Market insight: Swaziland's 2004 budget

1 April 2004

Background

The Minister of Finance Majozi Sithole presented the Kingdom of Swaziland's 2004 budget to parliament on 24 March. It is his fourth budget. An important theme was that the country has limited resources available to address the major challenges of the HIV/Aids pandemic, the high incidence of poverty and unemployment.

Highlights

- Economic growth of 2.5% is expected in 2004. The IMF forecast is lower at 1.6%.
- A new Revenue Authority will be established, combining several departments into one, to streamline tax collection and improve efficiency.
- Personal income taxes will be revised in the coming year.
- The tax exemption threshold for lower income taxpayers was increased from E14 000 to E20 000. Tax benefits to retrenched workers have also been adjusted.
- Expenditure growth has outstripped revenue growth and drastic measures are needed to reverse the trend. The widening budget deficit is unsustainable.
- Public debt is increasing as result of the rising budget deficit, but it is not at unsustainable levels.
- Value added tax (VAT) will replace sales tax in 2006/07.
- South African rand notes have been made legal tender in Swaziland, reinstating a compensation agreement between the central banks.

The 2003 general economic review

In 2003 the Swazi economy grew by about 2.9%, underpinned by construction and manufacturing, according to the minister. The agricultural sector was adversely affected by the drought, which also had an adverse impact on the population. Nearly 297 000 people required assistance from the National Disaster Task Force. The drought has also affected the sugar and citrus industries, which require water for irrigation, and water rationing has been introduced. The rains at the beginning of the year were not sufficient to fill the dams.

Some 66% of the population live in poverty, which has been aggravated by the drought. Moreover, poverty levels and food shortages are increasing, particularly in the rural areas where 70% of the population reside.

The country now has the highest HIV/Aids infection rate in the world, thus overtaking Botswana. The pandemic has generally weakened the workforce, resulting in lower productivity.

The minister warned that new international trade rules will level the trade playing field and preferential trade agreements, such as the US African Growth and Opportunity Act (AGOA), will not have as much of a positive impact as they did before. In Swaziland some 28 000 jobs have been created in recent years as a result of expanding textile exports to the US under AGOA. Under the new trade rules other nations, such as China, will be able to export to the US quota-free, and Swazi exports will therefore compete with Chinese exports in the US. The AGOA agreement may be phased out, and Swaziland could lose its market share, unless it acts now to retain its export markets in the US and develops new markets.

Although there has been some disinvestment, several new companies have been established under AGOA, as well as under the Swaziland Investment Promotion Authority.

Budget performance in 2003/04

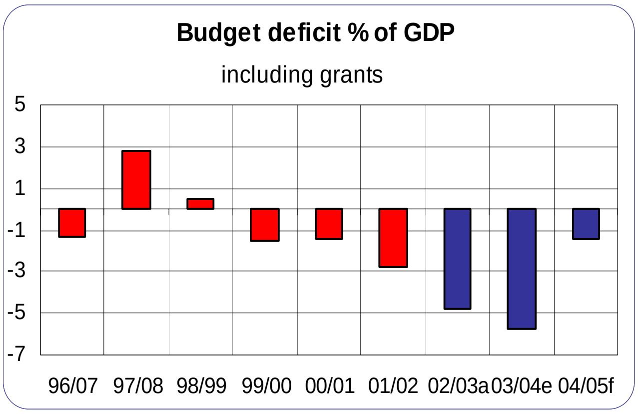
The minister noted that expenditure grew much faster than revenue. To finance the increasing fiscal deficit, the government is drawing down its foreign exchange reserves. Given that the fiscal deficit is already at high levels, this method of financing will undermine fiscal sustainability.

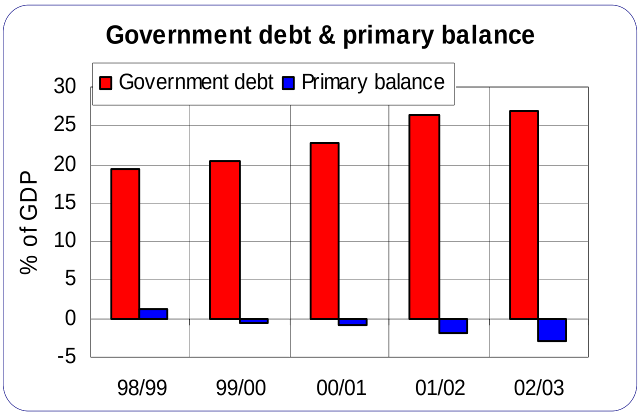
An important factor in the expenditure overrun was the salary increases granted to civil servants in 2003, which were backdated to April 2002. Other factors were increased expenditure on the SMART Partnership Dialogue, which was hosted in Swaziland, general fiscal indiscipline and misuse of government funds.

The stock of public debt at the end of 2003 amounted to E4.4 billion, which is equivalent to 31.4% of GDP. The international benchmark is an upper limit of about 60% of GDP for maintaining fiscal sustainability.

The bulk of government debt is foreign, with domestic debt comprising only an insignificant proportion. For example, in 2000/01 government debt comprised 22.7% of GDP, with foreign debt making up 22% and domestic debt 0.7%, according to IMF data.

One of the main concerns in recent years has been the growing budget deficit (see graph). The international benchmark for a budget deficit is 3% of GDP to ensure fiscal sustainability. According to the minister, the budget deficit in 2003/04 was 5.8% of GDP. In the previous tax year the deficit was 4.8% of GDP. Ongoing fiscal deficits will put upward pressure on public debt.





Macroeconomic policies for 2004/05

Government data and forecasts for real GDP growth provided in the 2004 budget speech are shown below.

	2002 actual	2003 projected	2004 forecast
GDP growth (%)	2.7	2.9	2.5

Economic growth is an important factor in helping to lower public debt. When real interest rates exceed the real GDP growth rate, there is upward pressure on public debt. The primary balance (the overall budget balance excluding interest) is the main instrument over which government has some control and it must run a primary surplus to reduce public debt. Although real government interest rates have not, on average, exceeded the economic growth rate significantly, government will need to run a small primary surplus to prevent its public debt from expanding. In 2003, however, there was a rise in real interest rates, which exceeded the economic growth rate. Higher growth will help to take pressure off public debt.

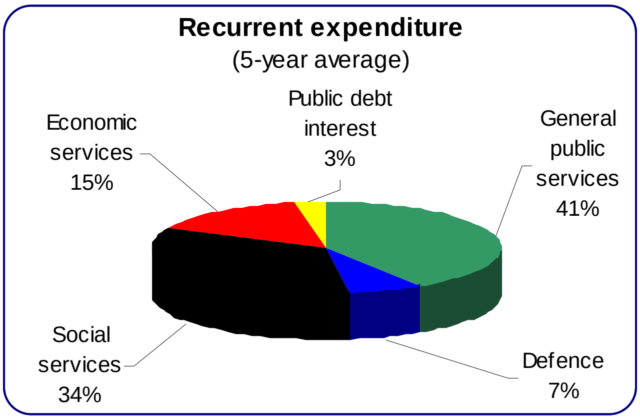
According to the minister, the budget deficit in 2004/05 is estimated at 1.4% of GDP, much lower than in the previous two years. The reduction in the deficit is made possible by several once-off factors, such as a SACU receipts windfall and higher tax revenues. An increase in grants and stronger GDP growth are also expected to boost revenues.

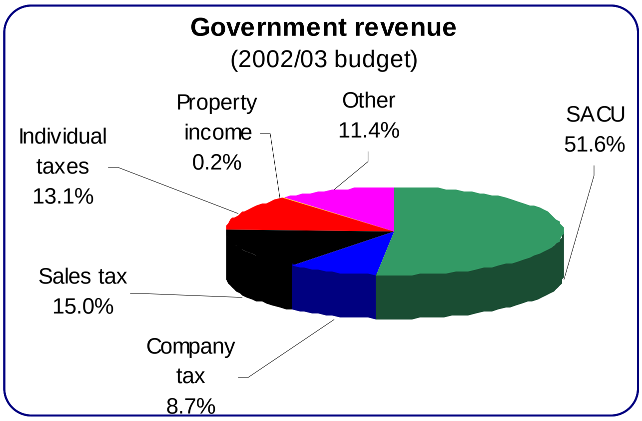
The government has started to draw down it foreign exchange reserves to finance the growing fiscal deficit (despite the low deficit in the current fiscal year), which exceeds the 3% of GDP benchmark. It is likely that the government expects the budget deficit to continue the upwards trend, unless drastic measures are as taken. The IMF has advised that the government should issue additional domestic debt, rather than deplete its foreign exchange reserves, to finance the fiscal deficit. The government did indeed raise the limit on domestic borrowing from E300 million to E1 billion in 2003 to allow for higher domestic borrowing.

The government's principal means of reducing the fiscal deficit is to maintain a primary surplus. The Government debt and primary balance graph, based on IMF data, shows that the government has run a primary deficit since 1999/2000, thus putting upward pressure on public debt. However, public debt is not yet approaching the international benchmark level of 60% of GDP. Moreover, to ensure fiscal sustainability, the Swazi Government is likely to adhere to the 40% benchmark which was proposed by the SADC Committee of the Central Bank Governors.

Budget proposals for 2004/5

The minister said that total revenue and grants are budgeted to make up about 32% of GDP in 2004/05. The fiscal situation will improve as revenue from the SACU will be higher and tax collection should be more efficient. However, the windfall of E707 million in SACU receipts in the current fiscal year over 2003/04 is a not-to-be-repeated event.





The minister said that revenue reforms in the coming year, particularly in personal income taxes, will also add to revenue. Tax collected from individuals and companies is expected to grow by 6%.

The main fiscal problem, however, is excessive government expenditure. The government’s participation in the Millennium Project has been criticised, not least by the IMF, in its Article IV Consultation in January 2003. The government’s involvement, particularly with the proposed new international airport, trade fair and sports complex, which forms part of the Millennium Project, will divert expenditure from much-needed spending on growing social needs.

Other factors are the Public Service Pension Fund is running a large deficit of E2.1 billion. The minister intends reducing the deficit by changing the rules from a defined-benefit to a defined-contribution scheme. Excessive wage increases in the past have also raised pressure on the budget. The wage bill alone accounts for 48% of recurrent expenditure. Although there will be rationalisation in the public service, the minister does not expect the wage bill to fall in the medium term.

Conclusion and outlook

According to the IMF, the country’s macroeconomic sustainability and stability is under threat. Trade liberalisation over the next few years – which implies lowering of tariffs and therefore revenue – will have a major impact on the country as well as the region. The SACU’s new revenue-sharing formula is generally expected to reduce government revenue, although the actual impact has not yet been determined. The government has traditionally derived about half of its revenue from SACU receipts (see Government revenue graph). The new agreement comes into force this year.

The country’s problems are deeper than just the budget overspending and government debt; the judiciary is in a crisis and the new draft constitution entrenches the absolute monarchy.

Government spending should be more focused on the country’s vast social needs.

The government’s overriding concern should be the standard of living of its citizens and this goal can only be achieved in the current circumstances by maintaining fiscal sustainability and targeting social spending at the most vulnerable members of society. The HIV/Aids pandemic is aggravating the socioeconomic crisis. The country’s deteriorating socioeconomic and humanitarian situation calls for appropriate government intervention.

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