



AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE
DE DEVELOPPEMENT

COUNTRY FOCUS REPORT 2024

ESWATINI

Driving Eswatini's Transformation
The Reform of the Global Financial Architecture





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ACRONYMS AND ABBREVIATIONS

AfCFTA	Africa Continental Free Trade Area
AFOLU	Agriculture, Forestry and Other Land Use
AIDI	Africa Infrastructure Development Index
CBE	Central Bank of Eswatini
CFR	Country Focus Report
CMA	Common Monetary Area
COP	Conference of Parties
DCP	Development Cooperation Policy
DRM	Domestic Resource Mobilization
DRR	Disaster Risk Reduction
ECCE	Country Economics Department
ECST	Eswatini Macroeconomic and Social Indicators
EEA	Eswatini Environmental Authority
EEC	Eswatini Electricity Company
EPZs	Export Processing Zones
ERS	Eswatini Revenue Service
E&S	Environmental and Social
FDI	Foreign Direct Investment
GCF	Green Climate Change Fund
GFA	Global Financial Architecture
GHG	Greenhouse Gas
GVA	Gross Value-Added
HCI	Human Capital Index
ICT	Information and Communications Technology
IMF	International Monetary Fund
IPPU	Industrial Processes and Product Use
LMIC	Lower Middle-Income Country
MDFIs	Multilateral Development Finance Institutions
MDIs	Multilateral Development Institutions
MNWAP	Mkhondvo-Ngwavuma Water Augmentation Project
NASA	National Aeronautics and Space Administration
NDC	Nationally Determined Contributions
NDPs	National Development Plans
NIEs	East Asian Newly Industrialized Economies
NPLs	Non-Performing Loans
ODA	Official Development Assistance
PFM	Public Finance Management
PPPs	Public-Private Partnerships
SACU	Southern Africa Customs Union
SARB	South African Reserve Bank
SDG	Sustainable Development Goals
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFCCC	United Nations Framework Convention on Climate Change
VAT	Value-Added Tax
WDI	World Development Indicators

EXECUTIVE SUMMARY

The 2024 Country Focus Report (CFR) for Eswatini gives an overview of macroeconomic developments since 2022 covering growth, monetary and fiscal policies, public debt, outlook and risks, and social developments. The report also presents an updated analysis of the country's economic performance for 2023, including medium-term growth projections over the period 2024-2025. In addition, the CFR presents a comprehensive overview of recent progress in Eswatini's economic transformation amidst a changing world, identify its key trends, and outline its characteristics. The report presents Eswatini's financing needs to achieve structural transformation, while dealing with the threat of climate change, using the Bank's estimates on financing needs and gaps to fast-track structural transformation, and to finance climate actions by 2030 and 2063. The report also assesses Eswatini's capacity to increase its tax-to-GDP ratio to close the financing gap to fast-track structural transformation by 2030 and 2063 and motivates the needs for reforms to the international financial architecture.

Eswatini's economy grew from 0.5 percent in 2022 to an estimated 4.8 percent in 2023, largely driven by stronger performance of the services sector. Aggregate demand is mainly driven by consumption, which constitutes 84 percent of GDP, and investment at 13 percent of GDP. The fiscal deficit widened from 4.5 percent in 2022 to an estimated 6.3 percent of GDP in 2023 as revenues underperformed. The public debt-to-GDP ratio marginally declined from 43 percent in December 2022 to an estimated 41 percent in December 2023, above the desired level of 35 percent of GDP. The economic outlook between 2024 – 2025 is positive, although downside risks remain. Growth is projected at 4.9 percent in 2024, underpinned by improvements in industry and services, then expected to taper in 2025, due to slowing agricultural growth. Downside risks stem from ongoing economic challenges in South Africa, especially energy supply, elevated prices, climate change impacts on agricultural output, and tighter credit conditions that may stymie new investments.

Although Eswatini is classified as a Lower-Middle Income Country (LMIC), the country's development challenges are akin to low-income countries. Over the last few decades, the country has been mired on low growth trajectory with the economy encumbered by challenges that include erratic climate conditions, low growth from South Africa (its biggest trading partner), and a difficult global landscape. Since 1980, two distinct phases of growth can be observed, between 1980 and 1994, when apartheid ended in South Africa, and the post-apartheid era. Between 1980 and 1994, Eswatini enjoyed remarkable investment-led growth which averaged 8.2 percent per annum, driven by large scale foreign investments into agriculture, forestry, and agro-processing. However, the advent of a democratic dispensation in South Africa in 1994 eroded Eswatini's advantage as the sub-region's preferred destination for foreign investment as many companies relocated to South Africa. As this happened, Eswatini did not optimally adjust to the changed circumstances to retain and attract significant new private investments, which had driven growth in the past. The country, instead, shifted its growth model from private-investment led to public sector-consumption driven, which did not yield the desired growth outcomes amidst constrained fiscal space. The growth outcomes of the two models are, thus, telling.

Eswatini's economic performance slowed down from around 8 percent in the 1980's to average 3.9 percent in the 1990s and early 2000, before further falling to average 2.6 percent between 2010-2019. COVID-19 induced the first economic contraction in nearly 50 years in 2020. These concerning growth trends, thus, calls for Eswatini to restore the private sector's position as the engine for growth, and catalyst for economic transformation and the attainment of higher, sustained, and inclusive growth.

Successful economic transformation is accompanied by a shift of an economy's structure from low-productivity, labor-intensive activities to higher productivity, capital and skill intensive activities. Although Eswatini's economy continued to experience a shift of output and employment from agriculture to services, the share of industry also declined. Eswatini, thus, experienced limited structural transformation. The share of agriculture in GDP dropped from an average of 12.3 percent to 8.1 percent between 1991 and 2022, and that of industry fell from 39.1 percent to 33 percent. However, the share of services increased from 39.8 percent to 53.5 percent in 2022. In terms of sector employment, services sector jobs increased from 54 percent of total employment in 1991 to 63 percent in 2022, while the share of agricultural jobs declined from 20 percent to 13 percent, and industry from 25 percent to 24. The analysis suggests that between 1991 and 2022, agricultural and services sectors labor productivity increased, while industrial sector labor productivity slightly decreased. Cross sector labor productivity analysis indicates that the industrial sector has been the most labor productive sector in Eswatini followed by services.

Eswatini's financing gap to achieve structural transformation by 2030 is estimated at 9.5 percent of annual GDP. The government recognizes that public resources are inadequate to finance structural transformation. The National Development Plan (NDP, 2023/24-2027/28) noted that financing development requirements has to come from a combination of financing sources, which includes domestic revenues, local and foreign borrowing, and by forming Public-Private Partnerships (PPPs) with the private sector as the financier of projects. The total resources needed annually by 2030 to fast-track Eswatini's structural transformation and catch up with high-performing developing countries amounts to USD584 million with a financing gap of USD494.9 million. The amount required to fast-track SDG4 (education) is estimated at USD61 million and has a financing gap of USD3.9 million. The amount required to achieve SDG 7 (energy) is USD60.6 million and has a financing gap of USD 30.7 million. The required increase in tax-to-GDP ratio to close the estimated annual financing gap for Eswatini to achieve structural transformation in 2030 and 2063 is estimated at 13.2 percent and 2.3 percent, respectively. Eswatini displays unattainable tax-to GDP ratio required for structural transformation by 2030 which implies that domestically mobilized resources will not be sufficient for Eswatini to close the existing financing gap for structural transformation by 2030, but slightly improves by 2063.

Eswatini resonates with calls for a re-evaluation of the Global Financial Architecture (GFA) to achieve the Sustainable Development Goals (SDGs), particularly the need to address interest rates on debt in a fair way that is beneficial to both the least and developing nations. The country has called for UN Member states to develop innovative financing strategies to ensure that implementation reaches the most left behind. The country's status as a LMIC presents challenges to unlocking adequate concessional finance, in particular grant resources, to propel structural transformation. Given this reality, the global financial system ought to be reformed to consider the unique situations, and diverse needs of MICs to boost their access to financial resources and accelerate their structural transformation. These include increasing concessional resources from Multilateral Development Banks (MDBs), and special project funds for MICs.

GENERAL INTRODUCTION

The Kingdom of Eswatini is a small (17, 364km²), land-locked nation with a population estimated at 1.2 million (2023). The country is bordered by Mozambique to its northeast and South Africa to its north, west, south, and southeast. Eswatini maintains a dual governance structure comprising the modern parliamentary as well as traditional systems under the monarchy. Although the country is classified as a Lower-Middle Income Country (LMIC), primary development challenges that include endemic poverty, inequalities, and high levels of unemployment persist. Transforming the economy into a well-diversified, resilient, and competitive one positioned to deliver high, inclusive, and sustained growth has been a persistent challenge. The country experienced limited structural transformation since 2000. Although the sectorial composition of output and employment continued to drift from agriculture, the shares of industry also declined while the shares of services sector increased. Over the last decade, the country has been on a low growth trajectory with the economy encumbered by challenges that include erratic climate conditions, low growth from South Africa, and a difficult global landscape. Structural challenges which have hampered robust economic growth and private sector growth include weak economic governance, a difficult investment climate due to business regulatory constraints, declining competitiveness attributed to high cost of doing business, and deteriorating infrastructure, among others.

This Country Focus Report (CFR) is organized into three main chapters. Chapter 1 analyzes the recent macroeconomic developments. Chapter 2 takes stock of Eswatini's structural transformation process, and analyses the financial needs required to fast track it. The chapter identifies structural transformation in the country's NDPs, financing needs, and gaps; how to close the financing gap through domestic resource mobilization; and the role of the private sector and Development Finance Institutions (DFIs) in financing structural transformation. The chapter further highlights that Eswatini's journey towards structural transformation requires significant resources and investments in infrastructure, human capital, and climate action. It further argues that the GFA has not adequately delivered development financing at scale to Eswatini in particular, and to Africa in general. Chapter 3 deals with Eswatini's financing of structural transformation, focusing on the requisite international financial architecture reforms to accelerate structural transformation, and Eswatini's position. The chapter proceeds to articulate on the need for mobilizing additional resources for Eswatini's structural transformation, financing climate action, and recommendations.

MACROECONOMIC PERFORMANCE AND OUTLOOK

1

KEY MESSAGES

- Eswatini's economy grew from 0.5 percent in 2022 to an estimated 4.8 percent in 2023, driven by stronger performance of the services sector. Aggregate demand is largely driven by consumption, which constitutes 84 percent of GDP, and investment at 13 percent of GDP. Inflation rose to 5 percent in 2023, and in the context of the currency peg, monetary authorities gradually raised the discount rate from 3.75 percent in March 2022 to 7.75 percent in July 2023 before adjusting it to 7.5 percent since August 2023 to tame inflation. The domestic unit, the lilangeni, which is pegged to the Rand, depreciated in 2022 and 2023 amid weak investor sentiment about South Africa's economic prospects.
- The fiscal deficit widened from 4.5 percent in 2022 to an estimated 6.3 percent of GDP in 2023 as revenues underperformed. The public debt-to-GDP ratio marginally declined from 43 percent in December 2022 to an estimated 41 percent in December 2023, above the desired level of 35 percent of GDP. Domestic tax revenues increased slightly from 15.6 percent of GDP in 2022 to about 16.1 percent in 2023. The current account balance recovered from a deficit of 2.6 percent of GDP in 2022 to an estimated surplus of 3.9 percent in 2023, buoyed by an improved trade balance, and secondary income inflows. Reserves improved slightly to 2.7 months of import cover in 2023, from 2.5 months in 2022. The financial sector was stable, although nonperforming loans remained elevated at around 7.2 percent of gross loans in 2023 compared to 7 percent in 2022. Banks maintained a strong capital adequacy ratio, which averaged around 18 percent in 2022/23, above the statutory minimum requirement of 8 percent. Poverty (58.9 percent in 2017), youth unemployment (56 percent in March 2023), and inequality (54.6 Gini index in 2016) remain high.
- The economic outlook is moderately positive, although downside risks remain. Growth is projected at 4.9 percent for 2024, underpinned by improvements in industry and services, and is expected to taper in 2025, due to slowing agricultural growth. The fiscal deficit is expected to narrow further in 2024 and 2025 on the back of high Southern Africa Customs Union (SACU) receipts. The public debt-to-GDP ratio is also poised to decline further, due to moderately strong growth prospects. The current account surplus is expected to rise to around 4 percent of GDP, buoyed by improving trade balances, and secondary income inflows.
- Headwinds stem from ongoing economic challenges in South Africa, especially energy supply, elevated domestic prices, climate change impacts on agricultural output, and tighter credit conditions. Inflation is projected to decline slightly to 4.8 percent in 2024, following global trends, but planned electricity tariff hikes, a weaker exchange rate, and high food prices could reverse the trend. Tailwinds include the successive SACU revenue windfalls set to continue propelling domestic demand, improved external demand for the country's key exports, and the improved external demand for the country's key exports, and the commencement of construction of the Mpakeni dam, which is phase 1A of the Mkhondvo-Ngwavuma Water Augmentation Project (MNWAP) that is expected to boost the construction sector.

Introduction

This chapter presents an updated analysis of Eswatini's economic performance for 2023, including medium-term growth projections over the period from 2024-2025. It will assess trends in, among others, key macroeconomic indicators, fiscal and monetary policies, and changes in domestic and international financial flows, investment, and public debt. The chapter also discusses the main downside and upside risks to the outlook and provide policy options to foster high, and resilient growth; supporting macroeconomic stability and economic transformation, and deal with potential shocks that may buffet the economy.

Section 1: Growth Performance

Eswatini's real GDP rebounded by an estimated 4.8 percent in 2023 from 0.5percent in 2022, driven by strong services sector performance, which grew by 8.2 percent, and industry which expanded by a modest 1.4 percent. The performance of industry was underpinned by improved external demand for key exports that buoyed manufacturing, and the rejuvenation of construction activity which benefitted from increased public spending on infrastructure projects. The services sector's performance was buoyed by growth in wholesale and retail, accommodation and food service, Information and Communications Technology (ICT), and public administration and defense. The 102 percent historic increase in SACU receipts in 2023 provided the government with the fiscal space to increase spending, which, in turn boosted government-linked services. Agriculture contracted by 2.5 percent, mainly due to weather-related challenges characterized by irregular rainfall patterns, as well as high input costs. In 2023, the services

sector contributed 4.4 percent to real GDP growth, followed by industry (0.5 percent), while agriculture's contribution was - 0.2 percent. Aggregate demand is dominated by consumption (85 percent), followed by investment (13 percent), and net exports (-0.6 percent). Consumption, investment, and net exports contributed 4.4percent, 1.2 percent, and -0.9 percent to growth, respectively.

Section 2: Other Recent Macroeconomic and Social Developments

Monetary Policy, Inflation and Exchange

Rate: Eswatini's monetary policy is aimed at promoting growth and price stability. However, the country's currency peg with the South African Rand limits the scope for independent monetary policy. The Central Bank of Eswatini (CBE) almost always adjusts its discount rate in tandem with the South African Reserve Bank (SARB)'s repo rate changes but maintains a very small gap with its discount rate to support the domestic economy and private sector credit. The discount rate gradually increased from 3.75percent in January 2022 to reach a peak of 7.75percent in June 2023, before adjusting downwards to 7.5percent from August 2023 to date. Eswatini's price developments generally trend South Africa's inflation dynamics, due to strong trade and exchange rate ties under the currency peg. Inflation increased from 4.8 percent in 2022 to 5 percent in 2023, while the local currency depreciated by an average of 11 percent in 2022 and 2023, following the Rand.

Fiscal Policy and Public Debt: Fiscal imbalances have continued to persist, fueled by high public spending that outpaces revenues, which has resulted in prolonged fiscal deficits. In 2023, public spending increased by 12.4 percent, while revenues increased by 4.7percent, which

resulted in the fiscal deficit increasing from 4.5 percent of GDP in 2022 to an estimated 6.3 percent in 2023. Fiscal deficits are largely financed by borrowing and accumulation of expenditure arrears. The primary balance deficit widened from 2.7percent of GDP to 4.2percent in 2023, reflecting the effects of the high public sector wage bill, and election-related expenditures. Eswatini's weak fiscal position led to a significant increase in total public debt, which climbed from 37

percent of GDP in 2022 to 41.3 percent in 2023, with external debt being equivalent to 19.4 percent of GDP, and domestic debt to 21.9 percent. Domestic debt account for 53 percent of total debt. Debt interest payments also increased from 1.8 percent of GDP to 2.2 percent in 2023, which further constrained the fiscus. In 2023, the International Monetary Fund (IMF) assessed Eswatini's sovereign debt stress risk to be high in the medium-term.

External Position – External Financial

Table 1 : Eswatini Macroeconomic and Social Indicators (ECST)							
Macroeconomic Indicators	2019	2020	2021	2022	2023(e)	2024(p)	2025(p)
Real GDP Growth	2.7	-1.6	10.7	0.5	4.8	4.9	3.6
Inflation	2.6	3.9	3.7	4.8	5.0	4.8	5.1
Overall Fiscal Balance, Including Grants (% GDP) *	-6.9	-6.5	-4.5	-4.5	-6.3	-2.2	-1.7
Current Account (% GDP)	3.8	6.7	2.6	-2.6	3.9	3.9	2.9
Total Population (Millions)	1.2	1.2	1.2	1.2	1.2
Life Expectancy at Birth (Years)	60.5	59.7	57.1	56.4	57.7

Source: Data from domestic authorities; estimates (e) and prediction (p) based on authors' calculations. AfDB Statistics Department, April 2024.

Note: *Data in fiscal year 1 April (n-1)/ 31 March (n).

Flows: The external current account balance recovered from -2.6% in 2022 to 3.9% of GDP in 2023, reflecting higher SACU revenue that boosted the secondary income account, and an increasing trade surplus, fueled by higher exports of key commodities such as soft drink concentrates, sugar, and sugar products. The official reserves position also improved to 2.7 months of import cover, from 2.5 months in 2022.

Social Developments: Poverty (58.9 percent in 2017), and inequality (Gini index 54.6 in 2016) remain core development challenges for Eswatini which are

exacerbated by high unemployment (35.4 percent in 2023). Poverty is more pronounced in rural areas (70.2 percent), more than urban areas (19.6 percent). The World Bank estimates show that poverty rates slightly declined from 54 percent in 2022 to 52.1 percent in 2023, using the LMIC poverty line. Youth unemployment remain stubbornly high for the 15-24 age group (56 percent), and 48.7 percent for the 15-35 years age group, and is driven by skills mismatches, weak private sector growth to absorb skilled youth labor, inadequate entrepreneurship development skills, lack of business finance, and COVID-19 induced company closures.

Box 1.1: Impact of Tighter International Financial Conditions (Transmissions Channels)

Since 2022, the world's central banks unleashed steep series of interest-rate increases in decades to tame inflation. Tighter international financial conditions imply that global growth is set to slow further amid tight monetary policy, restrictive financial conditions, and feeble global trade and investment. It also implies that there will be weak demand for Africa's exports, thus negatively affecting the current account and GDP growth. Tighter international financial conditions in developed countries negatively impacts Official Development Assistance (ODA) to African countries which will adversely affect Africa's development given that up to 80 percent of most African countries' development budgets are externally financed.

Eswatini's central bank has also pursued a financial tightening policy in the fight against inflation under the currency peg with the South African Rand under the Common Monetary Area (CMA) agreement with Lesotho, Namibia, and South Africa. Eswatini, thus, effectively has no independent monetary and exchange rate policy, which leads to a harmonization of interest rates with South Africa to anchor the fixed exchange rate. Any shocks from South Africa squarely fall on Eswatini as there is no exchange rate adjustment with South Africa. The CBE, however, maintains a very small interest rate gap with the SARB's benchmark rate to support the economy, and private sector credit. A high interest regime will stymie private sector credit, and hence growth.

When inflation is high, interest rates are increased to discourage spending and therefore reducing aggregate demand. As interest rates rise, household vulnerabilities could pose risks to financial stability. As loans dominate at flexible interest rates, households will see their interest payments increase, which could pose risks to financial stability as households reduce consumption, thus depressing GDP growth. The downward pressure on economic activity, coupled with a continuing rise in interest rates, could result in loan defaults, which weakens lenders. Eswatini's price developments generally trend South Africa's inflation dynamics, due to strong trade, and exchange rate ties under the peg. South Africa's inflation increased in 2022, prompting the SARB to tighten interest rates. Similarly, Eswatini's inflation also picked to 4.8%, and in sync with the SARB, the CBE adjusted its discount rate upwards to a peak of 7.75% in July 2023 before lowering it to 7.5% since August 2023. During periods of low inflation, interest rates are lowered to encourage spending, hence increasing aggregate demand.

The improvement in the fiscal position is expected to propel demand through public consumption and investment which will benefit sub-sectors such as 'wholesale and retail,' 'accommodation and food services,' and construction.

Section 3: Macroeconomic Outlook and Risks

3.1: Outlook

Eswatini's medium-term outlook is moderately optimistic, despite downside risks. In 2024, growth is projected at 4.9 percent, underpinned by recovery in agriculture on account of improvements in irrigated farming. The industry is expected to significantly recover, which is attributed to continued improvements in export demand and construction sector, due to substantial injections from the public sector investment program, financed by higher SACU revenues. The improvement in the fiscal position is expected to propel

demand through public consumption and investment which will benefit sub-sectors such as 'wholesale and retail,' 'accommodation and food services,' and construction. Manufacturing activity is expected to contribute to higher growth in the medium-term, benefiting from completed and ongoing expansions in different industries, boosting supply capacities, including beverages, textiles, and food manufacturing. Growth is projected to taper to 3.6 percent in 2025, due to an expected slowdown in agricultural performance. Inflation is projected at 4.9 percent and 5.1 percent in 2024 and 2025, respectively, driven by electricity tariffs hikes, elevated crude oil prices, a weak domestic currency, and higher food

prices, given prospects of lower agriculture yields in 2025. Monetary policy is, thus, expected to remain restrictive in the short-term. The fiscal situation is estimated to improve in 2024, with an estimated deficit of 2.2 percent of GDP, which stems from higher SACU revenue, projected to further increase by 11.5 percent, relative to the previous year. Debt is projected to stabilize and decline in the medium-term, with continued growth recovery, and careful debt contracting considerations. The current account is expected to remain in surplus in 2024 (3.6% of GDP), on the back of higher SACU receipts, and increased export demand of key products. Poverty, based on the LMIC poverty line, is projected by the World Bank to decline from 52.1 percent in 2024 to 51.4 percent in 2025.

3.2 Downside and Upside Risks to the Growth Outlook

Global shocks remain a major risk to the domestic economy's outlook, given strong trade links, particularly with South Africa. Risk for the manufacturing sector in the short-to-medium-term, include the uncertainty with regards to recovery and the stability of global demand as well as supply chains, influenced by the ongoing geopolitical tensions, and the high volatility of global commodity prices. Climate change continues to be a threat to growth. On the domestic front, any delays in the implementation of mega projects form part of the critical risks for the medium-term outlook. Other economic headwinds, stem from ongoing economic challenges in South Africa, the country's largest trading partner; the prospective impact of El Nino on agricultural output, food prices, and food security; the dampening effects of high inflation on disposable income; and the impact of a high interest rate environment on new investments, corporate balance sheets, and in turn higher Non-Performing Loans (NPLs) in financial institutions.

Tailwinds include the successive SACU revenue windfalls set to continue propelling domestic demand, improved external demand for the country's key exports, and the commencement of construction of the Mpakeni dam, which is phase 1A of the MNWAP that is expected to boost the construction sector and associated activities.

Section 4: Policy Options to Foster High and Resilient Growth: Supporting Macroeconomic Stability and Economic Transformation.

Eswatini has policy options at its disposal to reverse the low growth trap and foster sustained, high and resilient growth. A return to a private sector and export-led growth model, supported by prudent macroeconomic policies and structural reforms, is key to restore growth and bolster economic transformation.

Monetary policy, implications, and outlook: Monetary policy should remain focused on preserving the currency peg to the Rand and maintaining price stability. Keeping the policy rate in line with the SARBs' rate, and strengthening international reserves is, thus key for macroeconomic stability.

Fiscal positions and domestic resource mobilization: Eswatini's economic performance is highly dependent on South Africa, given the significant levels of trade, investment, and remittance flows between the two countries. In addition, a large proportion of the government revenues are derived from the volatile SACU receipts (around 35 percent) which has caused severe fiscal imbalances and cash flow constraints in the past. Revenue reform, thus, remain a priority to improve public finances, and enhance the effectiveness of fiscal policy. Policy options should focus on improving domestic revenue mobilization

by increasing non-SACU revenue and reducing the volatility of revenue by fully implementing the stabilization fund through adequate capitalization. There is scope for raising additional revenue by reducing tax expenditure and improving tax administration. Further formalization of the informal sector is also imperative, as is strengthening the investigation and enforcement function of the Eswatini Revenue Service (ERS). A fiscal rule to accompany the SACU stabilization fund, which imposes a ceiling on annual spending of SACU receipts to bolster the budget from SACU revenues volatility is worthy to pursue. The government should also continuously review the effectiveness of current tax orders. Reforms on the expenditure side are also important to ensuring fiscal sustainability. Rationalizing government spending and improving efficiencies is key to fiscal sustainability and Eswatini's weakness in the Public Financial Management (PFM) is a major cause of the macro-fiscal challenges, hence the need to continue (a) strengthening budget preparation and execution, including adherence to budget ceilings; (b) accelerating the reform of the wage bill; (c) eliminate domestic expenditure arrears; and (d) restructuring State-Owned Enterprise (SOEs) to reduce

their dependency on the fiscus.

Structural reforms should focus on improving the business environment, bolstering governance and reducing the state's footprint on the economy. Growing the private sector will galvanize efforts to diversify revenue sources through income taxes, and consumption taxes as disposable incomes increase. Improving the business environment will thus be imperative together with promoting policies that promote transition from informal business to formal will support the Domestic Resource Mobilization (DRM) efforts. Implementing governance reforms aimed at improving the business and investment climate will enhance the country's competitiveness and help the country to attract private investment. These include streamlining the business regulatory framework (over-regulation or under-regulation), which often creates a barrier to the entry of Small and Medium Enterprise (SMEs), and removal of bureaucratic requirements that make it difficult, and prohibitively expensive for SMEs to set up and run a business.

TAKING STOCK OF ESWATINI'S STRUCTURAL TRANSFORMATION PROGRESS

2

KEY MESSAGES

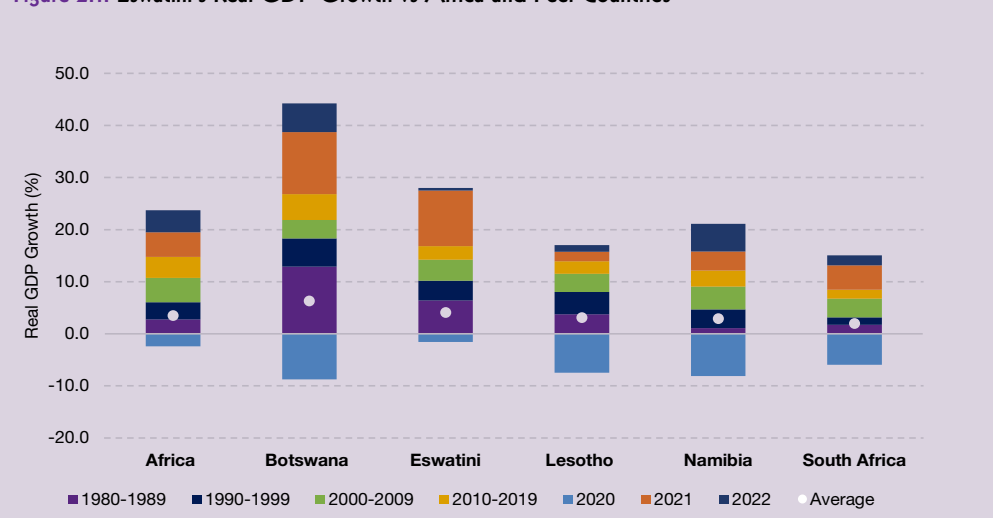
- Eswatini has two distinct phases of growth that can be observed since 1980, prior to the 1994 and post-apartheid to date. Between 1980 and 1994, Eswatini enjoyed remarkable investment-led growth which averaged 8.2 percent per annum, that was mostly driven by large scale foreign investments into agriculture, forestry, and agro-processing. However, the advent of a democratic dispensation in South Africa in 1994, eroded Eswatini's advantage as the sub-region's preferred destination for foreign investment. Many companies left Eswatini and relocated to South Africa, which placed the country on a low growth trajectory.
- The above developments led Eswatini to shift its growth model from private-investment higher-growth to public sector-consumption driven lower growth model, which, however, did not yield the desired growth outcomes, as the fiscal environment became constrained. The growth outcomes of the two models are telling. Eswatini's economic performance slowed down from around 8 percent in the 1980's to average 3.9 percent in the 1990's, and early 2000, before further falling to average around 2 percent over the last decade.
- The country has experienced limited structural transformation over the last 2-3 decades. While the structure of the economy continued with the shift of output and employment from agriculture to services, the share of industry also declined. While the share of services in GDP rose from 39.8 percent in 1991 to 53.5 percent in 2022, the share of agriculture dropped from 12.3 percent to 8.1 percent, and that of industry dropped from 39.1 percent to 33 percent during the same period. In terms of sector employment, service jobs increased from 54 percent of total employment in 1991 to 63 percent in 2022, while the share of agricultural jobs declined from 20 percent to 13 percent, and industry from 25 percent to 24 percent.
- The analysis suggests that between 1991 and 2022, agriculture and services sectors' labor productivity increased, while industrial sector labor productivity slightly decreased. However, cross sector labor productivity analysis indicates that industry has been the most labor productive sector in Eswatini, followed by services.
- The total resources needed annually by 2030 to fast-track Eswatini's structural transformation and catch up with high-performing developing countries from other regions amounts to USD584 million with a financing gap of USD494.9 million. The amount required to fast-track SDG4 (education) is USD61 million with a financing gap of USD 3.9 million. The amount required to achieve SDG 7 (energy) is USD60.6 million with a financing gap of USD 30.7 million.
- Accelerating structural transformation in Eswatini will, thus, require boosting total factor productivity through economic governance reforms aimed at attracting private investment, diversifying productive capabilities, and expanding local, and regional value-chains.

Introduction

This chapter aims to present a comprehensive overview of recent progress in Eswatini's economic transformation amid a changing world, identify its key trends, and outline its characteristics as well as estimate the financing needs to fast-track structural transformation. It takes both a historical perspective (what has been done so far), and a forward-looking approach (what can or should be done in the future

to fast-track progress) on structural transformation, comparing Eswatini's performance with that of Africa and other peer countries, and drawing lessons for the future. The chapter articulates the impact of a wide array of factors on Eswatini's structural transformation (or lack thereof), as well as the financing needs and financing gaps, with the objective of highlighting the main pull and push factors guiding both evidence-informed policymaking, and investment opportunities.

Figure 2.1: Eswatini's Real GDP Growth vs Africa and Peer Countries



Source: African Development Bank Statistics

Section 1: Taking Stock of Economic Performance and Transformation in Eswatini

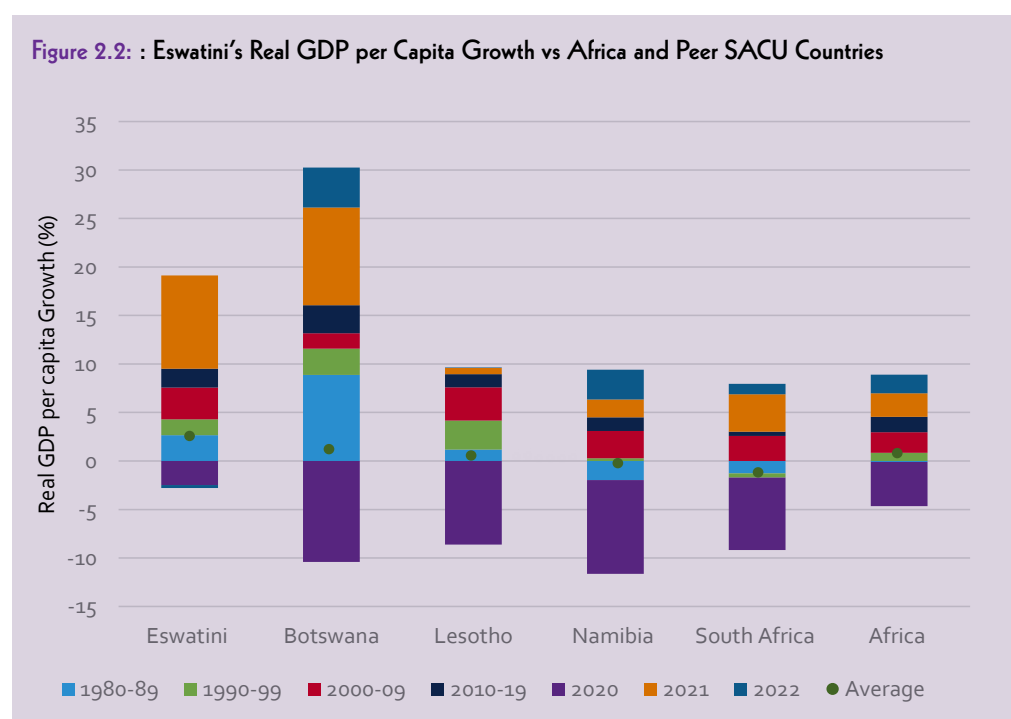
Eswatini's economy has experienced a prolonged period of weak growth over the last few decades. Two distinct phases of growth can be observed from 1980-1994, and from post-apartheid to date. Prior to 1994, Eswatini enjoyed remarkable investment-led growth which averaged 8.2 percent per annum, driven by large scale foreign investments into agriculture, forestry, and agro-processing.

During the 1980-1989 decade, Eswatini was the second fastest growing country in the SACU sub-region after Botswana. Investments in manufacturing expanded

the manufacturing share in GDP from around 13 percent in 1985 to 31 percent in 1990, which fostered the development of a modern industrial sector that facilitated jobs creation, transfer of technology, and rapid growth. The economy diversified and gained a relatively sophisticated export base, which propelled Eswatini to LMIC status. The end of apartheid in South Africa in 1994, however, eroded Eswatini's advantage as the sub-region's preferred destination for foreign investment, with many companies relocating from Eswatini to South Africa. As this happened, Eswatini was not able to optimally adjust to the changed circumstances to retain and attract more investment. Eswatini instead shifted its growth model from private-investment

led to public sector-consumption driven, which, amidst growing fiscal constraints did not yield the desired growth outcomes. Private investment was crowded-out from the productive sectors which undermined growth. Overall, gross investment declined from an average of 27.2 percent of GDP in the 1980s, to around 18.3 percent in the late 1990s, and further to 14.3 percent of GDP since 2000, further curtailing growth. The growth outcomes of the two models are telling. Eswatini's economic performance declined from around 8 percent in the

1980's to average 3.9percent in the 1990's and early 2000, before further falling to average 2.6 percent between 2010-2019. COVID-19 induced the first economic contraction in nearly 50 years in 2020, before growth recovered to 10.7 percent in 2021, 0.5 percent in 2022, and 4.8percent in 2023. These concerning growth trends call for Eswatini to restore the private sector's position as the engine for growth, and catalyst for economic transformation and attainment of higher, sustained, and inclusive growth.



Source: African Development Bank Statistics

Eswatini recorded a modest real GDP per capita growth of 2.7 percent in the 1980's, which slowed down to 1.6percent in the 1990's, as real GDP growth declined, amidst increase in the country's population. Between 2000-2009, real GDP per capita growth accelerated to 3.3 percent, which is linked to a slight uptick in real GDP growth to 4 percent during the period, from (3.8 percent) in the previous decade. Eswatini's population growth also slowed down at the peak of the HIV/AIDS crisis, which increased crude death rate from 7/1000 in 1990 to a peak of 19/1000 in 2005. With continued declines in real GDP growth to

2.6 percent between 2010-2019, real GDP per capita growth receded to average 2 percent. The COVID-19 pandemic induced a 2.5 percent decline in real GDP per capita growth, in tandem with the negative growth experienced, before recovering in 2021. In 2022, the slowdown in growth to 0.5percent, triggered a 0.3 percent fall in real GDP growth. Within the SACU region, on the average, between 1980 – 2022, Eswatini's real GDP growth (2.3 percent), was only second to Botswana (2.8 percent) and was also above Africa's average (0.6 percent).

Section 2: Eswatini's Structural Transformation: Drivers, Bottlenecks, Opportunities

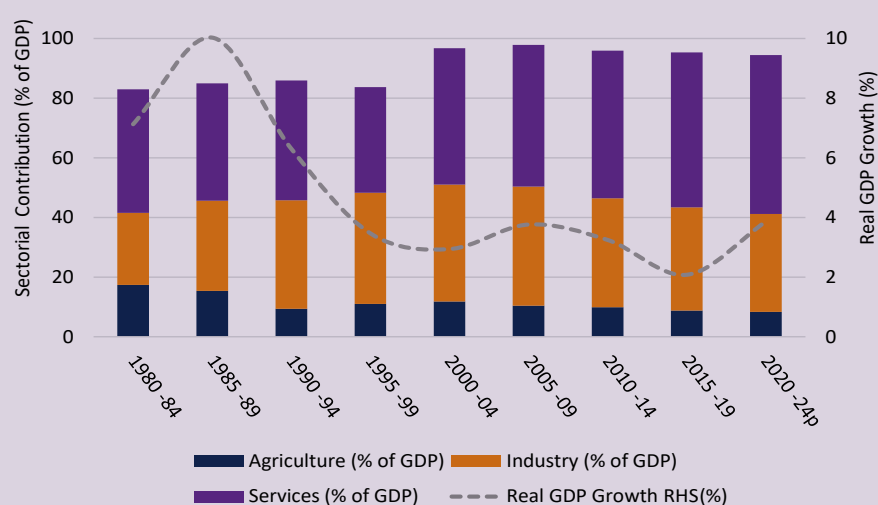
a. Eswatini's Structural/Economic Transformation

Structural transformation is defined as the shift of an economy's structure from low-productivity, labor-intensive activities

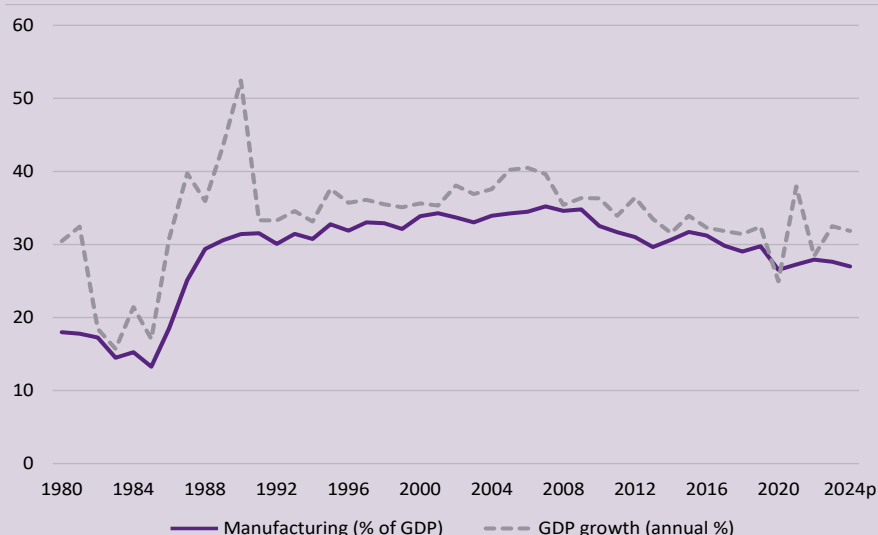
to higher productivity, capital, and skill intensive activities. Successful structural transformation is accompanied by the declining contribution from less productive sectors like agriculture and increasing shares of the industrial and the service sectors in national output, accompanied by a corresponding shift of labor from the former to the latter sectors.

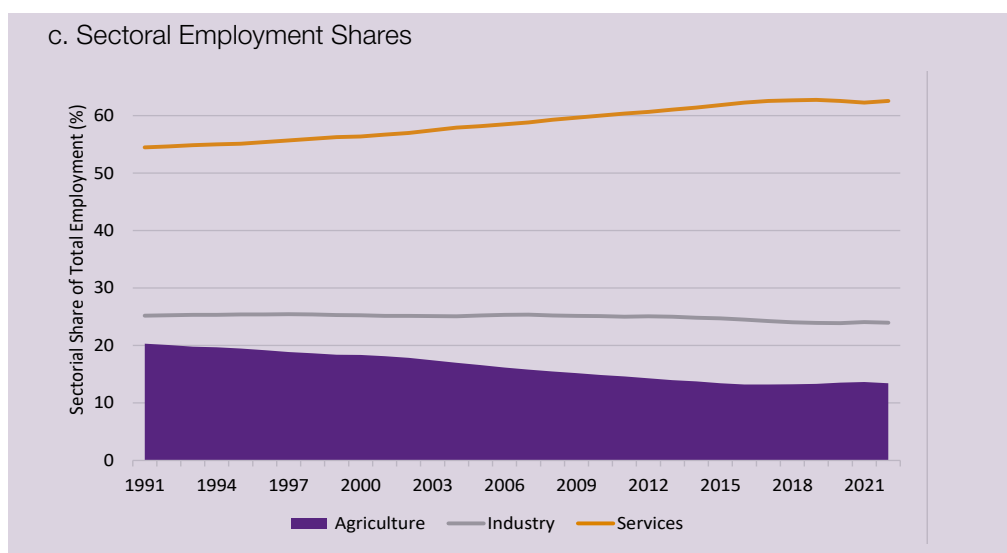
Figure 2.3: Sectoral Share of Output and Employment in Eswatini

a. Sectoral Shares of GDP



b. Manufacturing value added (percent of GDP)





Source: Author's derivations based on the World Development Indicators (WDI), and national data

Figure 2.3 (a) shows a declining share of agriculture to GDP from an average of around 16 percent of GDP in the 1980's to 10 percent in the 1990's to current levels of around 8 percent. Agriculture's share of GDP significantly dropped, following a devastating drought in 1991/92. The sector was negatively impacted by climate change induced weather shocks, particularly recurring droughts, poor land management, overgrazing, soil erosion, among others. Eswatini experienced another severe El Nino induced drought in 2015/16, drought which costed an equivalent of 7.01 percent of GDP. The absence of formal land tenure under the Swazi Nation Land is also often cited as a constraint to investment in agriculture as landholders are not able to use land as collateral for loans.

The share of the industry increased from 27.2 percent between 1980-1989 to 38.2 percent, and 35.6 percent between 1990 - 2009, and 2010-2019, respectively. The decline can be attributed to large-scale investments reversal from Eswatini post 1994, as well as fierce competition from large Asian producers, which hurt the textiles and apparel sector. As such, manufacturing value-added has been on a sustained decline since 2007 (Figure 2.3b). Between 2020-2022, the industry's

contribution remained low, averaging 32.7 percent of GDP. The sector-wise trend in output shares clearly indicate that Eswatini's economy experienced some form of de-industrialization, while the services sector's dominance in the economy was fortified.

Similarly, the sectoral trends in employment, Figure 2.3 (c) shows that the share of employment in the agricultural sector declined from 20.3 percent in 1991 to 13.4 percent in 2022, a 6.9 percent decline. The share of employment in the industry also declined from 25.2 percent to 24.1 percent during the same period, a 1.1 percent decline. However, services sector employment shot from 54.5 percent in 1991 to 62.6 percent in 2022, an 8 percent increase, which points to a shift in labor, mainly from agriculture to services. The above changes in the distribution of employment across sectors shows that in 1991, 20.3 percent of the working population produced 9.8 percent of the national output through agriculture, while in 2022, 13.4 percent produced 8.6 percent of GDP. It can thus be inferred that labor productivity of agriculture improved, given that less labor was required in 2022 to produce almost the same amount of output through agriculture compared to 1991. An analysis of the industrial sector also shows that in 1991, 25 percent of employed labor

The stagnant share of employment in the industry reflects the inability of Eswatini's industrial sector to absorb labor. Agricultural labor is transitioning to other sectors, but low-skilled sectors like manufacturing, construction, and trading services are not creating enough jobs to absorb substantial amounts of excess agricultural labor

produced 36 percent of output through the industry, while in 2022, 24 percent of the industrial workforce (almost similar to 1991) produced much less output through the industry (33 percent of GDP), which depicts a fall in labor productivity in the industrial sector. The stagnant share of employment in the industry reflects the inability of Eswatini's industrial sector to absorb labor. Agricultural labor is transitioning to other sectors, but low-skilled sectors like manufacturing, construction, and trading services are not creating enough jobs to absorb substantial amounts of excess agricultural labor. In the services sector, 55 percent of the working population in 1991, produced about 40 percent of the national output while in 2022, 63 percent of the working population produced 53 percent of output through services. This suggests an improvement in labor productivity. Overall, the analysis above suggests that between 1991 and 2022, agriculture and services sectors' labor productivity increased, while the industrial sector labor productivity slightly decreased. However, cross sector labor productivity analysis indicates that the industry is the most labor productive sector in Eswatini, followed by services.

b. Unpacking Structural Transformation Through Labor Productivity Decomposition

The Gross Value-Added (GVA) sector output and employment growth trends across the three sectors is depicted in Figure 2.4. The growth in the GVA of the agricultural sector stood at 1.8percent between 1992 – 2006 but contracted by 1.5percent between 2007-2022. The overall average growth in GVA for agriculture from 1992 to 2022 was 0.1percent, which indicates a muted growth. The GVA of the industrial sector depicts a decline from 0.7percent between 1992 – 2006 to a contraction of 1percent between 2007-2022. The overall GVA for the industry between 1992-2022 declined by 0.2percent. In the services sector,

GVA registered a 1.4 percent increase from 1992 to 2006, 0.8percent over the period between 2007-2022, and overall, 1.1percent between 1992 – 2022. The services sector, thus, posted the highest growth trend, followed by agriculture, while GVA for industrial growth decelerated by 0.2percent.

The growth in employment in all the three sectors is also analyzed. Employment growth in agriculture is shown to have declined by an average of 1.5percent between 1992 – 2006, by 1.1percent between 2007 – 2022, and an overall decline of 1.3percent between 1992 – 2022. On the other hand, industry employment that grew by 0.03percent between 1992 – 2006, contracted by 0.3percent between 2007 – 2022, and contracted overall by 0.2percent between 1992 - 2022. Services employment grew by an average of 0.5percent between 1992 – 2006, and 0.4percent between 2007 – 2022. Services employment growth increased by 0.5percent between 1992 – 2022.

Labor productivity growth in an economy can be achieved in two ways. Firstly, productivity within sectors can increase through capital investment, technological innovation, and intra-industry efficiency gains arising from trade. Secondly labor can move from low-productivity sectors to high productivity sectors, which increases the overall labor productivity in the economy. According to the AEO2024, there has been a significant reallocation of workers from agriculture to other sectors, mainly services. The report further highlights that, based on their sectoral employment shares, African economies can be categorized by their stage of structural transformation. The first set are those where agriculture is still the largest sector by employment share. These economies are considered structurally underdeveloped.

Figure 2.4: Growth Trends in Gross Value-Added (GVA) and Employment Growth in Eswatini



The next set of economies are those where more people are employed in services than in agriculture, with agriculture being the second-largest sector—structurally developing. The final set are those with more people employed in manufacturing/industry than in agriculture—structurally developed. Although Eswatini experienced a shift in output and employment from agriculture and industry, this did not transform into highly productive service sector given the elevated levels of informal employment (56.2percent), unemployment (35.4percent) and concentration on low value-added activities. The share of employment in industry, the most productive sector slightly declined. In addition, Eswatini's economy has become less complex, driven by a lack of diversification of exports. According to the IMF, since the early 2000s, the contribution of export to growth, and Eswatini's share of world exports have been in a secular decline. Eswatini is, thus, yet to achieve structural transformation

c. Rapid Growth in Income and Jobs Embodied in Services Export: New Evidence

The persistence of growth and structural transformation without industrialization,

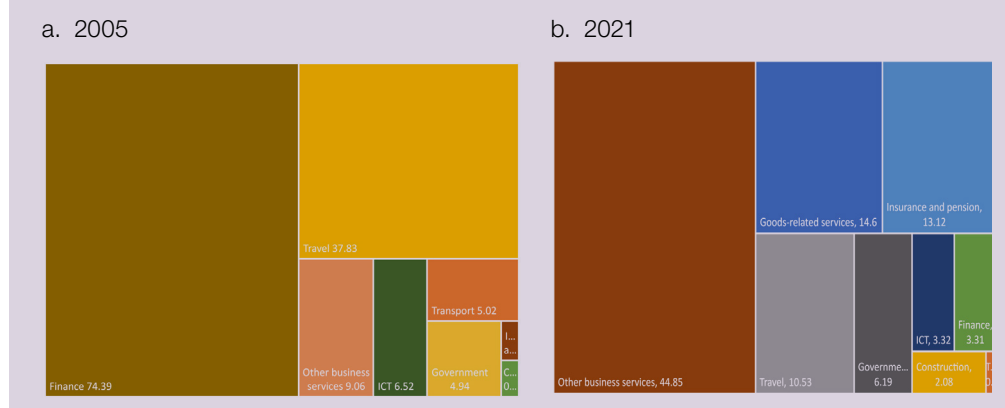
along with new evidence on productivity in services has raised the question of whether services can also plausibly drive a development and growth strategy. Eswatini's services sector dominates economic output at 53.5 percent. The sub-sector is dominated by wholesale and retail trade activities (14.7 percent to GDP), and public administration and defense (8.0 percent). Education, real estate activities, and financial and insurance activities contribute 5.6 percent, 5.5 percent, and 5.2 percent, respectively. In terms of employment, the wholesale and retail sub-sector employ 17.9 percent of the working population, followed by education (9.8 percent), transportation and storage (4.2 percent), public administration (4.1percent), and human health (4.1percent). Eswatini's services sector is diverse and can be clustered into three main categories: traditional, high knowledge-intensive, and nonmarket services.

Traditional services include transport, travel, and maintenance and repair services. High knowledge-intensive services are defined as activities and operations that are heavily reliant on professional and high-skill knowledge. These include goods-related services such as manufacturing services; construction; insurance, and pension

services; financial services; ICT services; and consulting and other business services. Government goods and services

are nonmarket services which include public administration, community services, and health and education services.

Figure 2.5: Sectoral Distribution of Services Exports in Africa, Between 2005 and 2021



Source: Staff calculations based on UNCTAD database.

Eswatini's service exports are concentrated in high knowledge-intensive services mainly other business service, insurance and pension, and goods related services. Fig 2.5. In 2005, they accounted for 91.1 percent of services exports. Their share dropped to 81.3 percent in 2021, due to a significant decline in finance. Other business and insurance sub-sectors gained significantly. However, services trade in Eswatini are still low, having declined from an average of 18.3 percent of

total services trade (USD0.7 billion) over the period between 2000-2010 to 8.3percent (USD0.3 billion) between 2011 to 2022. In terms of export intensity, most of Eswatini's manufacturing exports are characterized by low-tech exports, accounting for 79.9 percent between 2010 and 2021. Medium and high-tech exports account for 20.1 percent of exports. In comparison, South Africa exported 46.1 percent, and Zambia exported 24.3 percent in medium and high-tech products in the same period.

Box 2.1: Successful Experiences in Supporting Growth and Structural Transformation

China is an example of a country that has transformed its economic structure through agro-based industrialization in order to accelerate growth and development. In the period between 1978 – 1983, it emphasized on agriculture. In its Five-Year Plan (1981-1985), China encouraged foreign trade and Foreign Direct Investment (FDI) to facilitate importation of advanced technology. Strategic industries identified in the Five-Year-Plan of development were given targeted support such as protection from foreign competition, and subsidized loans from state -owned "policy banks." Based on a deliberate strategy, China has combined a variety of policies to develop both its agricultural and industrial, as well as its service sectors. As a result, and within a span of two decades, China became the largest exporter of manufactured goods.

Another example of successful transformation is that of the United Arab Emirates. The UAE diversified its economy that is essentially based on the crude oil sector, which accounted for about two-thirds of the GDP. The country developed its industrial base by investing its oil wealth in industry related infrastructures. Furthermore, in 1985, the first free zone in Dubai, Jebel-Ali,

was created with appealing incentives to foreign investors, such as allowing 100 percent foreign ownership, no customs duties, unlimited repatriation of funds, and exemptions from certain labor laws. The UAE government also promoted several manufacturing industries through industrial policy in the fertilizer, oil refining, and cement sectors. As of 2010, manufacturing in UAE accounted for around 10 percent of GDP, a significant increase from the 0.9% share in 1975 (World Bank).

Between 1957 and early 1990, Malaysia achieved substantive economic transformation with the share of manufacturing in GDP rising from 14 percent in 1971 to 30 percent in 1993. Malaysia's export to GDP ratio increased from 46 percent in 1970 to 95 percent in 1995, and the share of manufacturing in total exports rose from 12 percent to 71 percent between 1970 and 1993. This period had three distinct phases of industrial expansion: import substitution in 1957 – 1970; the New Economic Policy in 1970 – 1985; and the New Development Policy of 1986 that moved the country's industrial policy closer to those practiced by the East Asian Newly Industrialized Economies (NIEs).

d. Drivers to Accelerate Structural Transformation

Governance: Structural reforms to improve economic governance, quality of institutions, and competitiveness will be key to attract private investment and propel the country to a higher growth trajectory. Reforms should focus on improving transparency, accountability, and efficiency of the public sector, including SOE's restructuring and strengthening of their governance, and oversight to facilitate private sector growth. Broader reforms aimed at streamlining business operations, addressing constraints on regulation and competition, and reducing the cost of doing business will be key. Bureaucratic requirements make it difficult and even prohibitively expensive for SMEs to set up and run a business. Addressing corruption and bolstering its legal frameworks and institutional arrangement will help in reducing business transaction costs and improve service delivery by the public sector. These reforms will promote investment, support, job creation, and improve competitiveness through better governance and business environment.

Trade within Regional Economic Communities (SACU and SADC), and

the Africa Continental Free Trade Area (AfCFTA):

Eswatini's membership in several trade agreements presents significant opportunities for its private sector, including market access and diversification, thereby, offsetting the small domestic market. However, the country has not been able to optimally utilize the existing preferential trade agreements, due to inadequate capacity to consistently meet the supply needs of its markets. Deepening regional integration and leveraging trade links will be critical for private sector, export-led growth. To achieve this, Eswatini needs to work with other members of regional trade zones to help lower barriers to trade, and address key infrastructure gaps, especially around transportation and connectivity. The immediate focus for Eswatini is to take advantage of preferential access to the African market under the AfCFTA, to support its structural transformation. This entails maximizing on the sectors where the country currently possesses competitive strength, whilst putting the building blocks that will allow for increased volumes and diversity of exports in both goods and services. The current sectors under trade in goods include: agro-processing (agriculture and food-processing); sugar value-chain; clothing and textiles; beef and the leather value-chain. Under trade

in services, tourism, transport, financial, professional services, communication services, creative industries, including sports, music and art are identified as priority sectors. The production of automotive accessories and components, and the pharmaceuticals industry value-chains have been suggested for further development as they hold some potential for Eswatini but are under-developed.

Urbanization presents social and economic opportunities. Hhohho and Manzini, the most urbanized regions, witnessed population growth rates well above the national average. As of 2017, 76.2 percent of the population was rural and the rest urban. There are strong ties between rural and urban, due to dependency on employment as the major source of income and livelihoods. The rate of urbanization is rapidly growing at an estimated pace of about 2.5% per year. The growth in the number of people residing in Mbabane, Manzini, and other cities presents agglomeration benefits that could stimulate both trade, and productivity. This has the potential to boost the economy and promote growth, and development. It is therefore important to manage the urbanization process well, ensuring that service transformation has a huge potential to improve national productivity by making government and business enterprises more efficient, effective, and globally competitive.

Digital technologies offer new pathways for rapid economic growth, innovation, job creation, and access to services. Eswatini's digital infrastructure is relatively underdeveloped, mainly because of weak competition and private investment. With strong foundations in place, Eswatini can harness digital data and technologies as sources of productivity growth, economic, and social inclusion. Most of Eswatini's labor market is informal and characterized by low productivity, and digital technologies

provide the opportunity to simplify, and facilitate the transition of labor from the informal to the formal economy, as well as to foster the creation of jobs, and income growth alongside economic growth.

Quality of public infrastructure: Between 2020 and 2022, Eswatini was ranked 16/54 on the Africa Infrastructure Development Index (AIDI) but its overall score slightly increased from 28.2 to 29.1. As of 2022, water and sanitation registered the highest score (78.3), and ICT (16.5). Electricity and transport sectors scored 13.9 and 13.1, respectively. Population access to electricity increased from 77 percent in 2019 to 85.8 percent in 2023, compared with an average access rate of 50.6 percent for the continent. In transportation, roads dominate the sector with a market share of 86 percent, followed by railways (14 percent), and aviation (1percent). The total road network covers 4,335 km comprising 1,584 km (37 percent) of paved roads, and 2,751 km (63 percent) of unpaved roads. The railway system, which covers about 300km (of which 131 km needs rehabilitation), links Eswatini to key ports in South Africa, and Mozambique. However, poor maintenance and lack of new investments have contributed to the sub-sector's inefficiency. Access to potable water increased from 69 percent in 2019 to 73 percent in 2023, while access to basic sanitation increased from 46 percent during the same period to 64 percent. Internet connectivity cost is high (USD1.26 per GB in 2023) , due to incomplete market liberalization, and lack of direct access to submarine cables. Mobile phone penetration increased from 99 percent in 2020 to 106.4 percent in 2023, while internet penetration increased from 47 percent in 2020 to 59 percent in 2023.

Human capital development: The country's Human Capital Index (HCI) fell from 0.41 in 2018 to 0.37 in 2020, when it

ranked a low 163rd of 173 countries. The country's low HCI score is due to a low adult survival rate, and particularly poor learning outcomes. Challenges to build human capital include the world's highest adult HIV prevalence rate, poor maternal and child health care, and rising incidence of noncommunicable diseases. Eswatini has a large skills gap while the education system does not meet the needs of the labor market, and education-spending efficiency needs improvement. To fill these gaps, Eswatini needs to build a coordinated and articulated skills development system, focusing on increased access and

systematic linkages with the labor market to enhance relevance. Though Eswatini has achieved nearly universal access to primary education, fewer than 90 percent of students complete primary school, and fewer than 60 percent complete junior secondary. Challenges remain in ensuring a strong, equitable provision of quality education, including high repetition rates, and low retention rates at the primary level. In FY2024/25, to further strengthen human capital development, the educational and vocational training sector was allocated 16 percent of the budget.

Box 2.2: Potential and Existing Opportunities for Structural Transformation in Eswatini

There are several prerequisites for a structural transformation towards more productive sectors, as well as creating a conducive business environment, increasing access to SMEs, addressing regional and country barriers to trade, and improving transportation, and connectivity. Opportunities for diversification include expanding and diversifying the agricultural sector through commercialization, diversifying crop production, and increasing agro-processing; diversifying the manufacturing sector; and expanding tourism and trade in services. Boosting agricultural productivity through diversification would enhance employment, and income generation in that sector. Upgrading value-chains in the livestock and sugar markets and targeting exports to growing regional markets are also priorities. To this end, policies and incentives to diversify into more value-added agricultural activities (e.g. agro-processing) are key. Increasing SMEs' access to finance would help harness their potential contribution to growth, and job creation. In such a small, open economy, deepening regional integration, and leveraging trade links with South Africa are important for private sector, export-led growth. To take advantage of opportunities for diversifying the economy and creating jobs, Eswatini needs to work with other members of regional trade zones to help lower barriers to trade, and address key infrastructure gaps, especially around transportation, and connectivity. Given its dependence on South Africa, regional approaches are particularly important for addressing nontariff barriers to trade.

e. Key Bottlenecks to Fast-Paced Structural Transformation

Demographic challenges: Eswatini is one of the smallest countries in Sub-Saharan Africa with a population of 1.2 million people. Population growth has been relatively slow, with an average annual growth rate of 1.1percent (Central Statistics Office/CSO, 2017), decreasing substantially from 2.9percent during the period between 1986 -1997 (CSO, 2007). Eswatini is undergoing a demographic transition—its population is growing, due

to improved life expectancy. Since the early 2000s, adults have outnumbered children. Harnessing the demographic dividend requires enhancing health outcomes, particularly for low-income groups, building the skills of the population, especially young people. The population in Eswatini is young, and dependency ratios are high (although they are declining) Eswatini has one of the world's youngest populations: 56 percent of the population is under the age of 25, and the median age is 21.7. This young demographic structure presents an opportunity that can be harnessed through

investments in education, health, and job creation. The “demographic window of opportunity”—when the ratio of the working-age population to the dependent-age population increases rapidly—is projected to remain open for about 43 years.

Climate change: Eswatini faces significant climate change vulnerabilities because of a combination of geographical positioning, and climatic variabilities. The country is prone to hydrometeorological hazards, primarily drought, but also experiences storms, seasonal flooding, and wildfires. Periods of droughts are the most recurrent, with severe droughts experienced in 1983, 1992, 2001, 2007, 2008, and 2015/16. Persistent drought exacerbates existing challenges related to food insecurity, and the ability to achieve development goals. In particular, the droughts severely impact the agricultural sector, reducing its productivity, causing water scarcity, affecting energy production (which is predominantly hydro), and leaving a significant proportion of population vulnerable. Excessive rain, such as the Tropical Cyclone Eloise that fell in early 2021 caused severe damages to roads, and other infrastructure which resulted in the government spending significant resources on rehabilitation works. Institutional buildings and private houses were also affected.

Informality is high and represents a drag on productivity growth. The informal economy was estimated at 39 percent of GDP in 2017- the highest among SACU countries. Informality is most prevalent in trade services, mining and quarrying, manufacturing, arts, and recreation. Informal firms have low productivity and contribute just 5percent to total private sector turnover, according to the 2015 economic census. Weak investment in productive sectors has constrained the job market growth for a rising young labor force, with new formal jobs of just 1,000

per year, whereas 25,000 youths enter the labor market yearly. This has led to high informality — 56 percent of Swazis are informally employed. High informality reflects poor labor market outcomes, skills mismatches, business environment constraints, and declining productivity.

Section 3: Finance to Fast-Track Eswatini’s Structural Transformation: How Much is at Stake? The Country’s Commitments to Structural Change?

a. Identify Structural Change Strategy in the National Development Plan (NDP)

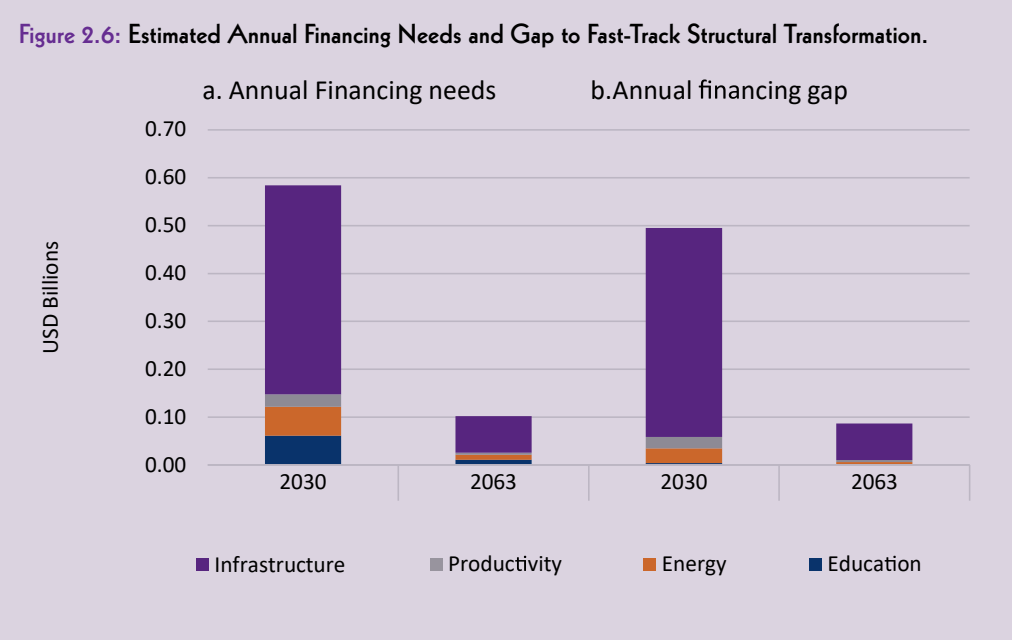
According to Eswatini’s NDP, 2023-2028, resources required to accelerate structural transformation are estimated at E158.7 billion (USD8.2 billion), against anticipated revenues amounting to E135.8 billion (USD7.1 billion), which leaves a financing gap of E21.9 (USD1.2 billion). Better access to finance is one of the key “pull” factors of structural transformation in Africa. This implies that Eswatini will urgently need to mobilize huge resources to fast-track structural transformation and sustain the momentum of development.

b. Financing Needs and Financing Gap

Bank estimates show that the total resources needed annually by 2030 to fast-track Eswatini’s structural transformation and catch up with high-performing developing countries from other regions amounts to USD584 million with a financing gap of USD494.9 million. The amount required to fast-track SDG4 (education) is USD61 million with a financing gap of USD 3.9 million. The amount required to achieve SDG 7 (energy) is USD60.6 million with a financing gap of USD 30.7 million. The amount required to achieve

SDG 8 (decent work and productivity) is USD26.1 million with a financing gap of USD23.9 million. In terms of needs, SDG9 has the biggest requirements at 74.7 percent, highlighting the dearth of current investment in the sector, followed by SDG

7 (10.4 percent), SDG 4 (10.4 percent), and SDG 8 (4.5%). The gaps to fast-track SDG 9 (infrastructure) is USD436.3 million (88 percent of financing gap), followed by SDG 7 at 6%, SDG 8 (4.9%), and SDG 4 (0.8%).



Source: Staff calculations based on database from Sachs et al. (2023), UNESCO, CIA, EIA, NASA, IMF, and World Bank.

When the deadline for the agenda 2063 is used as reference, the annual financing needs decline to USD102.2 million (2% of 2024 GDP), and the gap will be USD86.7 million. The amount required to fast track SDG 4 is USD10.7 million per annum with a financing gap of USD0.69 million. SDG 7 financing needs stands at USD10.6 million with a financing gap of USD5.4 million; SDG 8 financing needs stands at USD4.6 million with a gap of USD 4.2 million; SDG 9 financing needs stands at USD76.4 million. Closing the financing gap by 2030 is, therefore, realistically impossible for Eswatini. A more reasonable target and combination of financing options would be to allow for a gradual but steady structural transformation over a longer period to ensure mobilization of domestic and external resources, without jeopardizing the conditions preserving debt sustainability.

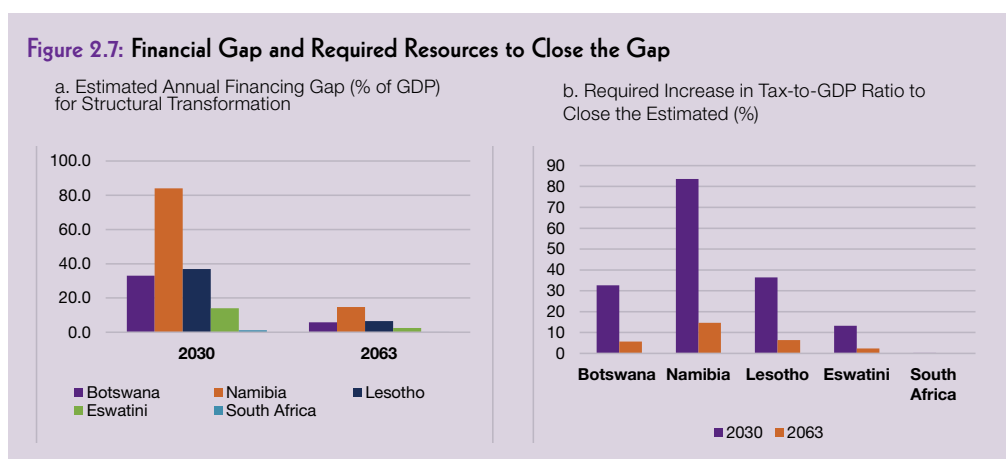
c.

d. Closing the Financial Gap

Eswatini's economy remains highly dependent on SACU revenues, which are highly volatile and have been declining in recent years. There is a need to diversify government revenue sources from SACU by focusing on improving revenue management by improving tax collections, reviewing tax orders. Growing the private sector will galvanize efforts to diversify revenue sources through income taxes and consumption taxes. Authorities should intensify domestic revenue mobilization efforts through effective tax enforcement, widening the tax base, and strengthening tax administration to close any revenue leakages by enhancing the capacity of the ERS, and raising public awareness. While Eswatini is expected to raise a significant proportion of the resources, there is also a pressing need for increased external

financing from public, and private sources. For instance, external financial flows—including FDI, ODA, remittances, and net portfolio investments. Eswatini's share of global climate finance remains marginal, despite being a country that is extremely

vulnerable to the effects of climate change. Eswatini's estimated annual financing gap for structural transformation by 2023 and 2063 is estimated to be 14 percent of GDP, and 2.5% of GDP, respectively.



Source: Staff calculations based on database from Sachs et al. (2023), UNESCO, CIA, EIA, NASA, IMF, and World Bank.

Estimates indicate that within SACU, Eswatini has the second lowest financial gap for structural transformation after South Africa. The required increase in tax-to-GDP ratio to close the estimated annual financing gap in Eswatini for structural transformation in 2030 and 2063 is estimated at 13.2 percent, and 2.3% respectively.

2.5 Concluding Remarks and Policy Recommendations

The above analyses strongly suggest that accelerating Eswatini's structural transformation will require a multipronged approach, consisting of the following elements:

a. The role of the government in building strong institutions and implementing critical measures to support structural change.

The role of the government is critical to accelerate structural transformation. This could be done through pursuing better governance and business enabling reforms critical to facilitate a shift to a private sector-led growth model, and to

support job creation. Concerted efforts are needed to improve the business environment (particularly for SMEs), facilitate entry into new sectors such as renewable power generation, ensure access to credit, and tackle perceptions of corruption, and an ineffective court system. Eswatini's public sector-driven growth model is unsustainable under the current constrained fiscal space, and there is a need to reduce, and reprioritize public spending. The current growth model can trap Eswatini in a low growth equilibrium, while continuing to accumulate domestic debt, and public spending arrears, further crowding out private sector growth.

A sustainable growth model would involve reducing recurrent public spending and returning to the private investment-led growth of pre-1995. This entails reversing the ongoing fall in capital stock, which, in the current constrained fiscal space, can only be sustainably funded by mobilizing sizeable private sector investments into productive sectors. The government's active participation in the economy must focus on being an enabler with private sector taking the lead. Other key reforms

that need to be taken include re-examining the state's role in the economy, through enacting an SOE ownership policy that explicitly includes a clear rationale for maintaining state shareholding in SOEs and strengthening the legal framework to include a clearer definition of SOEs, reclassifying public enterprises, and strengthening their governance, and oversight. Implement comprehensive institutional reforms to address the chronic weaknesses in PFM that have undermined public spending efficiency over the years. Continued implementation of structural reforms, as well as in PFM, enhancing transparency and accountability will promote a stable macroeconomic environment that is conducive for fiscal, and debt sustainability.

b. The role of the private sector in driving structural transformation

The private sector should play a collaborative role in terms of value-addition, investment, and job creation, using the incentives and support provided by an improved business environment during implementation of the NDP, 2023 – 2028. Private sector-led growth continues to be at the core of Eswatini developmental agenda, with private sector leading the path towards economic resurgence and the public sector following through with creating a favorable environment for businesses to flourish. The private sector is key to unlocking the country's development potential, job creation, and poverty reduction. The country needs a new growth strategy that places the private sector at the center of its economic transformation to address the challenges of slow growth, unemployment, and poverty. The first pathway to sustainable and productive growth is adopting an export-led private sector growth model, leveraging the current preferential access to regional, and global markets.

c. The role of regional institutions, DFIs and MDBs in supporting Eswatini's structural transformation

Regional institutions can support structural transformation by supporting regional integration of the continent's weak, small, and disparate economies. Regional integration is indispensable to building the economies of scale and achieving the international competitiveness necessary for Africa's structural transformation. Skills-mismatches in the labor market is a major challenge and hindrance to increased youth unemployability. The country faces challenges related to skilling its youth and preparing them to face the dynamic local, and external labor markets. Addressing skills' mismatch is critical in reducing unemployment levels, and in making businesses more competitive. The government could provide short-term training incentives to firms to address underinvestment in skills development, helping reduce the share of firm expenditures spent on training new workers. In the medium-to long-term, the government could set up a centralized skills development center, co-financed by firms and the government, and help alleviate the supply shortage. Furthermore, since MDBs have policies that require compliance with Environmental and Social (E&S) requirements to achieve sustainability in development interventions, Eswatini should continue ensuring alignment and compliance with E&S requirements of the MDBs, and international best practices and standards in order to tap into available financing opportunities. This involves strengthening institutional and legal framework and improving resourcing, and monitoring of E&S compliance of responsible agencies, including the Eswatini Environmental Authority (EEA).

FINANCING STRUCTURAL TRANSFORMATION IN ESWATINI: THE NEED FOR REFORMS OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

3

KEY MESSAGES

- Eswatini's financing gap to achieve structural transformation by 2030 is estimated at 9.5% of annual GDP. Its status as a LMIC presents challenges to unlocking adequate concessional finance to propel structural transformation.
- The required increase in tax-to-GDP ratio to close the estimated annual financing gap in Eswatini for structural transformation in 2030 and 2063 is estimated at 13.2 percent and 2.3% respectively. The difference between Eswatini's tax capacity and required tax-to-GDP ratio required for structural transformation if 2030 is considered as the target year is -2.2%. This means that Eswatini displays unattainable tax-to GDP ratio required for structural transformation by 2030. This finding suggests that, domestically mobilized resources will not be sufficient for Eswatini to close the existing financing gap for structural transformation by 2030 but slightly improves by 2063.
- Eswatini agrees with calls for a re-evaluation of the GFA to achieve the SDGs, particularly the need to address interest rates on debt in a fair way that is beneficial to both the least and developing nations. The country has called for UN Member states to develop innovative financing strategies to ensure that implementation reaches the most left behind.
- The government recognizes that public resources are inadequate for finance structural transformation. The NDP 2023-28 noted that financing development requirements will have to come from a combination of financing sources, which includes domestic revenues, local and foreign borrowing, and by forming PPPs with the private sector as the financier of projects.
- The global financial system ought to be reformed to consider the unique situations and diverse needs of MICs to boost their access to financial resources and accelerate their structural transformation. These include increasing concessional resources from MDBs, and special project funds for MICs. Moreover, strengthening the financial sector through legal and regulatory reforms will ensure financial sector stability, and greater economic diversification.

Section 1: Introduction

The chapter presents the external financing need of Eswatini to achieve structural transformation while dealing with the threat of climate change. It uses the Bank's estimates on financing needs and gaps to fast-track structural transformation (AEO 2024), and to finance climate actions (AEO2022 and 2023), respectively by 2030. The chapter assesses, using the Bank's estimates, Eswatini's capacity to increase the tax-to-GDP ratio to close the financing gap to fast-track structural transformation by 2030 and 2063, and motivates the needs for reforms to the international financial architecture.

Reforms of the GFA will be beneficial for Eswatini where above half of the population still lives in poverty, debt levels increased in recent years, and the impacts of climate change, which the country has contributed the least is costing the country. Eswatini's journey toward structural transformation demands heavy and well-thought-out investment in infrastructure, human capital, climate action, and productivity enhancing technology to put the country back on the path of higher and sustained growth. Yet, the current GFA and system of multilateralism are not delivering adequate resources in a timely manner and at the scale needed to meet Eswatini's national and global development goals, including SDGs, and AU Agenda 2063. The current system makes access to development finance expensive and cumbersome for Eswatini, and other developing economies. The high cost of sovereign borrowing by Eswatini as a LMIC has heightened its debt vulnerabilities, and risk of debt distress. The scale of resources to support Eswatini's structural transformation implies a radically reformed and strengthened GFA that is nimble and fit for purpose to mobilize resources at scale and on affordable terms. International calls for reforms present an opportunity for Africa to ensure that the

reformed GFA is responsive to its needs.

In terms of accelerating its structural transformation, Multilateral Development Institutions (MFIs) can expand contingency financing to countries in need like Eswatini, which are frequently hit by external shocks. Eswatini's enhanced Nationally Determined Contribution (NDC) implementation narrative indicated that the country requires USD1.3 billion over 2021-2030 to meet the NDC targets, which translates to USD127.3 million annually. Between 2019-2020, climate finance flow stood at around USD312 million. Given the enormous financial requirements, public resources alone are not adequate to finance climate action. Energy and transport mitigation requires the bulk of the support followed by agriculture. All stakeholders, including the government, private sector, and development partners, have a role to play, and a shared responsibility to invest in development through a climate smart and environmental sustainability lens.

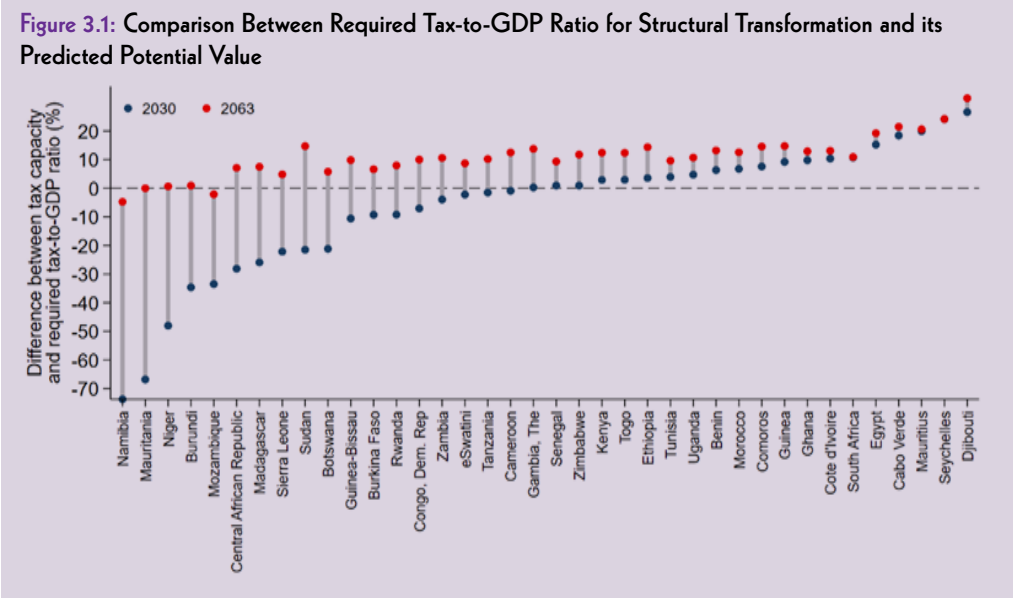
The required increase in tax-to-GDP ratio to close the estimated annual financing gap in Eswatini for structural transformation in 2030 and 2063 is estimated at 13.2 percent and 2.3percent, respectively. To assess whether such tax efforts could be reasonably made by Eswatini, Figure 3.1 compares Eswatini's estimated level of tax-to-GDP ratio compatibility with the need to fast-track structural transformation, i.e., the tax-to-GDP ratio that allows for closing the financing gap – to each country's tax capacity – defined as the predicted value of the potential tax-to-GDP ratio. The difference between Eswatini' tax capacity and required tax-to-GDP ratio for structural transformation if 2030 is considered as the target year is -2.2 percent. This means that Eswatini displays unattainable tax-to GDP ratio required for structural transformation by 2030. However, if 2063 is considered, the difference between Eswatini' tax capacity and required tax-to-GDP ratio

Eswatini's journey toward structural transformation demands heavy and well-thought-out investment in infrastructure, human capital, climate action, and productivity enhancing technology to put the country back on the path of higher and sustained growth.

required for structural transformation turns positive to 8.7 percent. This finding suggests that, domestically mobilized resources will not be sufficient for Eswatini to close the existing financing gap for structural transformation by 2030 but slightly improves by 2063. The international financial architecture, with the contribution

from the private sector, should therefore be an integral part of the financing strategy for structural transformation, not only to complement domestic resources, but also to facilitate access to more affordable external resources.

Section 2: Eswatini's Stand on the



Source: Staff computations based on methodology described in Annex 2.2 and database from the Bank Statistics Department, Sachs et al (2023), UNESCO, USAID, CIA, NASA, IMF, and World Bank.

Need to Reform the International Financial Architecture

Eswatini resonates with calls for a re-evaluation of the GFA to achieve the SDGs, particularly the need to address interest rates on debt in a fair way that is beneficial to both the least and developing nations. The country has called for UN Member states to develop innovative financing strategies to ensure that implementation reaches the most left behind. According to the NDP 2023-2028, Eswatini's MIC status is in contrast with the country's social indicators and eligibility to accessing concessional loans, and grants. The country's classification as a LMIC limits it from accessing concessional loans and significant grant financing. The global financial system ought to be reformed to consider the unique situations and diverse needs of MICs to boost their access to financial resources and accelerate their

structural transformation. These include increasing concessional resources from MDBs, and special project funds for MICs. As part of the Africa's agenda for GFA, reform through the African Union, to which Eswatini is party to, African leaders and institutions have prioritized global reforms on debt architecture, concessional finance, SDR rechanneling, increased voice, and power in decision making, and charting a green industrialization and growth path for the continent

Section 3: Mobilizing Additional Resources for Eswatini's Structural Transformation

To succeed in its structural transformation, reach the SDGs, and attain the milestones in Agenda 2063, Eswatini needs significant investments annually. Although domestic resources have been and will remain Eswatini's main source of development

financing, given the enormity of the financing gap, reforms of the GFA should support increased external flows to finance Eswatini's economic transformation. The government recognizes the fact that public resources alone are inadequate to finance structural transformation. The NDP 2023-28 noted that financing development requirements will have to come from a combination of financing sources, which includes domestic revenues, local and foreign borrowing and by forming PPPs with the private sector as the financier of projects. External aid for the promotion of economic development and welfare is provided in the form of grants and concessional loan financing. Eswatini has a relatively small number of partners, numbering around ten providing external assistance. External assistance remains a significant part of the overall resource envelope of the country for financing the implementation of national priorities and sector development plans. During the FY2021/22 and FY2022/23, external assistance to Eswatini amounted to approximately USD 201.1 million and USD250.7 million, respectively. According to the Development Cooperation Policy (DCP), the Government of Eswatini acknowledges that development investments, both external and domestic, are no longer generating growth at the levels they used to. Furthermore, Eswatini is moving into a period in which development finance flows are likely to be much more constrained and less concessional than in the past. Thus, it is imperative to devise new policy measures that adopt a more holistic approach to the management and use of public investments, paying greater attention to how they can help to reinforce other development finance flows, and enhance the pace of the country's growth, and human development.

Eswatini is among the top three labor-exporting countries in Southern Africa, with over 90 percent of emigrants bound

for South Africa due to the easy migration between the two neighboring countries. As such, remittances have a remarkable contribution to the economy but highly vulnerable to shocks. According to the World Bank, the inflow of remittances to Eswatini has averaged USD82.6 million between 1991-1999 and declined to USD79.4 million between 2000-2009 before recovering to USD96.1 million between 2010-2019. There was a significant rise in remittances from 2020 to 2023 as remittances increased to average USD122.9 million. The inflow of remittances reached its highest recorded level in 2017 when it reached USD144.4 million (3.3percent of GDP). As a proportion of GDP, remittances averaged 5.9 percent of GDP between 1991-1999 before declining to 3.0 percent and 2.2 percent during the period between 2000-2009 and 2010-2019, respectively. Between 2020-2023, remittances inflows have averaged 2.7 percent of GDP. Official figures may be an underestimation, as many migrants could be using unofficial or informal channels to send their money home as formal channels are deemed expensive, estimated at 20percent. There is an opportunity to identify ways to maximize the development benefits of remittances and improve transfer mechanisms, as well as reducing costs of transferring remittances to Eswatini. This will boost the beneficial impacts that remittances will have on debt sustainability, and financial deepening.

Section 4: Dealing with Eswatini's Debt

Several countries are facing debt distress at a time when the world is falling behind on achieving SDGs and in reaching the Paris Agreement's target of limiting global warming to 1.5°C. Although the country's debt levels remained sustainable by international and regional standards (threshold of 50 percent of GDP for

Emerging Markets), the recent increase in central government debt and the high gross financing needs raise both sustainability and liquidity concerns. The rise in debt has been accompanied by accumulation of expenditure arrears, financing constraints, and pressures to cut public projects. It has also significantly increased the costs of debt servicing, which precludes the government from fully financing key social spending if unabated. Moreover, the continued uptake of domestic debt is crowding out the private sector as the government out-competes the private sector for financing. Total public debt increased from 13.6 percent of GDP in 2015 to 40.7 percent in 2023. Domestic borrowing is the main driver of the rapid debt accumulation, from 6 percent of GDP in 2015 to 21.4 percent in 2023, crowding out the private sector. Contemporaneously, external debt increased from 7.4 percent of GDP to 19.3 percent. Multilateral debt dominates external debt at 63.5 percent, followed by commercial debt (28.4 percent), and bilateral debt (8.1 percent).

Eswatini has witnessed a gradual decline in concessional sources of financing (multilateral and bilateral) as they are gradually being replaced by non-concessional loans from commercial creditors. The decline in concessional financing and donor flows have necessitated the government soliciting and accessing non-concessional loans which are expected to gradually increase the share of floating rate debt in the debt portfolio and exposure to the risky factors, that is, interest rate, and exchange rate volatility. At the global level, financial and economic governance must be reformed to improve conditions of access to capital markets. Africa's development financing framework is closely linked to the GFA, and governance mechanisms anchored on domestic resource mobilization, the use of ODA, and financial markets and codes

such as the Paris Declaration, BASEL III, and IMF debt sustainability framework

Section 5: Financing Climate Action

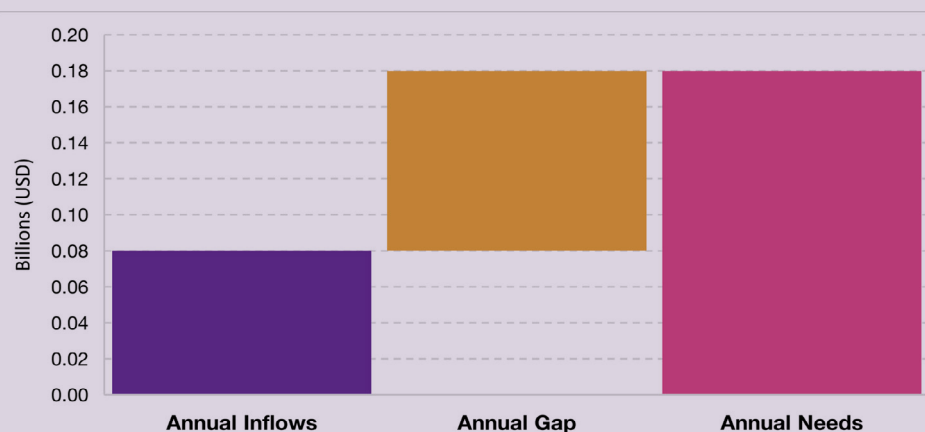
Despite Eswatini's minor contribution to global warming, the country faces increased vulnerability to droughts, floods, cyclones, and tropical storms. These hazards affect livelihoods, primarily through their impacts on the agricultural sector. Erratic rainfall is affecting the country's crops and livestock production systems, including the maize and vegetable production value-chain dominated by smallholder farmers for domestic market supply, as well as the sugar production value-chain for export markets. The 2016 El Nino drought, which is regarded as the most severe in Eswatini since 1992, caused a loss of 30 percent in revenues from sugar production, an estimated loss of USD 20 million in cattle production, and overall cost the economy 7 percent of GDP or 19 percent of fiscal revenues.

Eswatini has demonstrated political commitment to tackling climate change as witnessed by adoption of the institutional, policy and legislative framework for driving green growth, and climate action. The Government of Eswatini takes climate change mitigation and adaption as key to national development. By ratifying the Paris Agreement in 2016, Eswatini committed to actively combat global warming and to communicate to the Conference of Parties (COP) regular roadmaps for its adaptation and mitigation targets. In this context, the country drafted the first NDC in 2015 and updated it in 2021. The enhanced NDC represents a progression beyond the 2015 NDC by adopting an economy wide Greenhouse Gas (GHG) emissions reduction target of 5 percent by 2030, compared to the baseline scenario. This economy wide emission reduction can increase to 14 percent with external financing. Eswatini has further developed a costed NDC Implementation Plan.

The demands for climate change adaptation and mitigation are huge and require both the private, public, and international partners to join hands. Meeting the green growth and climate action needs will require significant investments. For

instance, assessments show that to adapt to the effects of floods and drought in Eswatini will require around 26 percent of the country's GDP between 2021-2024, with floods mitigation accounting for a greater share (18.3 percent).

Figure 3.2: Annual Climate Finance Gaps, USD Billion



Source: Staff computations based on AEO (2022), Africa NDC Hub, Integral Consult and OECD data

The estimated cumulative financing needs for Eswatini to respond adequately to climate change range from about USD1.7 billion to USD1.9 billion, averaging USD1.8 billion, between 2020–2030. Between 2010-20, Eswatini received USD0.62 billion of climate finance mobilized by developed countries, averaging USD0.06 billion per year. Climate finance inflows have increased annually by 10.1 percent on the average over the same period, ranging from USD26.9 million in 2010 to USD70.5 million in 2020, after peaking at USD135 million in 2019. Between 2010-15, the country received USD192 million of climate finance (or USD93.3 million annually), compared to USD1.7 billion for the period 2016-2020 (or USD32 million per year). Assuming that Eswatini continues to receive the same annual amount of climate finance as received between 2016-2020 (USD0.08 billion per year), the resulting financing gap would range from USD0.08 billion – USD0.1 billion a year in 2020–30,

averaging at USD0.095 billion, greatly limiting countries' ability to build climate resilience.

Over the 2019/20 period, Eswatini received approximately USD31.7 million on the average towards climate change action with 98.5 percent of resources being contributions from public sources and 1.5percent from private sources. Public climate finance resources were dominated by Multilateral Development Finance Institutions (MDFIs) traditional instruments, comprising of 75 percent concessional finance and grants. The government's contributions account for 21 percent of the total climate finance resources. Due to the limited fiscal space to adequately meet the country's NDC implementation needs, governments often seek for concessional finance from MDFIs to augment the national resources. The low flow of climate finance in Eswatini is primarily due to project risks, low access to lines of credit,

and relatively low private sector investment in supporting public climate finance, which is dominated by conventional instruments. Project risks are associated with high capital and operational expenditures, mainly due to the relatively small size of existing project preparation funds, and guarantee mechanisms. This calls for more private sector participation and financing in supporting climate action. Given the limited financing dedicated to climate change adaptation, and mitigation from the traditional financiers, innovations to diversify climate financing are critical. To enhance the national climate finance resource mobilization capacity, the country developed a Green Climate Change Fund (GCF) Country Program, which includes priorities for both mitigation, and adaptation. Mitigation priorities encompass energy generation and access, energy efficiency, transport, buildings, cities, industries, and appliances, as well as forest, and land use. Meanwhile, adaptation priorities encompass health, food, and water security, livelihoods of people and communities, infrastructure and the built environment, ecosystems and ecosystem services, and early warning systems.

Section 6: Policy Recommendations

- **Global economic governance:** This should involve updating IMF quota formulas to reflect the changing global landscape; reforming voting rights and decision-making rules to make them more democratic, for example through a double majority rule; and delinking access to resources from quotas, with access instead determined by both income, and vulnerabilities.
- **Debt relief and the cost of sovereign borrowing:** This should involve

updating principles of responsible borrowing and lending to reflect the changing global environment, and the human rights obligations of States; increasing debt management and transparency; improving debt sustainability analysis and credit ratings; improving debt contracts, and by incorporating State-contingent clauses.

- **Increasing local currency lending is critical to reducing the currency risks faced by governments.** International financial institutions are better placed than sovereigns to manage currency risk, since they can diversify across currencies, while sovereigns face a concentrated foreign exchange risk. Increased local currency lending should also go hand in hand with greater use of diversification in risk management, as called for in the Addis Ababa Action Agenda, as well as by better leveraging the system of MDBs.
- **Reforms are also important in the context of climate finance.** Climate funds under the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement, such as the GCF, must play a critical role of delivering to developing countries.
- Strengthening institutional and legislative framework for E&S safeguards in accordance with international best practices, and adequate resourcing of key institutions involved in E&S capacity building and compliance monitoring, would ensure alignment and easy access to available financing opportunities from development partners.

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