International Monetary Fund

Kingdom of Swaziland and the IMF

Kingdom of Swaziland: Staff-Monitored Program: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

March 29, 2011

Country's Policy Intentions Documents

The following item is a Letter of Intent of the government of the Kingdom of Swaziland, which describes the policies that the Kingdom of Swaziland intends to implement in the context of its request for financial support from the IMF. The document, which is the property of the Kingdom of Swaziland, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Letter of Intent

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund (IMF)
Washington, DC, USA

March 29, 2011

Dear Mr. Strauss-Kahn:

RE: LETTER OF INTENT FOR AN IMF STAFF-MONITORED PROGRAMME

Following several years of improved economic performance, the economy of the Kingdom of Swaziland has been hard-hit by the global economic crisis. Economic activity has slowed owing to a significant reduction in exports. In addition, fiscal pressures have mounted because of a sharp decline in revenues from the Southern African Customs Union (SACU) as well as structural imbalances in the budget. Medium-term prospects remain uncertain. Fiscal consolidation will take time, and our export potential may be negatively affected by possible removal of trade preferences (textile, preferential prices for sugar exports to the European Union), and the accession by Asian countries to similar preferences.

Against this background, Government has adopted policies, described in the attached Memorandum of Economic and Financial Policies (MEFP), for the period January 2011 to June 2011, which will make the first steps towards fiscal consolidation, while preserving developmental and poverty-reduction objectives. These policies complement the recent budget and are in line with our medium-term Fiscal Adjustment Roadmap (FAR), as well as our Poverty Reduction Strategy and Action Program (PRSAP).

In support of these policies, Government hereby requests a six-month Staff-Monitored Program, which could pave the way to a formal Fund arrangement later in 2011. Government will take any additional measure that may become necessary to maintain its fiscal consolidation objectives. Government will consult with IMF staff, at its own initiative or whenever the Managing Director of the IMF requests such a consultation, on the adoption of these measures and in advance of any revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultations. Government will provide IMF staff with information related to progress made in implementing the program, as described in the Technical Memorandum of Understanding (TMU). The fiscal program for 2011/12 under the Staff-Monitored Program differs from the budget submitted to Parliament because Government plans a prudent execution of the budget based on available funds and in line with more conservative revenue projections recommended by the IMF. The budget also did not include the planned 5 percent reduction in the wage bill, which will further reduce the fiscal deficit and the proportion of spending going to the recurrent government Budget.

This letter of intent is signed by the Minister of Finance and the Governor of the Central Bank of Swaziland on behalf of Government after approval by Cabinet. Government authorizes the IMF to publish this letter, the attached MEFP and TMU, and the related staff report, including placement of these documents on the IMF website, subject to Fund policy on the removal of potentially market-sensitive information.

Yours sincerely,

/s/

Majozi Sithole
Minister of Finance
Government of Swaziland

/s/

Martin G. Dlamini
Governor
Central Bank of Swaziland

Attachment 1 –Memorandum of Economic and Financial Policies

1. **This memorandum sets out Swaziland's economic and financial policies for the period January 2011-June 2011, for which Government is seeking a six month IMF Staff-Monitored Program (SMP)**. The program is anchored on two main objectives: (a) restoring fiscal sustainability and thus external sustainability; and (b) sustaining poverty reduction efforts, including by promoting a private-sector-led growth. The proposed SMP supports these development objectives as follows: (i) it aims to achieve macroeconomic stability through an orderly fiscal adjustment that addresses the permanent reduction in SACU revenues; (ii) it focuses on raising non-SACU revenues and improving public expenditure and financial management to focus the budget on key priority sectors, in particular the education and health sectors; and (iii) it seeks to accelerate structural reforms in order to increase productivity and competiveness which would facilitate higher economic growth. The program also protects the vulnerable by putting a floor on critical social expenditures, including on HIV/AIDS.

I. Recent Economic Developments

2. **Swaziland's recovery from the global economic crisis is being slowed down by the decline of some sectors and macroeconomic imbalances**. Real GDP growth in 2010 is estimated to have been higher than in 2009 (2 percent vs. 1¼ percent), but remains below the pre-crisis level (about 3 percent on average). These lower growth performances reflect a marked decline in textile and wood pulp exports and a prolonged drought in 2009. As a result, the external current account is expected to have deteriorated significantly, from about 14 percent of GDP in 2009 to about 18 percent in 2010. Against this background, inflation has dropped from 7½ percent in 2009 to 4½ percent (year-on-year) in 2010, reflecting a moderate increase in food prices and falling international fuel prices.

3. **The fiscal deficit is projected to reach about 13 percent of GDP in 2010/11 due to the decline in SACU revenues and historically high levels of expenditure**. This deterioration can be largely explained by one of the highest public sector wage bills in Sub-Saharan Africa (close to 18 percent of GDP in 2010/11), and a sharp decline in SACU receipts from 20½ percent of GDP in 2009/10 to 9½ percent in 2010/11. Government anticipates this loss to be permanent, on current assumptions. Government has not been in a position to raise enough financing for the 2010/11 budget and has accumulated around E900 million in outstanding domestic payment arrears (3½ percent of GDP) at end-December 2010.

4. **The major vulnerability to the financial system in Swaziland stems from weakly supervised nonbank financial institutions (NBFIs), but efforts are underway to establish a regulatory system for these institutions**. Otherwise, the financial sector has weathered the global economic crisis relatively well, and banks are well capitalized, profitable and liquid.

II. Policies Under the SMP

A. Fiscal Policy

5. **Government has defined several fiscal objectives, in line with its Fiscal Adjustment Roadmap (FAR), which provide a guiding medium-term framework**.

- **Objective 1: To reduce the deficit to below 3 percent of GDP by 2014/15.** Government intends to reduce expenditure over the medium term to a level consistent with a sustainable revenue stream. In this regard, Government will continue to reduce total expenditure (by cutting non-priority spending and the wage bill), and raise revenue through tax adjustments (such as introducing VAT and harmonizing some tax rates with South Africa) and through revenue administration improvements.

- **Objective 2: To maintain the debt-to-GDP ratio at less than 40 percent over the medium term**. Beyond this threshold, Swaziland risk of debt distress would rise rapidly.

- **Objective 3: To strengthen public institutions in support of the FAR**. By doing so, Government initially intends to (i) improve expenditure control, including by strengthening the role of the Ministry of Finance (MOF), which will have the core responsibilities for elaborating, implementing and monitoring the budget and its execution; and (ii) improve the ease and lower the cost of doing business in Swaziland.

- **Objective 4: To continue making progress towards development objectives,** including the United Nations Millennium Development Goals, and especially in the fight against HIV/AIDS.

Measures Taken During the Fiscal Year 2010/11

6. **Because the level of expenditure is the main source of fiscal imbalance, Government has reduced in-year expenditure to contain the overall fiscal deficit in 2010/11 to E3.6 billion (13 percent of GDP) including arrears**. The measures include:

- **Cutting capital projects by around 30 percent**. Capital expenditures have been reduced from E2½ billion to 2 billion.

- **Stopping overtime and introducing a hiring and wage freeze over the next three fiscal years**. On the wage bill, Government has terminated non-statutory overtime pay (saving around E10 million) and implemented a hiring and wage freeze.

7. **All new expenditure commitments have been stopped from November 15, 2010 until the end of the 2010/11 fiscal year, except in the areas of education and health**. This measure is expected to save at least E200 million in the 2010/11 budget (around ¾ percent of GDP).

Government has covered the additional cost (E350 million) incurred in November 2010 from the ongoing construction of the new Sikhuphe Airport by reducing commitments in other non-priority investment spending.

8. **Some tax rates have been increased in line with those in the SACU region, and Government has taken major steps towards strengthening tax administration**. The following changes have been adopted: (i) the fuel levy was increased by 50 cents per liter in three stages: first by 25 cents per liter for gasoline and diesel in November 2010; second by 10 cents per liter in February 2011; and third by 15 cents per liter in March 2011. This increase will yield around E100 million (¼ percent of GDP) in additional revenue annually. (ii) Excise duties on alcohol and cigarettes have been raised in line with the SACU region. (iii) The sales tax base has been broadened by removing exemptions on several products and services, including mobile phone services, which will now be taxed at the standard rate of 14 percent. Furthermore, the sales tax on tobacco and alcohol has been increased from 25 to 30 percent. Overall these measures are expected to raise around E150 million (½ percent of GDP). These tax measures are being supported by the establishment of the Swaziland Revenue Authority (SRA) and the introduction of a Large Taxpayer Unit in January 2011.

9. **Government has initiated the transformation of the Central Transportation Administration (CTA) into a public enterprise with its independent board and finances by June 2011 (structural benchmark)**. The CTA has become a significant drain on the budget, with transfers of around E400 million (1½ percent of GDP) in 2010/11. Government has reduced this allocation to around E300 million in 2011/12 and intends to strengthen the monitoring of the CTA in the new fiscal year. Government will also submit legislation to Parliament in June 2011 to transform the CTA into a public enterprise (structural benchmark). As such, the CTA will be subject to quarterly reporting, and annual audited reporting. This is expected to improve the financial situation of the company and enhance transparency and accountability.

10. **Immediate public financial management (PFM) reforms focus on strengthening expenditure controls**. The MOF and the Central Bank have established a Cash-Flow Monitoring Committee with the responsibility of projecting and monitoring all cash inflows and outflows, and calculating the cash balance available for expenditures to be authorized centrally by the MOF. This Cash-Flow Monitoring Committee meets on a weekly basis. In addition, a commitment register has been set up in all ministries and departments, and commitments will be reported to the MOF on a monthly basis to help ensure compliance with budget allocations (structural benchmark). Thus, all priority expenditure will be authorized centrally by the MOF. Over the medium term, Government will continue to implement PFM reforms and the MOF will be restructured by establishing units to develop tax policy and to coordinate and improve debt management.

11. **In addition, the new Public Financial Management Bill will be submitted to Parliament by end-June 2011 (structural benchmark)**. It lays out the functions, duties, and responsibilities of all budgetary institutions in the implementation of the budget. Proposed measures in the Bill include: adopting the International Public Sector Accounting Standards (IPSAS) across ministries; and consolidating expenditure reporting using IPSAS with the compilation and publication of quarterly budget execution reports with commentary on changes in revenue and expenditure

against the approved budget; and timely production of final accounts (within three months of the end of the fiscal year).

12. **The budget process has also been strengthened, with the core budget functions centralized with the MOF to ensure that fiscal policy objectives are met**. Government has entrusted the MOF with all the powers to effectively design, implement, and monitor the budget process, including the capital budget, by disbanding the Planning and Budget Committee (PBC), as of 15 November, 2010 (prior action). The PBC has been replaced with bilateral discussions between the MOF and line ministries and departments. The Minister of Finance will have sole responsibility for setting binding expenditure ceilings for all line ministries and budget institutions. The Ministry of Economic Planning and Development and the Ministry of Public Service and Information will continue to advise the MOF on the appropriate expenditure allocations, but will not authorize such expenditures.

13. **Government is aware of the rapid accumulation of domestic arrears**. In this context, the MOF issued a budgetary circular on November 11, 2010, to instruct all line ministries and departments to begin reporting outstanding invoices to the Ministry of Finance on a monthly basis. Government is committed to clearing all domestic arrears accumulated in 2010/11 by end-March 2012.

The 2011/12 Budget: the First Full Year of Fiscal Consolidation

14. **The 2011/12 Budget is a prudent one and makes further progress towards medium-term targets set in the FAR**. The main fiscal objective is to reduce the deficit to less than E2,373 million (around 8 percent of GDP), while preserving expenditure on education and health. It will be achieved through the full-year impact of increases in gambling tax and the fuel levy, the extension of the sales tax to mobile phone (and other) services at a rate of 14 percent, and higher sales tax rates on alcohol and tobacco (increasing from 25 to 30 percent), which will be effective in the first quarter of the fiscal year 2011/12. Transfers from the SACU revenue pool are projected to be E2,881 million. Overall, fiscal revenue, excluding grants is expected to raise around E7,715 million.

15. **Government is committed to reducing the wage bill by 5 percent annually (E 240 million).** The 2011/12 Budget already incorporates the wage and hiring freeze announced earlier, stopping notch increases (saving E25 million), as well as a reduction in allocations for travel and communication allowances (saving E30). Government also intends to reverse the 4.5 percent increase in wages granted in August 2010 through a staggered wage reduction to generate E240 million to the 2011/12 Budget and has engaged politicians and trade unions in negotiations to effect the reversal. As an upfront measure, Government agreed to cut the salaries of Cabinet ministers by 10 percent on March 22, 2011, and has made a public announcement to that effect. This will also reduce allowances for Cabinet ministers, which are a function of basic pay. The outcome of the negotiations with politicians and trade unions will be discussed at the time of the first assessment of the Staff-Monitored Program. The approval of the first assessment will be conditional on implementing measures sufficient to achieve the targeted reduction in the wage bill by E240 million in 2011/12 (structural benchmark for end-May 2011). Together with the steps already taken in 2010/11, Government expects these measures to reduce the wage bill by nearly

E700 million to around E4,200 million (14 percent of GDP). In addition, goods and services and transfers will be rationalized, including through initiating steps to transform the CTA into a public enterprise. Overall, Government spending will be capped at E10,534 million in 2011/12. Over the medium term, the wage and hiring freeze will continue to remain in place, while the Enhanced Voluntary Early Retirement Separation (EVERS) packages will start yielding some positive savings on the wage bill.

16. **Following the recommendations of the IMF technical assistance on revenue administration, Government will formulate a comprehensive taxpayer compliance strategy by September 30, 2011**. To facilitate tax compliance, a comprehensive taxpayer registry will be developed covering all SRA operations with a single taxpayer identification number for each business unit. The SRA will also continue to make preparations for the introduction of the VAT scheduled for 1 April, 2012, including by submitting legislation to Parliament by end-June 2011 (structural benchmark).

17. **PFM reforms will continue, with the improvement of the MOF website to strengthen fiscal transparency, and the development of a PFM action plan, based on IMF technical assistance recommendations, by June 2011**. Government will post the medium-term policy statement, the Treasury Annual Report, the annual report on public enterprises, budget documentation for Parliament and the quarterly Budget Execution Report, starting April, 2011. Government will introduce amendments to the Audit Act by September 30, 2011, which will cover the following areas: (i) expand the Auditor General's auditing activities to include local Governments and public enterprises; (ii) apply the auditing standards of the International Organization of Supreme Audit Institutions (INTOSAI); and (iii) speed up the auditing of accounts to within 6 months following the end of the fiscal year. Government will also adopt an action plan, by September 30, 2011, to implement strategic PFM reforms.

18. **Government's domestic resources are not expected to be sufficient to cover the overall Government deficit**. In particular, the financing gap is expected to be about E1½ billion. Government will seek additional external resources from donors to cover this financing gap. In parallel, exceptional financing may also come from the issuance of a second mobile network license and the privatization of Swazi Bank. Government has already taken steps towards the privatization of Swazi Bank and has approached consulting firms to provide an assessment.

19. **Fiscal space created by containing spending and identifying new sources of tax revenue will be used to finance programs that best support economic growth and poverty reduction**. These resources will be directed at curbing the spread of HIV/AIDS, improving education, and helping to achieve Government's objective of halving the poverty rate by 2015. In this regard, Government has agreed to monitor the level of education and health expenditure under the Staff-Monitored Program, as indicated in the attached Technical Memorandum of Understanding. The efficiency of public spending will also be strengthened by improving the selection of investment projects. This will help underscore Government's commitment to prioritize projects in the areas of education, health, and infrastructure and help fulfill capital commitments in a timely manner. The implementation rate of capital spending will steadily increase, as project approval becomes dependent on a clear implementation schedule.

Medium-Term Reforms

20. **Over the medium term, the expenditure and tax measures envisaged in the FAR are projected to yield savings of around 6 percent of GDP**. The projected savings are as follows: (i) a wage and hiring freeze, coupled with a steady reduction in the number of civil servants (2 percent of GDP); (ii) cuts in goods and services (1 percent of GDP); (iii) continued improvements in tax administration (1 percent of GDP); (iv) introducing VAT at a rate of 14 percent, to be implemented in 2012/13 (1 percent of GDP); and (v) revisiting tax policy with the aim of broadening the tax base through the removal of tax exemptions and the introduction of additional taxes (1 percent of GDP).

21. **Growth will be led by the private sector, with Government providing a stable and attractive economic environment through**: (i) sound macroeconomic management; (ii) a conducive investment climate; and (iii) a sound financial system. These measures will complement the Poverty Reduction Strategy and Action Program (PRSAP), adopted in 2007, which defines Government's strategy to halve the poverty rate by 2015.

B. Monetary, Exchange, and Financial Sector Policies

22. **Objective 1: Preserving the viability of the fixed exchange rate system with gross reserves covering at least 3 months of imports and 200 percent of reserve money**. Swaziland is part of the Common Monetary Area (CMA) with Namibia, Lesotho, and South Africa. The peg of the lilangeni at par to the rand has facilitated transactions with South Africa and helped maintain low inflation, which is expected to stabilize at around 5 percent over the medium term, broadly in line with inflation in South Africa. The Central Bank will maintain its monetary policy in line with that in South Africa in order to avoid any instability in the monetary and financial markets. The objective set on the level of gross international reserves will also go beyond the basic requirement of reserve money coverage. Setting the coverage at a level to cover reserve money fully as well as 50 percent of domestic currency deposits in commercial banks is in line with international best practice and will provide resources for contingencies, should unexpected stress on banks materialize. The coverage is expected to be largely achieved through the fiscal consolidation. However, the Central Bank will consider additional actions on reserve requirements in the event of an immediate and/or temporary need.

23. **Objective 2: Raising the debt ceiling to provide additional financing resources to the budget and to develop financial markets**. Deepening the money and capital markets is a key priority for Government. Indeed, owing to the limited availability of instruments to absorb excess liquidity, the Central Bank introduced Central Bank of Swaziland (CBS) paper with 182 days maturity in January 2011 to complement the existing 28-day and 56-day CBS bills and Government 91-day treasury bills already in the market. Government has amended the law defining the domestic debt ceiling to raise it to 25 percent of GDP from November 15, 2010 (prior action). Bonds will be issued to help finance the budget deficit for the remainder of 2010/11 and 2011/12.

24. **Objective 3: Strengthening the surveillance of non-bank financial institutions**. Government passed the Financial Services Regulatory Authority Bill in 2010 to help address weaknesses in the supervision of savings and credit cooperatives (SACCOs), and other non-bank

financial institutions (NBFIs), including pension funds. To maximize its effectiveness, the bill will be implemented swiftly. A separate Securities Act enacted in December 2010 provides guidelines to improve the regulatory framework of the stock market and is expected to boost private sector investment by increasing the number of available investment instruments. Government has also requested assistance from the IMF to strengthen the surveillance of the financial sector.

25. **Based on the forthcoming IMF safeguard, the Central Bank will develop an action plan to address all necessary measures to strengthen internal control systems**. The recommendations of the safeguards assessment of the Central Bank will be the subject of the first assessment under the Staff-Monitored Program scheduled for May 2011.

C. Improving Productivity and the Business Climate

26. **In order to strengthen private sector competitiveness, Government is pursuing a National Export Strategy (NES)** to: (i) expand the export base with a focus on key areas such as food, forestry, horticulture, tourism and information technology; (ii) enhance market access through product branding and improved quality; (iii) improve trade facilitation through the establishment of strong public-private partnerships (PPPs); and (iv) restart the privatization process.

27. **Government is committed to improving the business climate in order to attract increased private sector investment and create employment opportunities to reduce the high level of unemployment**. To this end, Government is pursuing reforms that will make it easier to start, operate, and expand businesses. Government has already implemented a competition framework through the Competition Act and is in the process of streamlining licensing arrangements. Government is also considering incentives for FDI to enter the domestic market and exploit the comparative advantage held in commercial agriculture (sugar, cassava, cotton) and some niche agricultural areas (canned fruit, juice concentrates, and vegetables). Small claims courts will be established to strengthen investment protection for investors and reduce the backlog in court cases. An independent regulator will be set up to oversee competition in the telecommunications and information technology sector. In light of Swaziland's proximity to South Africa, Government will intensify efforts to take advantage of this large market as a way of developing the manufacturing industry through lower unit labor costs and a favorable investment climate for FDI. Efforts will also be made to further harmonize trade standards with those of South Africa to facilitate trade. The tight monitoring of public wages, as well as a prudent fiscal policy will preserve labor costs and reduce the cost of doing business in Swaziland.

28. **Government will redouble its efforts to implement the 2004 privatization program**. As a first step, preparations will be made to begin privatizing Swazi Bank in late 2011. Government will also shortly offer for sale a second network license to increase competitiveness in the telecommunications sector, reduce the cost of doing business and increase access to communication services for those on the lowest incomes.

29. **On the basis of these reforms, the medium-term growth profile is premised on the implementation of macroeconomic and structural reforms aimed at increasing competitiveness and achieving diversification**. Real GDP growth is expected to decelerate from

a projected 2 percent in 2010 to ½ percent in 2011 on account of the sizeable fiscal adjustment in 2011/12, but then rise to average 2½ percent per annum over the medium term. Growth will be underpinned by an expansion in private sector activities, complemented by public investment in health, education, and infrastructure.

III. Risks and Contingency Plans

30. **Although there are signs of a regional and global recovery, some downside risks to the program remain**. These risks relate to the pace of the global and regional economic recovery, and, a reduction in tariff rates due to trade liberalization and/or the creation of a SADC customs union as well as possible changes in the SACU revenue sharing formula, which is currently under discussion. If such risks were to materialize, Government, in close consultation with IMF staff, stands ready to take additional measures, while safeguarding social spending to ensure the achievement of a sustainable fiscal position and prevent a destabilizing reduction of gross international reserves.

IV. Program Monitoring

31. **The Staff-Monitored Program will have two assessments, one based on end–March 2011 targets and the second one based on end-June 2011 targets**. Completion of the first and second assessments of the Staff-Monitored Program will be based on the observance of quantitative targets (Table 1) through end–March 2011 and end–June 2011, respectively, and a set of prior actions and structural benchmarks (Table 2). All prior actions have been completed. The variables monitored as quantitative targets are defined in the Technical Memorandum of Understanding (TMU).

32. **Government is committed to ensuring that the program remains on track, and has set up a monitoring team, chaired by the Ministry of Finance, to monitor implementation**. The monitoring team includes representatives of the Central Bank, the Swaziland Revenue Authority, and the Treasury.

Table 1. Swaziland: Indicative Targets, 2010–11

	2010	2011			
	Dec.	Mar.	Jun.	Sep.	Dec.
	Actual	Program		Projections	
Indicative targets:					
	(Emalangeni millions)				
Ceiling on the total financing requirement of the central government [1, 2]	2,633	3,510	584	1,569	2,553
Ceiling on the net domestic assets of the Central Bank of Swaziland [2]	-2,668	-1,796	-1,977	-2,758	-2,938
Floor on the central government social expenditures [3]	2,118	2,824	770	1,551	2,496
Ceiling on the stock of domestic arrears	900	1,200	1,200	800	400
	(US$ millions)				
Floor on the stock of net international reserves of the Central Bank of Swaziland [2]	548	437	476	600	639
Ceiling on the stock of external payments arrears [4]	0	0	0	0	0
Memorandum items :					
Net disbursements [1,2]					
General budget support	0.0	0.0	40.0	75.0	100.0
Debt service payments	142.5	190.0	52.5	105.0	157.5
	(Emalangeni millions)				
SACU receipts [1]	2,138	2,630	720	1,440	2,160

Sources: Ministry of Finance and Development Planning; Central Bank of Swaziland; and Fund staff estimates.

[1] Values are cumulative from April 1st (beginning of the fiscal year).

[2] Definitions and program adjusters are specified in the TMU.

[3] Includes spending on school feeding program, old age pension and HIV/AIDS

[4] Continuous indicative target

Table 2. Swaziland: Prior Actions and Structural Benchmarks under the Staff-Monitored Program

Prior Actions	Macroeconomic Rationale	Status
Tax Increases		
Increase levy on gasoline, and diesel, to generate E 100 million in additional revenue on an annual basis	To achieve immediate revenue increases	Done on March 15, 2011
Expenditure Cuts		
Stop all new budget commitments, except for health and education, for the remainder of 2010/11	To stem expenditure overruns and achieve immediate expenditure cuts	Done on November 16, 2010
Budget process		
Abolish the Planning and Budget Committee.	To give Ministry of Finance the sole responsibility for elaborating, monitoring and executing the budget.	Done on March 7, 2011
Financing		
Change the ceiling of domestic debt from E 1 billion (4 percent of GDP) to 25 percent of GDP (about E 6.7 million)	Reduce liquidity risks	Done on November 15, 2010
Benchmarks	Macroeconomic Rationale	Test Date
Expenditure Cuts		
Implement measures to cut the public wage bill by E240 million in nominal terms for the 2011/12 Budget.	To restore fiscal sustainability	end-May 2011
Public Financial Management		
Submission to Parliament of the Public Financial Management Bill	Strengthening PFM processes is key to strenghten the control fo the Ministry of Finance over the budget.	end-June 2011
Establish a commitment register in all ministries and departments and report commitments on a monthly basis to the Ministry of Finance (for the current month and within budget allocations).	Improve expenditure controls and limit budget overruns to make progress toward restoring fiscal and debt sustainability.	end-March 2011
Submission to Parliament of legislation to convert the Central Transport Administration into a proper public enterprise with budget reporting requirements and oversight by the Ministry of Finance.	Rationalize expenditures to make progress toward restoring fiscal and debt sustainability	end-June 2011
Tax Policy		
Submission to Parliament of amendments to the Income Tax Order, in line with Fund staff recommendations.	Adjust tax policy to make progress toward restoring fiscal and debt sustainability.	end-April 2011
Submission to Parliament of amendments to the Finance Act, in line with Fund staff recommendations.	Adjust tax policy to make progress toward restoring fiscal and debt sustainability.	end-June 2011
Submission to Parliament of the VAT legislation	Improve efficiency of the tax system to make progress toward restoring fiscal and debt sustainability.	end-June 2011

Attachment 2 – Technical Memorandum of Understanding

1. **This memorandum sets forth the understandings between Government of Swaziland and the IMF staff regarding the definitions of the quantitative targets and benchmarks for the Staff-Monitored Program (SMP), as well as the respective reporting requirements**. These targets and benchmarks are reported in Table 1 and 2 of Government's Memorandum of Economic and Financial Policies (MEFP).

A. Ceiling on the Total Financing Requirement (TFR) of the central Government

2. **Definition**. The central Government includes the central administration and all district administrations. The total financing requirement of the central Government is defined as net credit to Government from the banking system (that is, the Central Bank of Swaziland and the commercial banks) plus holdings of treasury bills and other Government securities by the domestic nonbank sector and by foreigners. For program monitoring purposes, the financing requirement will be calculated as the change from end-December 2010 of net credit to Government by the banking system and of holdings of treasury bills and other Government securities by the domestic nonbank sector and by foreigners. In particular, the calculation of the financing requirement shall include changes in (i) balances held in the privatization account or balances of other accounts into which proceeds from the sale of public enterprises are deposited; (ii) the amount of outstanding treasury bills issued by the Central Bank of Swaziland for monetary policy purposes; and (iii) the balance of Government deposit account used by the Central Bank of Swaziland to sterilize reserve money absorbed by monetary policy operations. The calculation of the financing requirement shall exclude changes in balances held in any account into which revenues collected by the customs department are held pending their transfer to the SACU revenue pool. External debt service, amortization, disbursements and external grants will be calculated at an exchange rate of E 7 per US$.

3. **Supporting material**. The Central Bank of Swaziland will provide the monetary survey and other monthly monetary statistics, as well as a table showing the details of all Government financing operations from the nonbank public, both domestic and foreign, on a monthly basis and within 30 days of the end of the month. The following information will be presented as memorandum items in the monetary survey: (i) the outstanding balances in the privatization account or accounts; and (ii) details of any monetary operations with treasury bills and other Government securities, including changes in Government deposits as a result of such operations. The Central Bank of Swaziland will also provide a table showing the details of Government debt by type and holder. The Ministry of Finance will provide detailed monthly budget operation reports and tax arrears reports.

B. Ceiling on the Stock of Net Domestic Assets of the Central Bank of Swaziland

4. **Definition**. The net domestic assets (NDA) of the Central Bank of Swaziland are defined as the difference between reserve money (currency in circulation plus total bank deposits at the Central Bank) and NFA (as defined in paragraph 5). The NDA thus includes net claims by the Central Bank of Swaziland on Government (loans, treasury bills and other

Government securities purchased less Government deposits), claims on banks, and "other items net" (other assets, other liabilities, and the capital account).

5. **Definition**. The net foreign assets (NFA) of the Central Bank of Swaziland are defined as foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the Central Bank. The values of all foreign assets and liabilities will be calculated in U.S. dollars at the end of each quarter using the program exchange rates.

6. **Supporting material**. The Central Bank of Swaziland will provide detailed data on its balance sheet on a monthly basis within 30 days of the end of the month. The Central Bank will also provide a table of selected monetary indicators covering the major elements of its balance sheet on a weekly basis.

C. Floor on the Stock of Net International Reserves of the Central Bank of Swaziland

7. **Definition**. The net international reserves (NIR) are defined as the Central Bank of Swaziland's liquid, convertible foreign assets minus its convertible foreign liabilities. Pledged or otherwise encumbered assets, including, but not limited to, assets used as collateral or as guarantee for third-party external liabilities are excluded from reserve assets. Reserve assets include cash and balances held with banks, bankers' acceptances, investments, foreign notes and coins held by the Central Bank of Swaziland, Swaziland's reserve position in the Fund, and SDR holdings. Reserve liabilities include nonresident deposits at the Central Bank of Swaziland, use of IMF credit, and any other liabilities of the Central Bank to nonresidents. The stock of NIR at the end of each quarter is defined in U.S. dollars and will be calculated using the program exchange rates.[1]

8. **Supporting material**. The Central Bank of Swaziland will provide data on its NIR on a monthly basis within one week of the end of the month. The NIR data will be provided in a table showing the currency breakdown of the reserve assets and reserve liabilities of the Central Bank of Swaziland converted into U.S. dollars and lilangeni at the program exchange rates.

D. Ceiling on the Stock of External Payments Arrears

9. **Definition**. During the period of the arrangement, the stock of external payments arrears of the public sector (central Government, Central Bank of Swaziland, and all enterprises with majority state ownership) will continually remain zero. Arrears on external debt-service obligations include any nonpayment of interest and/or principal *in full and on time* falling due to all creditors.

10. **Supporting material**. Details of arrears accumulated on interest and principal payments to creditors will be reported within one week from the date of the missed payment.

[1] Program cross exchange rates are: South African rand per US$: 7; US$ per pound sterling: 1.5; US$ per euro: 1.3.

E. Ceiling on Domestic Arrears

11. **Definition**: Domestic arrears are overdue payment obligations of the central Government other than external payment arrears, including on wages and salaries, pensions, transfers, domestic interest, goods and services, obligations arising from court cases, legally established compensation claims, and tax refunds. Payments on wages and salaries, pensions, transfers, court-established obligations, and compensations are in arrears when they remain unpaid for more than 45 days beyond their due date. Domestic interest payments are in arrears when the payment is not made on the due date. Payments for goods and services are deemed to be in arrears if they have not been made within 30 days of the date of invoice, or—if a grace period has been agreed—within the contractually agreed grace period.

12. **Supporting material**: Information regarding domestic arrears is to be compiled in monthly reporting of invoices received and paid by all ministries to the Treasury according to the MOF Budget Circular CF/51. The audits will be completed and data will be submitted to IMF staff within 30 days of the end of each month.

F. Floor on the Central Government Social Expenditures

13. **Definition**: There will be a floor on the central Government social expenditures. The observance of this floor is an indicative target. Social expenditures comprise spending on the following programs: school feeding program, old age pension, and HIV/AIDS. The details of the targets for 2010-11 are indicated in the table below.

14. **Supporting material**: Data on social spending will be compiled by the Ministry of Finance and will be provided on a quarterly basis, to be submitted no later than six weeks after the end of each reporting period.

Swaziland: Social Expenditures, 2010–11

	2010	2011			
	Dec.	Mar.	Jun.	Sep.	Dec.
	Actual	Est.	Target	Benchmarks	
	(Emalangeni millions)				
Social Expenditures	2,118	2,824	770	1,551	2,496
Education	1,500	2,000	480	970	1,625
Health	525	700	250	500	750
Other	93	124	40	81	121

G. Adjusters

15. **The quantitative targets specified under the program are subject to the following adjusters**:

- **Southern African Customs Union Revenues**. The program targets for the NIR in any quarter will be adjusted upward by the amount of Southern African Customs

Union (SACU) receipts above Fund staff projections outlined in Table 1 of the MEFP. The program targets for NDA and TFR in any quarter will be adjusted downwards by the amount of SACU receipts above Fund staff projections outlined in Table 1 of the MEFP. **Supporting material**: The Central Bank of Swaziland will provide data on SACU receipts on a quarterly basis within the first month of the quarter.

- **Budgetary Support net of Debt Service.**[2] The *ceilings* on NDA and TFR will be adjusted downward (upward) by the full amount of the delayed (advanced) budgetary support, net of debt service, relative to the programmed schedule specified in Table 1 of the MEFP. The *floor* on the NIR of the Central Bank of Swaziland will be adjusted upward (downward) by the full amount of the delayed (advanced) budgetary support, net of debt service, relative to the programmed schedule specified in Table 1 of the MEFP. **Supporting material**: Data on budget support and debt service will be compiled by the Ministry of Finance and will be provided on a quarterly basis, to be submitted no later than six weeks after the end of each reporting period.

- **Payment of Arrears**. The ceilings on NDA and TFR will be adjusted downward (upward) by the full amount of the excess (shortfall) in payments of arrears relative to the programmed stock levels specified in Table 1 of the MEFP. The floor on the NIR of the Central Bank of Swaziland will be adjusted downward (upward) by the full amount of the excess (shortfall) in payment of arrears relative to the programmed stock levels specified in Table 1 of the MEFP. **Supporting material**: Data on domestic arrears will be compiled by the Ministry of Finance and will be provided on a monthly basis, to be submitted no later than 30 days after the end of each month.

[2] General budget support consists of grants and concessional loans received by the central Government for financing its overall policy and budget priorities.