MEDIUM TERM BUDGET POLICY STATEMENT

2008/09 – 2010/11

PRESENTED BY

THE MINISTER OF FINANCE

THE HONOURABLE MAJOZI V. SITHOLE (MP)

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Table of Contents

GOVERNMENT OF SWAZILAND
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1. BACKGROUND

The government of Swaziland adopted the Medium Term Expenditure Framework (MTEF), which requires planning over a three-year period. This system of budgeting is an improvement on the annual budgeting system that was used previously. The MTEF advocates for public participation in the budgeting process coupled with transparency and accountability in the use of government resources. The purpose of this Policy Statement therefore is to inform the public of the policies that will guide the allocation of resources during the 2008/09 to 2010/11 period and to solicit the views of the public on the budget. This will allow broader understanding of the fiscal situation and enable the public to make meaningful contribution to the budget process. The last Policy Statement covering the period 2005/06 to 2007/08 was issued in 2004.

The 2007 Medium Term Budget Policy Statement (MTBPS) sets out the economic context for the 2008/09 budget and outlines the fiscal policy considerations that underlie government budget proposals for the next three years. The MTBPS aims to encourage the participation of Parliament, civil society, the private sector and the general public in addressing social, economic and developmental challenges currently facing the country. It also serves to assist government in reviewing its alignment of resource allocation to identified priorities.

2. INTRODUCTION

While the demand for services continues to grow significantly, government continues to face the challenge of limited resources. This growing demand has resulted in increased expenditure, which has in turn resulted in the chronic budget deficits observed in recent years. Government therefore finds it essential to have broader participation in the budget process to ensure prioritisation of government spending in line with the requirements of the people. In order to address the current fiscal situation, it is essential for government to observe strict prioritisation, expenditure control measures and to improve on the collection of revenue. Though the result of this effort may not be realised in the short term, with more commitment, government should be able to maintain a reasonable budget balance.

This MTBPS reaffirms government’s commitment to the achievement of social and economic goals within a sound fiscal and budgetary framework. It entails strengthening of fiscal policy as a key instrument of achieving macroeconomic stability, which needs to be accompanied by prudent public expenditure that reflects social objectives. To achieve this, social expenditures must be targeted to the poor and the most vulnerable groups.

This statement is organised as follows. The next section examines the critical macroeconomic challenges facing the country and the measures being taken to address them over the medium term. This is followed, in chapter 4, by an overview of the regional and domestic economic outlook. Chapter 5 looks at the government's revenue/taxation prospects in the medium term, which is then followed by Chapter 6, which looks at proposed medium term expenditure framework. Chapter 7 looks at the fiscal challenges facing the government. This is followed by Chapter 8, which looks at the policy reforms that are proposed to deal with these challenges. The medium term budget framework is presented in Chapter 9, which attempts to marry the available resources to the spending levels. This is then followed by a conclusion and a request for feedback from the public.

What is clear from this statement is that the resource envelope has not changed much and as a result, a deliberate policy decision needs to be taken to reorient expenditures in line with identified priority areas. In simple language, government needs to consider reducing expenditure in some areas in order to achieve increased allocations to articulated priorities such as health, agriculture and education. This implies that certain programmes will be staggered over time. The allocation of resources will be aligned to the Poverty Reduction Strategy and Action Programme (PRSAP).

3. CRITICAL MACROECONOMIC CHALLENGES AND ADJUSTMENTS

3.1 Overview of Macroeconomic Challenges facing Swaziland

In terms of international and regional standards, Swaziland is a small country with a very small domestic market. As such, it is an open export oriented economy whose performance is largely dependent on exogenous factors. These factors become a major challenge if they do not favour the trade and investment environment of the country.

Swaziland is faced with growth challenges that have seen the economic growth weakening over the past decade. More recently, real GDP growth decelerated to 2.1% in 2004, rising slightly to 2.4 percent in 2005 and again to an estimated 2.8% in 2006. However, growth has consistently stayed below the annual population growth rate, which means a deterioration in the quality of life for the people of Swaziland. This is attributable to a combination of factors that include prolonged droughts, depressed world prices for the agricultural sector, the real effective appreciation of the exchange rate of 24% in 2002-04 and high oil prices, which hurt Swaziland's main exports (sugar, wood pulp and garments) and other manufacturing activities. Other factors that have caused the slow growth include the expiration of the Multi Fibre Agreement in January 2005, which led to factory closures and significant job losses in the garment industry, further worsening the unemployment rate.

Another challenge facing the country is that of high poverty levels, as the economic activity in a given year has remained lower than the population growth (reduction in GDP per capita in real terms). The rate of poverty is estimated at 69% and although the GDP per capita is high enough for the country to be ranked as a middle-income country, there are serious income inequalities, which result in a large proportion of the population being highly marginalised.

Government's bias towards consumptive expenditure has resulted in increased demand for credit in the domestic market, which has led to a severe contraction of growth because of the overcrowding of the private sector as government competes for the same resources and diverting them from investment.

Government had increasing fiscal imbalances until the financial year 2007/8 where a surplus of 1.8% of GDP is projected. These imbalances have been exacerbated by sharp increments in the wage bill and other current expenditures following the civil service wage increase granted in 2004. The basic concern is the dependency in SACU receipts and with the uncertainty regarding a continued income from trade taxes, government's pattern of expenditures calls for a serious restructuring.

Swaziland last enjoyed a balance of payments surplus between 2000 and 2001, and has been incurring deficits until 2005. However the deficit has been decreasing during recent years due to improved balances in the Current Account. The country has also experienced severe Capital outflow in recent years and this is reflected in the Financial account which has been recording deficits since 2001.

The country is faced with low levels of foreign direct investment. The country's reserve position is a cause for concern as it has remained below the recommended three months import cover since 2003. The reserve position in 2005 was equivalent to 1.9 months of imports. It however improved to 2.9 months in 2006 and will be at 4.2 months of import cover with the allocation of E705 million in 2007/08. This was achieved through allocation of increases in SACU receipts into improving the reserves. Given that the country has attained the recommended 3 months level, government needs to take a decision on how to invest future receipts from adjustments in the SACU revenue pool.

The present situation compels Government to embark on a recovery plan that focuses on a strategy for accelerated, shared and sustainable economic growth, as enshrined in the NDS and the PRSAP. The strategy for a recovery plan will bring back the growth stimulus giving prominence to the private sector as the engine for growth. There is need to provide a conducive environment for both domestic and foreign investment. Human capital development is another essential area for attracting investment and for fighting poverty. The recovery plan will focus on the creation of employment opportunities, building capacity in policy making and implementation, improving planning and budgeting for efficient resource allocation and for addressing poverty, HIV and AIDS and governance issues.

The development and maintenance of essential public infrastructure is an important ingredient for sustained economic growth and poverty reduction. Structural reforms also form a pivotal role in economic development. The Government needs to provide a regulatory and legal framework to correct any distortions, encourage market performance and ensure equitability in accessing services. The approval and coming into effect of the Constitution will lead to political and legal reforms that will facilitate, change and create an enabling investment environment. Government needs to exercise sound macroeconomic management and develop infrastructure to boost consumer, donor and investor confidence.

3.2 Savings and Investment

Other macroeconomic indicators re-affirm the sluggish performance of the economy discussed above. Gross National Savings (GNS) to GDP decelerated in 2005 to 24.5 percent from 28.3 percent in 2003. The fall is attributable to Government dissaving, as evidenced by the deterioration in Government net balances in the banking system. Despite the SACU receipts being the major contributor to GNS, growth in Government National Savings has been relatively lower when compared to growth in private national savings.

Gross investment on the other hand, remained very low despite the high savings in the country. Only 22.9 percent of nominal GDP is attributed to investment expenditure (private investment contributes 14.6 percent and 8.3 percent for public investment) and this component increased by less than 5 percent in 2005. It is clear that private investment continues to dominate gross investment. The high savings rate in the private sector should have led to an increase in gross investment through credit extended to the private sector. However this has not been the case as gross investment has continued to fall.

Following the promulgation of the Insurance Act and the Retirement Funds Act, which provides among others the repatriation of up to 30 percent of funds invested offshore, Government, has to develop a strategy of creating investment within Swaziland where the money will be invested. This will improve the level of investment that would induce faster economic growth and reduce unemployment.

3.3 Labour Markets

Like all developing countries, Swaziland’s labour market is characterised by the formal sector and a large informal sector. The informal sector is dominated by agriculture employment or subsistence farming and street vending which has gained prominence in recent years. The labour force has been growing at an average of 5.2 percent per annum since 1991 compared to an average growth of 1.03 percent of formal employment. Driving formal sector employment has been the civil service, which has been increasing at an average of 1.65 percent per annum. The residual nature of the informal sector has resulted to excess labour within this sector, whilst on the contrary, the formal sector is moving towards capital intensity in an attempt to remain competitive.

One of the challenges facing the local economy is the imbalance in the labour market. The labour force continues to grow faster than the rate of employment creation in the economy. As a result the unemployment rate had increased to 29 percent by 2001 and even higher at 40 percent for the youth.

There remains the challenge of addressing the quality of the employment opportunities we need to create. This has to be complemented by the skills required by the job market. Government has currently commissioned a Labour Force Survey that will address this challenge. She is also in the process of implementing the Human Resource Skills Survey with the aim of matching skills required by the job market.

3.4 Monetary Developments (money supply, interest rates, inflation)

As a member of the CMA, developments in the monetary policy track changes implemented by the Reserve Bank of South Africa. In 2006, the Central Bank increased the discount rate six times in June, August, October, December, June, and August 2007 by a total of 3 percent points. As of August 2007, the discount and prime rates are 10 percent and 13.5 percent, respectively. The upward pressure was largely as a result of non-processed food prices and other goods as well as increased money demand matching growing household consumption expenditure.

On average inflation stayed above 5 percent in 2006 resulting in an annual average of 5.3 percent. For the period January to May 2007, prices increased from a year on year inflation of 4.87 percent in January to 8 percent in May. The unabated increase in prices of food, fuel, alcohol and tobacco contributed to the overall price developments.

On another note, the local currency depreciated to reach an average of E7 per US dollar. However projections show that it will stabilise at an average of E6.50 at the end of the year. The volatility of the exchange rate did not only reflect the poor performance of the dollar against other currencies but the significant fluctuations in commodity prices especially gold, increase in the volume of capital goods and oil imports in South Africa and high inflation expectations that prevail. Effectively, the widened current account deficit in South Africa and risky yet adequate financing became the key factors responsible for the Rand losing value against the Dollar, Euro and Sterling pound in the first half of 2007.

The year-on-year growth in broad money supply (M2) was slightly high at 9.3 percent in December 2006 compared to the 8.7 percent reached in December 2005. In actual figures, broad money supply amounted to E3, 892 billion in December 2006. While the increase was largely a reflection of the improvement in external reserves it also indicated an increase in inflationary pressure in the economy. On one hand, savings and time deposits (quasi money) recorded the highest year-on-year growth of 11.3 percent, reaching E2.530

billion by end 2006. The significant growth was due to 14.7 percent increase in time deposits which boosted the whole envelope since savings deposits recorded 3.1 percent growth only. On the other hand, the 5.7 percent year-on-year growth in narrow money supply (M1) was less than the 19.4 percent growth observed in 2005. Both Emalangeni in circulation and demand deposits reflected increases of 5.7 percent over the year.

3.5 Global Developments and Trade Issues

Preliminary figures show that world output increased by 5.4 percent in 2006. The strong global expansion was broadly maintained in the first quarter of 2007 into 2008 notwithstanding recent financial market nervousness.

While economic growth in emerging and developing countries maintained the highest growth rate, advanced economies, led by the USA expanded the projected figures. Real GDP in the US is estimated to have grown by 3.4 percent in 2006, which is 0.2 percent higher than in 2005. Factors that enhanced economic performance include a better than expected fiscal performance and business environment. On another note, sustaining high levels of growth in 2006 has been high growth rates in emerging markets like China and India. These two economies maintained growth rates above 8 percent on average in 2006 with a current account surplus of 7 percent of GDP in China while India recorded a small deficit in the same year. Growth in global demand for imported goods propels investment in these economies.

Among other indicators, the world trade patterns illustrate that demand for imported goods increased by 7.5 percent in advanced economies and 13 percent in emerging and developing economies from 6 percent and 11.9 percent in 2005, respectively. In contrast, growth in exports from emerging and developing countries deteriorated by 1.1 percent due to a temporal reduction in oil production (from oil producing and exporting countries). It is noteworthy that benefits from global trade for developing countries are not promising. The slow progress in the world negotiations poses some concerns to the developing countries. The recent impasse in the Doha negotiations further delays the benefits of development from these economies. Developed countries continue with protectionist trade policies, in which they continue to subsidize their farmers and this erodes the competitiveness of exports for the developing economies. Over and above this, the developing countries are requesting for the reduction or complete elimination of developed economies' tariff escalation and remaining tariff peaks vis-à-vis developing countries. However this has been received with opposition from the developed economies, hence the present stalemate in the Doha Round.

On another note, negotiations between the EU and SADC on the EPAS are ongoing as the World Trade Organisation (WTO) waiver on trade component of the Cotonou Agreement will expire in December 2007. However the negotiations are not making sufficient progress and SADC is concerned that a further delay in reaching meaningful progress in the negotiations will put them in a difficult position, should they not be concluded by the deadline of December 2007. The further delay is caused by the inclusion of the New Generation issues (Government Procurement, Trade in Services and Investment), which SADC feels they have no capacity to negotiate.

4. REGIONAL AND DOMESTIC ECONOMIC OUTLOOK

It is expected that growth on the African continent will expand by 6.2 percent led by oil exporting-countries, sustained high commodity prices and for some countries macroeconomic stability. South African economy continues to expand and an economic growth of 4.8 percent is projected in 2007, down slightly from the 4.9 percent in 2006. The expansion is expected to strengthen over the medium term as exports increase and the pace of investment spending rises. Growth is expected to reach 5.1 percent in 2008 and 5.4 percent in 2009.

In Swaziland, the outlook is forged under the assumption that Government implements decisive reforms on improving service delivery, privatisation of some public enterprises, fiscal consolidation and bright revenue outlook, which could spur spending on economic infrastructure which improve the competitiveness of local industries. Moreover, with tax revenue administration strengthened through the revenue collection agencies, revenue forecasts look promising. The implementation of the necessary structural reforms will help improve the business climate and attract donor financing and enable Swaziland to benefit from strong growth in South Africa.

Consequently, in the medium term, the local economy is expected to improve marginally. However, the challenge is on Governance which impacts on investor, donor and public confidence. The buoyant services sector, especially banking and financial services as well as revamping the investment climate, agriculture and improving the public expenditure, adds to optimism that the economy is recovering and will reach a sustainable growth rate in the medium term.

However it is imperative to note that failure to implement the above reforms, could result in an unwelcoming medium term outlook, with real GDP growth decelerating to less than 2% as opposed to a growth of about 2 percent with the Reforms scenario.

5. REVENUE/TAXATION

Given the serious challenges facing the country resulting from high and growing government expenditures, fiscal reforms are urgently needed. The likely reduction of SACU revenue in the medium term on which Swaziland has relied for many years also poses a further challenge, which calls for government to find alternative sources of revenue that will compensate for the loss of revenue from the decline. To address the above challenges, government remains committed to implementing policy reform initiatives that seek to diversify and strengthen the collection of government revenues in order to reduce the over reliance on trade related taxes (SACU).

Over the past years the Ministry has amended the Income Tax Order in order to close loopholes exploited by taxpayers to reduce their tax liability. The Order has also been amended to broaden the tax base by bringing into the tax net activities that were previously not taxed and improving efficiency of collection.

In line with advice from the IMF both Departments of Income Tax and Customs and Excise are working towards modernising tax administration, drawing on international and regional developments. This entails establishment of a Large Taxpayer Office (LTO) whose major rationale is to enhance revenue collection by improving the level of compliance of the largest taxpayers. The establishment of the LTO allows the Departments to strategically allocate scarce resources to the most important revenue risk.

The Customs and Excise Department is in the process of implementing a computer system called ASYCUDA ++ before the end of 2007/08. The implementation of this project is expected to enhance data capture of imports into the country through effective risk assessment; implementation of pre-arrival and pre-departure declaration that minimises incidence of fraud. ASYCUDA++ has the ability to link Customs with any Customs system regionally and internationally. This facility will therefore enable Swaziland to link with South African Customs at the borders as well as other Customs Authorities in the region and internationally. The enhancement of data capture of imports into the country is expected to translate to enhanced sales tax collection.

Government remains committed to the establishment of a Revenue Authority (RA) as a catalyst to enable broader revenue administration reform. The establishment of a Revenue Authority is set for July 2008 and meeting this target depends on completion of the preparations, including approval of the legislation. The introduction of VAT to replace the current sales tax is one of the initiatives in the pipeline and the ability to successfully implement VAT is entirely predicated on strengthening tax administration. Since the establishment of the Revenue Authority seeks to further strengthen tax administration, the strategy is to introduce VAT 2 to 3 years after the establishment of the Revenue Authority when the level of efficiency has improved.

6. MEDIUM TERM EXPENDITURE FRAMEWORK

6.1 Policy Priorities

The medium term expenditure framework is guided by the Poverty Reduction Strategy and Action Programme (PRSAP) as the planning framework adopted by government for the next ten years. This framework builds on the priority areas that government has been focusing on over the past five years, which are also in line with the MDGs and the PRSAP. Therefore the key priorities for the 2008/09-2010/11 MTEF will be the following:

- Safe water and sanitation,
- Access to health care
- The fight against HIV and AIDS
- Hunger and food security
- Education
- Economic Growth

6.1.1 Poverty Reduction

a) Safe water and sanitation

Safe water is a basic requirement for human health. Water supply is important for agricultural and industrial production. The persistent drought has resulted in a shortage of the water resource thus threatening the livelihoods of many citizens. The low level of water in rivers, streams, spring sources and dams has an impact on the supply of safe water for domestic use and agricultural production. Another challenge is lack of sanitation which includes proper sanitation, which covers proper toilets and other waste management facilities. Due to water shortages, lack of proper sanitary facilities and poor unplanned human settlements the problem of communicable diseases has reached high proportion. The poor people in peri-urban and rural areas are the most susceptible to poor sanitation and communicable diseases.

In 2004, the water coverage was 87% in urban areas and 54 percent in rural areas. There are currently, 660 water supply schemes in Swaziland, 330 small-scale and 270 large-scale water supply schemes. Of the 330 small-scale water schemes 27% are non-operational and 21% of the large-scale are non-operational. In terms of sanitation, the coverage is 63 percent in urban areas including peri-urban areas and 45 percent in rural areas. Government will therefore be increasing coverage and access to safe water and proper sanitation in urban, peri-urban and rural areas.

To address the repercussions of the persistent drought, government will continue spending on water resources development, especially in the lowveld, which is most affected. This includes the ongoing dam projects, portable water supply and earth dam construction. Complementary to this, the Rural Water Supply branch will focus on providing safe water in rural areas using labour intensive approaches. This encourages community participation and ownership, which ensures proper hygiene, the health of the communities and sustainability of the water schemes.

b) Hunger and Food Security

Government has a challenge of ensuring that nutritious food is available, affordable and accessible to all citizens of the country particularly the poor. While the country has been a net-importer of food since independence, output from agriculture remains a significant factor in food security. Agricultural production has been on a downward trend over the past ten years and this has been exacerbated by the persistent drought. For example, maize which is a staple food declined from about 140,000 metric tonnes in 1996/7 to 30,000 metric tonnes in 2006/7. This means that an increasing proportion of the population especially in rural areas is now dependent on food aid.

There are currently 470,000 people in need of food assistance. Production of cash crops, which is a source of income for households in areas with marginal rainfall, has declined and this has resulted in poor access to food commodities. As an ongoing response government has set up the Disaster Management Unit and will be increasing the resources allocated towards disaster management to address the immediate crisis and continue supporting all other interventions towards improving agricultural production.

Through the Ministry of Agriculture & Co-operatives, Government has taken a major stride by completing a National Programme for Food Security. The purpose of the programme is to provide clear guidance regarding the strategies and measures that must be adopted in order to improve the country's food security status. The programme is also aimed at supporting related initiatives on poverty reduction, improving agricultural production and marketing, enhancing environmental management, strengthening disaster preparedness and broadening access to water and sanitation.
Priority components of the programme include;

- i) Crop and livestock intensification and diversification
- ii) Support services and rural infrastructure
- iii) Community development and livelihoods diversification
- iv) Natural resources management
- v) Health and nutrition
- vi) Disaster management and safety nets

The national programme for food security will be implemented through a consultative and participatory process with all stakeholders; hence the agriculture summit held recently with the aim of soliciting views from stakeholders on how agricultural production can be improved. The resolutions of the summit will be implemented and carried forward to a stage where tangible results will be realised and enjoyed by the citizens of the country. This requires that the Agricultural sector prepare viable programmes/projects that will support the development of the agriculture and production.

c) Social Protection

There is a growing number of orphans, street children, destitute children, the poor, elderly, people living with disabilities and widows who have no one to support them. These groups are vulnerable and deprived in a number of ways, including lack of access to food, shelter and clothing. Other indicators are the lack of access to education and health, physical and emotional abuse and unemployment.

The preliminary findings of the Demographic Health Survey (DHS) reveal that about 31.1 percent of children under the age 18 years are orphans and vulnerable. This might be an underestimation as the definition of vulnerable children excludes those who have both parents who are neither sick nor dead but cannot afford to maintain their children. On another aspect, the elderly are faced with the responsibility of caring for the orphans and vulnerable children using their meagre resources. Additionally, people living with disabilities are exposed to various societal constraints and risks, which on average results in them not participating in mainstream economic activities. For example, evidence indicates that there are few primary schools to accommodate children with disabilities and even less high schools, making it impossible for a majority of them to attain tertiary education, hence perpetuating their marginalisation. The orphans and vulnerable children together with the poor, elderly and people living with disabilities have increased the dependent population such that even their basic needs have to be provided for by government.

Government will continue with the provision of social grants to the elderly and bursaries for needy children, complemented by other interventions for the disabled and other disadvantaged groups. Subsequently, government will review and co-ordinate existing interventions directed towards vulnerable groups to ensure that allocated resources are well targeted and they yield the desired impact.

6.1.2 Health

The country is in need of a vibrant health system for overall economic and social development in the country. The health systems should assist in addressing health problems such as malnutrition, maternal health care, child mortality and communicable diseases such as TB, HIV/AIDS, Malaria, Cholera and other infectious diseases.

The number of outreach sites and clinics has increased over the years and this has improved access to health facilities, especially in the rural areas. However, the health facilities tend to experience shortages of drugs, equipment and staff for speciality services, which lowers the general quality of health in public centres. In response government will critically review the capacity and management of the health sector, mortality rate, opportunistic infections, increased disease burden resulting from HIV/AIDS and other emerging diseases.

There has been a steady increase in the prevalence of HIV and AIDS among the Swazi population. The effect of HIV and AIDS is prominent in the life expectancy at birth which has deteriorated from 58 years in 1997 to 40 years in 2003 and just above 31 years in 2006. It is vital to understand that the impact of the scourge is cross-cutting in the economy and it undermines the goal of reducing poverty. The HIV/AIDS pandemic reduction affects every sector of the economy and imposes a strain on the national resources. The situation is aggravated by the water and food shortage, which results from the prolonged drought.

The Sero-surveillance surveys show that the HIV prevalence rate escalated from 3.9 percent in 1992 to 39.2 percent in 2006. Another recent survey, the Demographic Health Survey (DHS) indicates a high HIV prevalence rate of 26 percent among the most sexually active group of 15 – 49 years at the national population level. In order to mitigate the impact and spread of the endemic, government will continue providing resources for preventive and treatment as well as palliative (VCT, home based care and sexually transmitted infections) interventions. Moreover, government has to assess the sustainability of non-public sector funded HIV and AIDS interventions in a quest to prevent risks in the long term.

For the health sector, expenditure will focus on provision of drugs and medical supplies, purchase and maintenance of medical equipment and rehabilitation of health facilities. In continuing with the fight against HIV and AIDS, government will continue with the ARVs rollout programme, prevention of mother-to-child transmission (PMTCT), home based care, public awareness campaigns and provision of social support to the infected and affected, especially children. Other social protection programmes will continue and these include grants to the elderly, bursaries for orphans and vulnerable children and social support for the disabled.

6.1.3 Education

Education improves livelihoods through knowledge, skills and confidence to participate in the economic development of the country. It is every citizen’s right to be afforded basic education as enshrined in the constitution.

About 23 percent of children in Swaziland are not afforded the opportunity to attend school and a further 17 percent drop out before finishing primary school. The recent gradual introduction of universal primary education with the provision of free textbooks to primary schools has been an attempt to make education accessible to the poor. In line with the Poverty Reduction and Action Programme and the Millennium Development Goals and Constitution, it is desirable that relevant, quality and affordable education be accessible to all by 2015. Such a goal can be achieved if education policies at all levels are coherent and complement each other. In addition, the resource allocation and management of these resources will have to address constraints in the sector and make a significant impact on sustainable socio-economic development.

The Constitution states that primary education should be free within three years of its coming into effect. Government is still making the necessary preparations and assessing the cost of this undertaking. It is worth mentioning that this will increase expenditure on education significantly, as government will bear some of the costs currently borne by parents. In the meantime, government will continue providing books, stationery and other support materials in primary schools. Development of human capacity will continue through the support of tertiary institutions and provision of scholarships for specific priority programmes.

6.1.4 Economic Growth

Every country requires a vibrant and sustainable economic growth in order to achieve poverty reduction, create employment and for overall development. In the case of Swaziland, it is estimated that an annual GDP growth rate of 5 percent along an estimated population growth rate of 2.75 percent is essential to reduce the poverty rate by 50 percent in 2015. However, a trend analysis shows that economic growth has been declining to reach an average 2 percent over the past five years while the population expanded by 2.9 percent annually. This implies that the gross domestic product (GDP) per capita has also been declining in real terms.

The situation demonstrates that the economy is growing below potential in view of the investment incentives, roads infrastructure and the high growth rate of available worker-hours in the labour force. As a result economic activity is not well diversified and supply constraints are evident in a number of sectors.

The target growth rate for the medium term is 3 percent and this requires increase in growth enhancing expenditures that will stimulate production. Government will continue with the development of infrastructure and has made progress, particularly on the roads network. This will include expansion of the ongoing rural electrification programme.

As South Africa will be hosting the Soccer World Cup in 2010, the neighbouring countries also stand to benefit from spill-over effects of the event. It is therefore important to ensure that Swaziland benefits from this important event. In continuing with the implementation of the Millennium Projects, government will give priority to the construction of the Sikhuphe airport and access road. These facilities will be used by tourists and country teams that will visit the country.

Like other developing countries that experienced similar economic downturns in Africa and are now consistently growing at 4.5 percent on average, Swaziland needs to re-channel investment resources into building productive capacity and capital formation. Learning from the experience of these countries, government will not only continue investing in road infrastructure but also places emphasis on macroeconomic and political stability and addressing constraints in other forms of infrastructure such as telecommunications, power, water and financial services. This calls for change in policy to attract investment into these sectors, which creates competition and improve efficiency of service delivery and affordability. Improvement in these sectors leads to employment creation and ultimately increased GDP growth.

Moreover, there is need to review the education system in order to develop demand driven skills. Experience has shown that human capital development increases productivity as a result of training, skill development and experience. The development of human capital is complementary to government's effort in attracting private investment as well as sustainable external aid.

7. FISCAL CHALLENGES

Government's efforts to address the above mentioned challenges have been hindered by severe financial constraints. Over the past five years, expenditure has increased significantly and much faster than revenue, resulting in the budget deficits over the past years. Due to the improvement in SACU revenues, which accounted for over 60% in the last few years, coupled with fiscal discipline, the deficit position has gradually improved to an estimated 1.6% of GDP in 2005/06 and an even better situation in 2006/07. Preliminary figures indicate a surplus of 1.8% for 2007/08 and balanced budget in the two subsequent years.

In spite of the need to continue to spend to address the challenges facing our nation, fiscal prudence has to be embedded in our systems to ensure macroeconomic stability and to restore investor confidence in the economy. Budget reprioritisation and public sector reform underlie the budget choices that will be pursued in the medium term.

The deficits of the past few years have been financed through borrowing externally and from the domestic market. However, the necessary precautions are taken to ensure that the debt stock is maintained at sustainable levels. Currently, public and publicly guaranteed external debt stands at E2.74 billion reflecting an increase of 19.1 percent from the previous year. The central government has the dominant share of total debt stock, representing 82.2 percent of the total loan portfolio. As at the end of March 2007, central government debt stood at E2.64 billion, denoting an increase of 32 percent from last year's figure of E2 billion. According to

The domestic market continued to be driven by the weekly auctions of the 91 days Treasury Bills. While used as an instrument to address the government's cash flow problems, it was also designed to develop the economy's capital market. However, the challenging factor is the interest costs to government, which have escalated as a result of the general rise in interest rates.

8. POLICY REFORMS FOR THE MEDIUM TERM

Government will continue with the implementation of the policy reform initiatives in order to improve service delivery and transformation across a wide range of public administration functions and systems. These include the Decentralisation policy; Privatisation policy, Public Sector Management Programme and review of government procurement procedures.

One of the notable features in the current financial year is the production of Quarterly Performance Review for Parliament, which also supports government's efforts in monitoring expenditures and timely implementation of programmes. The role played by Parliament is very important as it supports government in promoting accountability to the public in the use of funds. With the assistance of the World Bank, government will improve on public expenditure management and this includes strengthening of the internal and external audit functions.

The Constitution Rollout Programme will continue over the medium term. With the assistance of the Commonwealth, Government will continue with the review of several pieces of legislation to align them with the Constitution and set up the institutional framework accordingly.

The Public Sector Management Programme still remains a key programme to government in ensuring efficient service delivery and the growing civil service wage bill. The wage bill currently is at 51% of recurrent expenditure continues to be a serious concern to government and it is above the internationally accepted levels of 40%. The Voluntary Early Retirement Scheme (VERS), which was shelved in the current financial year whilst awaiting the review of the formula for the VERS packages and the removal of the Pension Act punitive clause, will be implemented in the medium term. This exercise will be complemented with the revival of the staff inspection function to determine the appropriate and required levels of staffing for Ministries and Departments. In order to monitor the monthly wage trend and forecasting the Human Resources emoluments, government has developed an Information Management System (IMS) that will assist in policy decision for government.

In an effort to improve performance in the civil service and quality service delivery, a Performance Management System (PMS) has been developed and piloted in a few ministries. This programme will be rolled out to all the ministries and departments over the medium term.

Following the approval of the roadmap for implementation of the Privatisation Policy, a consultant has been engaged to establish a Public Enterprise Agency (PEA), which will implement the Privatisation Policy. The PEA will start operating in 2008. Government will also establish a multi-sector regulator for the energy, water and telecommunications sectors. A consultant has been engaged to assist in the establishment of the regulatory framework, including drafting of the enabling legislation. The consultant is expected to complete work at the end of November 2007. A steering committee has been established and is comprised of affected ministries and parastatals. It is envisaged that the regulator will start operating in 2008/09.
The implementation of the Decentralisation policy will be done in an incremental phased manner. In the medium term focus will be mainly on putting in place the institutional framework that will drive the process and sensitisation of the public. These include polices, the legal framework, administrative structures, systems and mechanisms for local governments. The civic education exercise is already ongoing to sensitise. The provision of services such as the issuing of birth, marriage and death certificates and travel documents will continue. The Ministry of Regional Development and Youth Affairs will also embark on a capacity building exercise over the medium term, to assist communities to start bottom-up planning.

9. MEDIUM TERM FRAMEWORK FOR 2008/09-2010/11

9.1 2006/07 Main Budget Outcome

The preliminary outcome of the main budget for 2006/2007 shows that the total revenue and grants collected were E6.4billion. The SACU revenues were the largest revenue item contributing 63% of total revenue.

Total recurrent expenditure in 2006/07 is estimated to be E5.5billion. Personnel expenditure increased to E2.9 billion and this was largely due to E448 million being transferred to the Public Service Pension Fund to reduce the pension fund deficit. Expenditure on Goods and Service was E958 million, a decrease of 4%. This is due to the control measures in place, including the suspension of the purchase of durable items. Transfers and subsidies were E1.4billion and included a transfer of E420million to increase the official reserves and recapitalise the Central Bank.

Capital expenditure was E1.6 billion in 2006/07, an increase of 16%. This is as a result of delays in the implementation of the projects and cost escalation due to underestimation of projects. Total expenditure was E.7.2billion resulting in a deficit of E711 million, which is 3.6% of GDP.

9.2 2007/08 Estimated Outturn

Total revenue for 2007/08 is estimated to be E9.3 billion. Again SACU receipts are expected to take a major share at E6.3 billion and 71% of total revenue. Taxes on income, sales tax and other revenue items will respectively account for 20%, 7.5% and 6.5%. Built into the estimate of the SACU share of E6.2 billion for 2007/08 is an estimated adjustment of E1.7 billion, arising from an upward revision of the 2005/06 SACU estimated Revenue Pool.

In accordance with the existing revenue sharing arrangement under the New SACU Agreement, SACU shares are determined at the beginning of a fiscal year and paid in four equal instalments during that year. The basis for determining the share of member states is an agreed formula annexed in the SACU Agreement. The size of the pool is based on forecasted collections into the pool at the beginning of a fiscal year. The collections are recorded and closely monitored during the year. Once all entries into and out of the pool have been closed and properly audited member states agree on the adjustment entries to be made on the originally agreed shares. This usually takes place at the end of the 2nd year after the determination of the shares. Hence the E1.7 billion adjustment mentioned above is in respect of the forecasted pool of 2005/06. It must be noted that the adjustment could be negative if the actual and audited pool is found to be less than the forecasted pool. In accordance with the Agreement where an adjustment arises, payment into or out of the pool should be made by member states on the year following its determination or over a period approved by Council. Although Council approved the E1.7 billion in December 2006, it is still a subject for debate as one member state raised some concerns over its calculation.

The increase in SACU revenue resulted in an appropriated surplus of E551 million, which is 2.6% of GDP. However, following the recent supplementary budget and projections for increase in some of the revenue items, the projected deficit is estimated at E375 million, which is 1.8% of GDP.

9.3 Fiscal Framework for the Medium Term

The projections for the medium term indicate that there will be a surplus of E10 million in 2008/09, which is 0.04% of GDP. This will be followed by another surplus of less than 1% in 2009/10 and a deficit of less than 1% in 2010/11. This is as a result of the projected decline in revenue from the Customs Union.

The deficits will be financed largely by domestic borrowing in the medium term. However, caution will be taken considering the cost of borrowing and its implications on debt service. The main objective is to match expenditure to the available resources and to minimise waste and corrupt practices. Government is currently reviewing the procurement procedures with the aim of streamlining the procurement of goods and services and minimising losses.

9.4 Expenditure by Sector

The proposed framework and the budget for the medium term will build upon the policy priorities as articulated in the 2007/08 budget. Hence expenditure for the medium term will be targeted at the following priority areas:

- Poverty reduction and rural development, addressing the needs of vulnerable groups through extending social assistance.
- Health Combating HIV and AIDS
- Education
- Food security
- Water and sanitation.
- Infrastructure development
- Economic growth

In line with the priorities for the medium term, it is proposed that the budget allocations for the priority sectors be increased over the medium term. This requires that allocations to the non-priority sectors be reduced to make resources available for the priority areas. The allocation for the health sector is currently at 8.6% of the total budget, compared to 7.9% in 2006/07. The objective is to gradually increase the allocation for this sector to 10.6% in 2008/09, 12.6% in 2009/10, 14.6% in 2010/11 and ultimately meet the international requirement of 15% in 2011/12.

For the agriculture sector, the budget increased from 4.5% in 2006/07 to 5% in 2007/08. Improvement of performance in this sector is urgent, given the poor performance as a result of the drought and other factors. The aim is to increase the allocation to this sector to 7% in 2008/09, 9% in 2009/10 and 10% in 2010/11. This takes into account new programmes that will come out from the Agricultural Summit action plan.

The education sector currently gets the largest share of the budget and this will also be increasing over the medium term. As per the provisions of the Constitution, primary education should be free in 2009/10 and this will significantly increase the allocation towards this sector. It is estimated that the budget for the education sector will increase to 22% in 2008/09 and at least 25% of the budget in 2009/10.

Although there is considerable work going on in the water sector, there is still a lot to be done in improving access to safe water, especially in the low veld. The budget for water resources management has increased from 4.9% in 2006/07 to 7.2% in 2007/08. This will continue to increase by at least 1% over the medium term, with focus mainly on provision of portable water especially in the rural areas.

The proposed increases in the allocations towards the priority sectors will be determined by the submission of acceptable comprehensive programmes and projects in line with the priority areas. The projects must be well articulated and planned. Resources will be provided only when projects are ready for implementation to avoid delays and cost escalations. Ministries are encouraged to focus more on these and make trade-offs within the resource envelope. This is expected to eventually lead to the allocations as required by international declarations, which currently government is unable to meet due to resource constraints.

10 CONCLUSION

While government has progressively increased expenditure in the social sector and infrastructure development, the challenge to do more still remains. It is therefore important to increase the impact, improve efficiency of government spending and delivery of public services. For this to be attained there is need for improved management of programmes, stronger coordination between ministries and departments and closer monitoring of implementation.

11 FEEDBACK

Comments on this statement should be addresses to the Director, Budget and Economic Affairs, Ministry of Finance, P. O. Box 443 Mbabane e-mail address: mabuzak@gov.sz. The deadline for submission is 23rd November 2007.