its transportation links to the port at Maputo in Mozambique, both arising from political instability in the southern African region.

The Swazi authorities recognize that generating adequate levels of employment will remain a major challenge for economic policy, especially in light of the rapidly growing labor force, the influx of refugees, and the uncertain prospects for Swazi migrant labor in South Africa. The maintenance of highly competitive wages will be crucial. In this regard, the restraint shown in granting public sector wage increases, and in not raising minimum wages, is to be commended and needs to be continued. The availability of timely data on employment and wages would facilitate policy assessment and formulation.

There would appear to be room for a somewhat more active role for the Government in facilitating the development of smallholder agriculture, which could help absorb the growing labor force. In particular, there could be a greater role for the Government in providing extension services and in improving the physical and institutional infrastructure needed to facilitate the marketing of agricultural produce. Moreover, assistance might usefully be sought from bilateral and multilateral agencies that had experience with successful programs for credit to small businesses and agriculture, particularly in the context of traditional land tenure systems.

Despite the persistence of negative real interest rates, money demand has thus far remained strong, apparently reflecting, at least in part, depositors' increasing preference for keeping their funds in Swaziland rather than in South Africa. In this environment, the Government's generally moderate net recourse to domestic bank financing, combined with stagnation in bank loans and advances to nongovernment sectors, has resulted in a good performance of the overall balance of payments. There is, however, a possibility that money demand could weaken in the near future. The growth in personal deposits has already slowed and the buildup of very liquid business deposits could be reversed if the rand and lilangeni begin to move downward vis-à-vis financial center currencies. The possibility of a slowdown in the growth of money holdings underscores the need for caution in fiscal

policy and, given the liquidity of the banking system, may require that the monetary authorities take steps to put upward pressure on deposit rates.

As long as the lilangeni remains pegged to the rand, Swaziland's export potential over the medium term will depend crucially on South Africa's exchange rate policy. At the present level of the exchange rate, Swaziland's export industries appear to continue to be profitable and competitive and foreign investor interest remains strong. However, inflation in Swaziland exceeds that in its trading partners, other than South Africa, by a substantial margin and Swaziland's competitiveness could be eroded rapidly unless the lilangeni is depreciated sufficiently to offset that differential.

The authorities' response to a cumulative decline in SACU revenues equal to almost 10 percent of GDP over the past five years, as well as to the associated sharp increase in the fiscal deficit in 1986/87, has been both determined and timely. At 2.3 percent of GDP, the Government's overall deficit for 1987/88 is expected to be less than half that of 1986/87 and, indeed, below that recorded five years ago. Although capital expenditure and net lending have borne the brunt of the adjustment, the authorities' decision to introduce a sales tax in 1984 and double that tax rate in 1986 has generated substantial additional revenues, and current spending has been held in check despite the higher local currency costs of servicing the foreign debt. Restraint in both hiring and salaries has kept the increase in the wage bill, which accounts for half of government current spending, below the growth in nominal GDP.

The recent and anticipated increases in manufacturing investment and output should result in a substantial growth in company tax receipts in the current and future fiscal years. This, combined with some recovery in SACU receipts, is expected to strengthen revenue performance over the medium term. A major area of concern, however, is the apparent recent increase in sales tax evasion, particularly through the underreporting of imports at border posts. The staff would urge the authorities to attach the highest priority to improvements in the administration and staffing of the Customs and Excise Department, as any loss of sales tax revenue from an underreporting of imports will be compounded by an associated loss of SACU revenues. If this problem is successfully addressed and total revenues turn upward, the staff agrees with the authorities that some adjustment of income tax brackets would be desirable to offset the impact of the rapid inflation of recent years on marginal tax rates. The staff would also endorse the idea presently under consideration of establishing a public sector monitoring unit to facilitate orderly debt management and permit more effective control of parastatal recourse to the government budget.

Swaziland maintains an exchange system that is free of restrictions, except that an exchange restriction subject to the Fund's approval under Article VIII, Section 2(a) arises from provisions for limited conversion of balances under the common monetary arrangements between South Africa, Lesotho, and Swaziland, as amended with effect from April 1, 1986. The staff does not recommend approval of this restriction.

It is recommended that the next Article IV consultation with Swaziland be held on the standard 12-month cycle.

SWAZILAND - Relations with the Fund
(As of July 31, 1987)

I. Membership Status

a. Date of membership: September 22, 1969
b. Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

a. Quota: SDR 24.7 million

	Amount (In millions of SDRs)	Percent of Quota
b. Total Fund holdings of emalangeni	29.2	118.2
c. Use of Fund credit:		
Compensatory financing facility--exports	4.5	18.2
d. Reserve tranche position	--	--

III. Current Stand-By or Extended Arrangement and Special Facilities

Swaziland has not made use of Fund resources to date under stand-by or extended arrangements. A purchase under the buffer stock financing facility equivalent to SDR 0.975 million was made on January 6, 1983 and repurchased on February 7, 1985. A purchase of SDR 9.0 million under the compensatory financing facility was made in June 1983.

	Amount (In millions of SDRs)
IV. SDR Department	
a. Net cumulative allocation	6.4
b. Holdings	2.2 (or 33.6 percent of net cumulative allocation)
V. Trust Fund Loans Outstanding	
a. Disbursed	4.5
b. Outstanding	2.4
VI. Overdue Obligations to the Fund	--

SWAZILAND - Relations with the Fund (concluded)

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

Following the renegotiation of the Rand Monetary Agreement, now called "Trilateral Monetary Agreement," in April 1986, the rand ceased to be legal tender in Swaziland effective July 1, 1986. However, 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 commercial rand against the U.S. dollar. The rate on July 31, 1987 was E 1 = US$0.4855.

VIII. Last Article IV Consultation

The 1986 Article IV consultation discussions took place in Mbabane during June 9-19, 1986. The Executive Board discussed the reports (SM/86/192 and SM/86/221) on September 9, 1986, and the following decision was taken:

"1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Swaziland, and in the light of the 1986 Article IV consultation with Swaziland conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Swaziland continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions."

Swaziland is on the standard 12-month cycle for Article IV consultations.

IX. Technical Assistance

There are two experts currently serving at the Central Bank of Swaziland, one as Advisor for Research and the other as Chief Manager, Bank Supervision Department. The Fiscal Affairs Department has provided frequent technical assistance, including most recently a staff visit in May 1987 to review revenue measures.

SWAZILAND - Financial Relations with the World Bank Group

Since 1962 the World Bank Group has approved 11 IBRD loans, 2 IDA credits, and 3 IFC investments for a total of US$91.9 million. The Group has helped finance four road projects, four power projects, two education projects, one project each for water supply/sewerage, rural development, and development finance, and has made investments in support of a development finance corporation, an agro-industrial enterprise producing sugar and cotton, and textile production. As of June 30, 1987, there were active loans of US$10.1 million to be disbursed in education (US$2.0 million), road rehabilitation (US$5.3 million), a textile company (US$0.5 million), and a development finance corporation (US$2.3 million). Equity yet to be disbursed amounted to US$0.7 million, of which US$0.6 million was to a development finance corporation and US$0.1 million was to a textile company. The amount of outstanding loans totaled US$56.6 million.

Swaziland: Status of Lending by World Bank Group
as of June 30, 1987

(In millions of U.S. dollars)

	IDA Credits 1/	IBRD Loans 2/	Total
Number of projects	2	11	13
Amount approved	8.4	75.8	84.2
Less: Cancellations	--	2.4	2.4
Repayments	1.0	21.1	22.1
Undisbursed	--	7.3	7.3
Education	(--)	(2.0)	(2.0)
Road rehabilitation	(--)	(5.3)	(5.3)
Exchange rate adjustment	--	14.1	14.1
Borrower's obligations	7.3	59.0	66.3

IFC investments 3/

	Loans	Equity	Total
Disbursed	6.7	1.0	7.7
Undisbursed	2.8	0.7	3.5
Total	9.5	1.7	11.2

Source: World Bank Group.

1/ Projects for roads and education.
2/ Three power projects; three roads projects; two education projects; and one project each for water supply/sewerage, rural development, and development finance.
3/ Investments in support of a development finance corporation, an agro-industrial enterprise producing sugar and cotton, and textile production.

SWAZILAND - Basic Data

Area, population, and GDP per capita

Area	17,364 square kilometers
Population: Total (1986)	694,000
Growth rate	3.1 percent
GDP per capita (1986)	SDR 572

	1982	1983	1984	1985	1986 Est.	1987 Proj.
	(In millions of emalangeni)					
GDP						
GDP at current market prices	547	580	666	754	957	1,104
	(In percent)					
Growth of real GDP (factor cost)	2.6	-0.3	4.2	2.4	7.4	2.5
Agriculture/GDP	22.4	22.4	22.7	23.8	25.3	...
Manufacturing/GDP	23.0	23.3	22.3	21.9	22.7	...
Government/GDP	17.7	17.3	18.7	18.4	16.7	...
Gross fixed capital formation/ GDP at market prices	27.9	36.0	31.3	29.9	27.1	...
Prices						
GDP deflator	7.9	7.0	10.4	9.7	18.2	12.5
Consumer retail prices						
Annual average	13.2	11.4	13.5	20.8	10.4	13.0
December to December	12.7	8.7	19.0	18.1	9.4	15.0

	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88 Est.
	(In millions of emalangeni)					
Central government finance						
Total revenue and grants	182.1	185.6	221.5	243.9	249.8	293.6
Revenue	176.7	179.7	210.8	233.7	239.3	283.0
Grants	5.4	5.9	10.7	10.2	10.5	10.6
Total expenditure and net lending	199.4	205.2	225.1	270.1	303.8	320.6
Current expenditure	124.0	136.7	142.5	170.6	216.4	238.0
Capital expenditure 1/	57.7	53.9	53.8	87.3	73.3	78.6
Net lending	17.7	14.6	15.3	12.2	14.1	4.0
Payment of arrears	--	--	13.5	--	--	--
Overall surplus/deficit (-)	-17.3	-19.6	-3.6	-26.2	-54.0	-26.9
	(In percent of GDP)					
Overall surplus/deficit (-)	-3.1	-3.3	-0.5	-3.3	-5.4	-2.3
External borrowing (net)	0.1	0.2	-0.8	0.3	3.4	2.2
Domestic bank borrowing (net)	3.0	2.9	1.0	0.8	0.9	--

1/ Includes net lending.

SWAZILAND - Basic Data (concluded)

	1982	1983	1984	1985	1986 Est.	1987 1/ Proj.
	(In millions of emalangeni)					
Money and credit						
Net foreign assets 2/	86	105	143	203	195	222
Domestic credit	110	130	132	138	178	180
Government (net)	(-31)	(-16)	(-24)	(-22)	(13)	(9)
Nongovernment	(141)	(147)	(156)	(159)	(165)	(171)
Other items (net) 2/	-34	-37	-37	-47	-47	-34
Broad money	161	198	239	293	326	368
	(In millions of SDRs, unless otherwise specified)					
Balance of payments						
Exports, f.o.b.	295	285	231	173	227	262
Imports, f.o.b.	-398	-434	-370	-277	-275	-300
Trade balance	-103	-149	-139	-104	-48	-37
Services and transfers and nonduty SACU receipts (net)	28	65	90	72	31	26
Current account balance	-75	84	-49	-32	-17	-11
Long-term capital (net)	27	16	11	35	37	28
Official	(17)	(26)	(13)	(-1)	(16)	(1)
Private	(10)	(-10)	(-2)	(36)	(21)	(27)
Short-term capital (net)	10	21	8	14	-5	-5
Errors and omissions	30	66	51	1	-11	...
Transactions balance (deficit -)	-8	19	21	19	4	13
Current account deficit as percent of GDP	-16	-17	-11	-9	-5	-3
Gross official foreign reserves (end of period)	70	91	83	77	79	92
In months of imports of goods and nonfactor services	1.7	2.1	2.2	2.8	2.9	3.0
External public debt						
Disbursed and outstanding 3/	171	196	195	222	259	...
Debt service (in percent of exports of goods and services)	4.9	4.8	6.1	9.2	8.7	7.9

1/ Money and credit data are as at June 30, 1987.
2/ Includes valuation effect of changes in reserves. For analytical presentation of data, excluding valuation effects, see Table 1.
3/ Public and publicly guaranteed external debt in millions of U.S. dollars, as of March 31 of the following year.

Swaziland--Statistical Issues

1. Outstanding statistical issues

a. General economic data

No production data are reported for publication in IFS. A quarterly index of industrial production covering manufacturing and mining is already being compiled. Given the importance of manufacturing in Swaziland (over 20 percent of GDP), the index of industrial production needs to be reported regularly for publication in IFS. No trade indices are compiled.

b. Government finance

The 1986 GFS Yearbook includes the derivation table and statistical tables on revenue, expenditure, and lending minus repayments for the budgetary Central Government through fiscal year 1984. It also includes provisional data in the statistical tables for fiscal years 1985 and 1986. The statistical tables on financing and debt for the budgetary Central Government are incomplete; the latest breakdown available for domestic financing corresponds to 1985. For local governments, the 1986 Yearbook only includes data through 1979.

The published annual time series in IFS corresponds with the data in the GFS Yearbook. A technical assistance mission recently helped redesign the derivation tables for principal fiscal aggregates as a result of which revised data for budgetary Central Government for 1983-86 and projections for 1987 have become available for publication in GFS and IFS. An update of the operations of local governments for 1980-86 has also been received.

c. Balance of payments

In the present staff report, a transactions or performance balance is presented above the line. Total changes in reserves not due to transactions are shown separately as a valuation adjustment. The calculation of the transactions changes and counterpart entries accord in general with the recommendations of the IMF's Balance of Payments Manual. The Central Bank of Swaziland, in its balance of payments presentations in emalangeni, calculates an additional counterpart to valuation changes to reflect changes in the SDR purchasing power of reserves, with offsetting entries above the line in net errors and omissions.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Swaziland in the September 1987 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Swaziland, which during the past year have been provided on a timely basis; however, the currentness of the data for trade and national accounts could be improved.

Status of IFS Data

		Latest Data in September 1987 IFS
Real Sector	- National Accounts	1983 (GDP only, 1984)
	- Prices: CPI	April 1987
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1986 1/
	- Financing	1986 1/
	- Debt	1986 1/
Monetary Accounts	- Monetary Authorities	June 1987
	- Deposit Money Banks	June 1987
	- Other Financial Institutions	n.a.
Interest Rates	- Discount Rate	June 1987
	- Bank Lending/Deposit Rate	June 1987
	- Bond Yields	n.a.
External Sector	- Merchandise Trade:	
	Values: Exports	Q1 1986
	Imports	Q3 1986
	Prices	n.a.
	- Balance of Payments	1985
	- International Reserves	July 1987
	- Exchange Rates	July 1987

1/ Provisional.

Swaziland - Social and Demographic Indicators

Area	Population (1986)	Density (1986)
17,360 km	694,000	40.3 per sq. km

Population characteristics (1984)	
Life expectancy at birth	52.0
Infant mortality (percent)	11.0
Child death rate (percent)	
Male	9.0
Female	7.0

Health (1980)	
Population per physician	6,900
Population per nursing person	457

GDP per capita (1986)
SDR 572

Distribution of land (1986)	
Percent of land	
Traditional land tenure	56.0
Title deed lands	44.0

Access to safe water (1986)	
Percent of population	
Urban	100.0
Rural	40.0

Education (1985)	
Adult literacy rate (percent)	65.0
Primary school enrollment (percent)	107.0

Labor force (1986)	
Formal employment	74,611
Migrant workers	25,237
Working age population	340,000

Sources: World Bank; ILO, Swaziland: Manpower, Education, and Training, 1986; and staff estimates.

Medium-Term Scenario

This note describes the methodology used for the accompanying medium-term balance of payments projections (Table 4). Exports of goods and services should be interpreted as a forecast, while the exercise as a whole should be read as suggesting a possible scenario based on the assumptions outlined below. It should be stressed that uncertainties regarding weather conditions and the political situation in the Southern African region have not been incorporated in the analysis, even though their impact on the Swazi economy could be substantial.

The projections are based on two key assumptions: First, it is assumed that the lilangeni will remain pegged to the rand and that the current competitiveness of Swaziland's exports and its current attractiveness to foreign investors will be sustained through the maintenance of the real effective exchange rate for the rand. Second, it is assumed that the authorities would maintain reserves at the equivalent of three months of imports and borrow as necessary to meet that target. Within this framework, the implications of various rates of import growth on the financing requirement and on debt service were explored. The scenario presented here assumes real import growth of about 4 percent, which would be consistent with some increase in per capita income. 1/

Export projections were made for each major export commodity. Price projections were, in most cases, those of the Commodities Division of the Fund, while volume changes were based on respective market expectations and supply conditions that were discussed with the authorities. In general, the export projections are conservative. They are based on considerably lower price projections for sugar sold on the free market than those from the Commodities Division, and sugar volumes have been assumed to remain at the 1987 level. While that level of sugar production is well below the record achieved in 1986, it is in line with normal output and with the policy of not increasing the land under sugar production. Modest growth has been assumed for wood pulp and wood products, canned fruit, diamonds, coal, and new manufactured exports.

The projections have incorporated an increased repatriation of profits from new enterprises, including, beginning in 1987, from the soft drink concentrate operation. The average interest cost on new borrowing is assumed to be 8 percent. Labor remittances, almost exclusively from South Africa, are projected conservatively by assuming

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1/ The staff would expect the elasticity of imports with respect to GDP to be somewhat greater than one on the assumptions of this scenario. While, given the exchange rate assumption, there is no reason to presume a change in the share of imports in final demand, exports should become somewhat more import-intensive over time as the share of manufactured exports in the total rises.

Table 4. Swaziland: Medium-Term Balance of Payments Scenario, 1986-91

	1986 Est.	1987 Proj.	1988	1989	1990	1991
			(In millions of SDRs)			
Exports, f.o.b.	227	262	284	302	322	345
Sugar	(92)	(91)	(95)	(102)	(110)	(120)
Imports, f.o.b.	-275	-300	-324	-350	-378	-408
Trade balance	-48	-37	-40	-48	-56	-63
Services (net)	-5	-9	-10	-9	-12	-16
Nonfactor services (net)	-17	-15	-16	-17	-19	-20
Factor incomes (net)	12	5	6	7	7	4
Investment income	(-26)	(-37)	(-37)	(-38)	(-40)	(-44)
Labor income	(39)	(42)	(43)	(45)	(47)	(48)
Unrequited transfers (net)	18	19	20	21	22	24
Nonduty SACU receipts	18	16	27	28	24	25
Current account balance	-17	-11	-3	-8	-22	-30
Long-term capital (net) 1/	37	28	13	14	29	38
Short-term capital (net) 2/	-16	-5	--	--	--	--
Change in reserves	4	13	10	6	7	8
Memorandum items:			(In units indicated)			
Gross official reserves 1/						
(In millions of SDRs)	79	92	102	108	115	123
(In months of imports of goods and nonfactor services)	3	3	3	3	3	3
Debt service (in percent of exports of goods and services)	9	8 3/	8	9	7	6
Current account/GDP (in percent)	-5	-3	-1	-2	-4	-5
Emalangeni/SDR (period average)	2.6678	2.6138	2.9042	3.2129	3.5388	3.8807

Sources: Data provided by the Swazi authorities; and staff estimates and projections.

1/ For 1988-91, the scenario assumes the authorities maintain reserves at three months' imports and borrow as needed to meet that target. Foreign borrowing is, therefore, the residual.
2/ Includes errors and omissions.
3/ Capital account includes, but debt service ratio excludes, a DM 15 million debt prepayment by Swaziland Railways.

zero growth in the number of Swazi migrant workers in South Africa, despite significant growth in recent years; the lilangeni value of remittances is, therefore, assumed to increase at the South African rate of inflation.

The rand and the lilangeni are assumed to depreciate in line with the inflation differential between South Africa and its trading partners. The inflation rate in South Africa is projected to decline from 15.5 percent to 12.5 percent over the period, compared with a rate of about 3.5 percent for the industrial countries.

Under these assumptions and the continuation of present policies as described in this report, the analysis indicates that Swaziland's strong balance of payments will continue over the medium term. The ratio of the current account deficit to GDP, which declined from 16 percent in 1982-83 to about 10 percent in 1984-85 and fell further to less than 5 percent in 1986, would continue to decline through 1988 before rising back to 5 percent of GDP in 1991. Exports in SDRs are expected to increase at an annual average rate of about 9 percent, after a 15 percent rise in 1987, owing to the impact of the new enterprises that have been set up in Swaziland, as well as the effect of the relatively firm prices assumed for Swaziland's commodity exports. As a result of this export growth and an assumed 8 percent growth in imports in SDR terms, Swaziland would run trade deficits considerably lower than experienced in the recent past. The cumulative current account deficits over the five-year period would amount to SDR 74 million; financing this deficit while maintaining reserves at three months' imports would require net capital inflows totaling SDR 122 million over the period. Reflecting the strong export performance, the fact that part of the net capital inflow would be in the form of direct investment and the three-year grace period assumed for foreign borrowing, the ratio of debt service to exports of goods and services would decline to 6 percent by 1991.

Two key assumptions in the scenario are those regarding import growth and sugar prices. To test the sensitivity of the results to these assumptions, two alternative scenarios were run assuming in one a 10 percent growth in imports and in the second that sugar prices in the free market remained at the 1986 level of 6 U.S. cents per pound, rather than rising steadily to 9 U.S. cents per pound by 1991, as was assumed in the base scenario. 1/ Otherwise, the approach and assumptions were the same as in the base scenario. Given the high share of trade in Swaziland's GDP, the ratio of the current account deficit to GDP is highly sensitive to changes in key assumptions, as can be seen from the following comparison of the results of the three scenarios.

1/ More than 50 percent of Swaziland's sugar export volume is sold on the free market, where prices are subject to greater uncertainty than on the EEC or U.S. markets.

Ratio of Current Account to GDP

	1988	1989	1990	1991
Base scenario	-1	-2	-4	-5
10 percent import growth	-3	-5	-10	-13
No increase in free market sugar prices	-3	-4	-9	-11

Swaziland is also highly vulnerable to a possible decline in employment opportunities for Swazi workers in South Africa. Under the base scenario, which assumes that the number of Swazi workers remains constant, the ratio of workers' remittances to GDP falls from 12 percent in 1987 to 11 percent in 1991.

Swaziland: Interlinkages with South Africa

Swaziland's economy is very much dependent on that of South Africa. Geographically, Swaziland is entirely surrounded by South Africa, except for a short border with Mozambique in the northeastern part of the country. Swaziland shares its four main rivers with South Africa, and there are one million ethnic Swazis in South Africa.

Transportation is a vital aspect of the interlinkages with South Africa. At present, a large and rising share of Swaziland's exports and imports transit through South Africa; Swaziland would experience severe economic difficulties if it were not able to ship goods through South Africa. The recent disturbances in Mozambique have made this already important link even more important. While the port in Maputo provides Swaziland's most direct access to the sea, frequent disruptions to rail service and the lack of facilities at the port have meant that more goods must transit through South Africa than in the past.

Swaziland's dependence on South Africa is also highlighted by the direction of trade, which has remained fairly stable over the last five years. The share of imports from South Africa has ranged between 83 percent and 88 percent of the total. All of Swaziland's imported energy comes from South Africa, with South Africa presently supplying almost two thirds of electricity consumed in Swaziland. The share of South Africa in Swaziland's exports has been substantially less, varying between 33 percent and 37 percent during 1982-84, but then falling sharply to 24 percent in 1985 (Table 5). With the depreciation of the rand and the lilangeni, demand outside South Africa for Swaziland's exports increased. Also, three enterprises had moved to the "homelands" on account of the incentive package offered, and in 1984 a major chemical firm, whose output went primarily to South Africa, was liquidated.

More than two thirds of all tourists to Swaziland are South African, and an even larger share comes via South Africa. The recent construction of a luxury hotel and casino at Piggs Peak in the north is meant to cater primarily to South African tourists. On the one hand, the real depreciation of the lilangeni should serve, in itself, to attract tourists from outside the region; on the other hand, if tourist visits to South Africa decline, this would have a negative impact on the tourist trade in Swaziland.

A further indicator of interlinkage with the South African economy is the number of Swazi migrant workers in South Africa, a majority of whom are employed in the mines. Through 1986 there has been an upward trend in migrant employment, which serves as a pressure release valve for the excess supply of labor in Swaziland. Preliminary indications are that the number of migrant workers now exceeds the total number of employees in the Swazi public service and is over one third of total

Table 5. Swaziland: Interlinkages with South Africa, 1982-86

(In percent, unless otherwise specified)

	1982	1983	1984	1985	1986
Real effective exchange rates 1/					
Swaziland	-1.2	--	-4.6	-11.7	2.3
South Africa	6.0	2.5	-23.0	-30.2	24.4
Direction of trade					
South Africa's share of merchandise exports	36.9	32.4	33.4	23.6	...
South Africa's share of merchandise imports	83.1	84.2	88.1	88.2	86.9
Percent of total energy imports from South Africa	100.0	100.0	100.0	100.0	100.0
Percent of petroleum imports from South Africa	100.0	100.0	100.0	100.0	100.0
Percent of electricity consumption supplied by South Africa	70.2	90.6	88.7	68.6	66.4
South African visitors	74,002	86,014	107,842	139,325	179,107
(Percent of total)	68.7	70.0	70.0	69.6	69.8
Percent of gross official reserves held in rand	58.0	68.5	68.3	75.1	54.5
Employment in South African mines					
Total number	13,960	16,823	18,998	22,255	25,237
Percent of formal sector employees in Swaziland	18.0	21.4	23.9	30.5	33.8
Remittances (in thousands of rand)	40.4	59.1	77.7	105.7	125.7
Percent of exports of goods and nonfactor services	9.8	14.0	16.8	20.1	17.7
Percent of GNP	7.0	9.6	10.6	12.7	12.7
Receipts from SACU (percent of government revenue) 2/	66.6	67.2	61.1	58.5	50.1
Price indices (1980=100)					
Retail price index in Swaziland	134.0	149.2	169.4	204.6	225.9
Consumer price index in South Africa	132.1	148.4	165.7	192.6	228.5
Wholesale price index in South Africa	129.7	142.9	154.9	180.9	216.6
Interest rates					
Deposit rates 3/					
Swaziland	11.2	12.0	16.0	9.8	5.4
South Africa	13.0	13.9	19.2	13.4	8.8
Lending rates 4/					
Swaziland	18.0	18.0	22.0-25.0	17.0	12.5
South Africa	18.0	20.0	25.0	16.5	13.5

Sources: Central Bank of Swaziland, Quarterly Review; data provided by the Swazi authorities; and staff estimates.

1/ IMF trade weights used for effective exchange rate calculations; annual percentage changes shown (December to December).
2/ Fiscal year beginning April 1 of calendar year shown.
3/ 31-day time deposit rates, end of period.
4/ Prime lending rates, end of period.

paid employment in Swaziland. Remittances of these workers have also been increasing steadily, reaching 20 percent of exports of goods and nonfactor services in 1985, or 13 percent of GNP. 1/

Swaziland's membership in the Southern African Customs Union (SACU) has helped attract foreign direct investment, as a number of companies have chosen to relocate to Swaziland, where they have access both to the South African market and to regional and foreign markets. Recently, a major soft drink company moved its concentrate plant to Swaziland, and it is expected that company taxes from this firm will account for about 2 1/2 percent of total government revenues in 1987/88, and 6 1/2 percent in 1988/89. Budgetary dependence on receipts from SACU has been reduced from 67 percent of total revenues in 1982/83, but remained high at 50 percent of revenues in 1986/87. The entry of the soft drink company and other firms will help to diversify revenues further.

Another aspect of the interlinkages between Swaziland and South Africa is that, until 1986, the South African rand was treated as legal tender for all transactions in Swaziland. Although the renegotiated Common Monetary Area agreement permits a delinking of the lilangeni and the rand, in practice there has been little impact. The lilangeni remains pegged at par to the rand; and the former stipulation of 100 percent rand cover for emalangeni in circulation has never been a binding constraint as rand reserves are well in excess of that requirement. Rand reserves as a share of gross official reserves peaked at 75 percent at end-1985, but declined to 55 percent by end-1986.

As with exchange rate policy, monetary developments in Swaziland are strongly affected by monetary policy in South Africa. Given the lack of restrictions on capital flows between the two countries, interest rates in Swaziland tend to follow those in South Africa. (Swazi deposit rates are, however, consistently below those in South Africa, and the differential has widened over time.) In addition, inflation in Swaziland tends to mirror developments in South Africa. While the response is not instantaneous, price indices in the two countries gravitate toward each other over time, because of the high degree of cross-border trade and the relatively large share of goods imported from South Africa in the Swazi consumption basket. Also, as mentioned above, the Government of Swaziland depends to a large extent on revenues from the customs union. All these factors greatly reduce the scope for independent macroeconomic policy in Swaziland.

In conclusion, the quantitative indicators presented in Table 5 and other, more qualitative factors, such as the transportation difficulties already mentioned, make it clear that the dependence of the Swazi economy on developments in South Africa remains high.

1/ In 1986 the ratio to exports of goods and nonfactor services fell somewhat as a result of the sharp increase in exports, but remittances remained constant as a share of GNP.