COUNTRY PRIVATE SECTOR DIAGNOSTIC

# CREATING MARKETS IN ESWATINI

## Strengthening the Private Sector to Grow Export Markets and Create Jobs

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# EXECUTIVE SUMMARY

**Eswatini is facing multiple challenges.** It was already experiencing weak economic growth before the COVID-19 pandemic, a reflection of longstanding, deeply rooted issues such as fiscal unsustainability, declining private investment, weakening productivity and competitiveness, and falling export diversification and complexity, compounded by the impact of climate shocks. These preexisting challenges have been amplified by COVID-19 since 2020 and later by political unrest since mid-2021. The economy contracted 1.9 percent in 2020, while economic recovery in 2021 were dashed by political unrest. The COVID-19 pandemic strained health systems in a country where health outcomes were already poor owing to high HIV prevalence, poor child nutrition, and poor maternal health. Eswatini faces high unemployment and poverty rates, especially in rural areas, and high inequality in access to assets, markets, opportunities, and rights, a situation in which women and youth in particular are disadvantaged. The immediate and direct economic loss (including loss of public property and business assets) from political unrest in Eswatini has been estimated at US$210 million, prompting the government to reallocate budget resources toward an E 500 million (US$35 million) reconstruction fund to assist affected businesses, despite the extremely constrained fiscal space. The indirect economic cost of the political unrest, though, will likely be higher and could cause a delay or cancellation of investment plans as investors weigh the risks of possible direct and indirect loss from future unrest. This underscores the importance of finding a long-term solution to the unrest. Consultations with the private sector suggest that all eyes are now on the national dialogue, the success of which would restore the country's past record of peace and stability and rebuild investor confidence.

**Eswatini shifted from a private investment–led higher-growth model to a government spending–led lower-growth model after the end of apartheid in South Africa.** Eswatini experienced strong investment-led growth during apartheid South Africa due to foreign direct investment (FDI) inflows from companies that sought to avoid the sanctions against South Africa while keeping access to its market. Eswatini lost its comparative advantage as an investment destination after South Africa's democratic transition in 1994, though, as the latter became the region's preferred destination for investment and skilled labor. As a result, Eswatini suffered disinvestment, and the contribution of capital accumulation to growth has been almost nonexistent since 2000. The government scaled up recurring spending to offset falling private investment, but its spending has been difficult to finance because of the weaker revenues of the Southern African Customs Union (SACU) since 2014, which has led to an accumulation of arrears and debt and crowding out of the private sector. The growth outcomes of the two models have been starkly different: real gross domestic product (GDP) growth averaged 6.7 percent between 1980 and 2000 and 3 percent between 2000 and 2019.

**With weak investment in productive sectors, Eswatini's job market failed to keep pace with an expanding, younger labor force, leading to a large informal sector.** Falling private investment left growth in the private sector stagnant, with a formal job creation rate of just 1,000 per year, yet 25,000 youths enter the labor market annually. About 40 percent of Eswatini's working-age population is either formally or informally engaged in micro, small, and medium enterprises (MSMEs), and this creates mostly low-productivity, low-wage jobs. Women face particularly significant challenges in accessing employment opportunities, the gender gap in labor force participation in 2019 being 6 percentage points.

**Eswatini's public sector–driven growth model is unsustainable under current fiscally constrained conditions, and there is a need to reduce and reprioritize public spending.** Staying with the current growth model would trap Eswatini in a low-growth equilibrium, while the country continues to accumulate domestic debt and public spending arrears, further crowding out private sector growth. A sustainable growth model would involve cuts to recurrent public spending and a return to the private investment–led growth of the pre-1995 era. This entails reversing the ongoing fall in capital stock, which under the current, fiscally constrained conditions can only be sustainably funded by mobilizing sizeable private sector investments into productive sectors. While public investments and social expenditures could be maintained at the current level, they could be reprioritized toward areas that unblock the cross-cutting constraints to private investments. For example, infrastructure that enhances the availability or quality of energy, water, and trade logistics, as well as health, education, and social protection could boost skills and human capital. Moreover, the public investment management system should be strengthened to ensure Eswatini gets value for its money. To gain economies of scale from additional private investment, Eswatini needs a larger market than what is available domestically given a small population, low incomes, and falling domestic private consumption over the past decade. The first pathway to sustainable and productive growth, therefore, is adopting an export-led private sector growth model that leverages the current preferential access to regional and global markets.

**An assessment of existing sectoral data and consultations with Eswatini's private sector and policy makers suggest that four sectors can help drive the export-led private sector growth model.** These are sectors in agribusiness (sugarcane, beef, and forestry value chains) and light manufacturing (textile and apparel). Eswatini has a comparative advantage in these sectors: they already attract sizable FDI, they possess job creation and value addition growth potential, and in the case of beef and textile and apparel, Eswatini has preferential market access that is currently being underused. In expanding export markets, Eswatini may leverage shifts in global value chains emerging from the COVID-19 pandemic that include the regionalization of value chains and the expansion of supplier bases.

**The second pathway entails leveraging MSMEs and entrepreneurship potential to enhance the inclusiveness of the export-led private sector growth model and to develop new products and services, especially opportunities in the digital economy.** Eswatini's missing middle suggests barriers to firm entry and growth, while linkages of MSMEs with export value chains remain limited. MSMEs account for 40 percent of employment but consist primarily of low-production, informal microenterprises. Supporting MSMEs with well-targeted policies, including those addressing the specific constraints in managerial capabilities and access to finance that women and youth face, would enhance their capacity to generate more jobs and increase productivity and wages. Eswatini has an opportunity to capitalize on the potential of digital transformation to increase productivity, develop new business models, and leverage the global acceleration in the use of digital technologies by firms resulting from the COVID-19 pandemic.

**Several factors constrain Eswatini's competitiveness and ability to unlock export potential and private sector–led growth, making reform an urgent priority.** The government has articulated an ambitious, long-term reform agenda to unlock private investment (the National Development Plan 2019/20–2021/22 and the Post-Covid-19 Economic Recovery Strategy), but the pace of implementation has been uneven. Eswatini has a dual governance system: a modern constitutional system and a traditional system, both of which place the king at the top. Most business transactions fall under the administration of the modern system, which is anchored in market institutions, but Eswatini's governance system creates avenues for discretionary access to opportunities and privilege by connected individuals and firms, and this dilutes the government's previous reform commitments. Moreover, land governance in the traditional system creates disincentives to investing in agriculture.

**Reforms need to focus on unlocking the potential of the digital economy and creating a more balanced playing field by completing ongoing reforms while sequentially implementing cross-cutting reforms to strengthen the trade environment, the regulatory environment, and access to financial services, land, and skills.** One reform priority is implementing the cabinet-approved state-owned enterprise (SOE) restructuring framework designed to separate commercial activities from regulatory functions, consolidate and close some SOEs to decrease their fiscal burden, improve operational performance, and reduce the state presence in sectors that can be served by the private sector. Among the most critical SOE reforms in progress is the unbundling of the Eswatini Posts and Telecommunications Company (EPTC), a necessary step that will allow increased competition and private investment in the digital sector and lead to lower prices and increased access. This reform can, in turn, open opportunities for job-creating digital services and help Eswatini reach the goal of the African Union's Digital Transformation Strategy ensuring that every African individual, business, and the government is digitally enabled by 2030.

**To return to an export-led growth model, Eswatini needs to increase export competitiveness by advancing regulatory reforms and improvements in trade logistics that include regional collaboration to address trade facilitation constraints.** Policy reforms also need to address existing skills mismatches. Small and medium enterprises (SMEs) in Eswatini face a large gap in managerial capabilities and financing. Reducing the latter gap will require strengthening financial sector infrastructure and encouraging the development of new financial products better tailored to company assets, cash flows, and financing requirements by leveraging digital technologies and the frequent use of mobile money platforms. Finally, given the country's vulnerability to climate risks, policies to foster economic resilience amid extreme weather events (mainly droughts that affect agriculture) and improve disaster preparedness need to be pursued. The private sector must adapt to this challenge and work with the government to improve climate resilience. Table ES.1 summarizes the main recommendations of this CPSD, ranking them by the level of priority (high to low) in terms of the needs for addressing constraints to private investment and the timelines required to implement them (short to long).

## Sector assessments

**Sugar.** Despite limited diversification and value addition, the sugar sector is one of Eswatini's key sectors, accounting for about 5 percent of GDP and about 20,000 jobs. Around 92 percent of the sugar output is exported. Sugar output is expected to grow by around 100,000 tons over the next five years because of the expansion of mill plantations and smallholder farm areas, and this could help scale up exports throughout the region by leveraging the resources of the African Continental Free Trade Area (AfCFTA). Efforts to introduce climate-smart agriculture in the sector could help improve water security and efficiency, a critical issue for sugarcane production sustainability. Smallholders are facing rising production costs, including energy for irrigation. Supporting smallholders to increase efficiency, adapt to climate change, and adopt on-farm solar irrigation is important for Eswatini's quest to maintain competitiveness. There are opportunities for diversifying into biomass if an enabling policy framework for renewable energy is developed. The government has proposed agro-industrial parks to develop downstream sugar processing opportunities, but ensuring that the model responds to investor demand and addresses Eswatini's competitiveness constraints will be necessary.

**Forestry.** Eswatini's forests cover approximately 33 percent of Eswatini's total land area, but commercial forestry constitutes only 22.6 percent of total forestry. Ninety percent of the plantations in Eswatini have forest management certification. The forestry sector accounts for about 1.3 percent of GDP, 5.9 percent of exports, and 14 percent of formal employment, and forestry sector productivity is relatively high. Eswatini has the potential to take advantage of a number of positive global and regional prospects for timber arising from growing demand for quality packaging and sanitation products to meet the rise in e-commerce shopping and face masks and an expected 51 percent growth in roundwood demand in South Africa by 2030. On the domestic front, biomass energy production is an opportunity for the forestry sector given an enabling energy policy. The constraints to private investment in the sector include issues around (a) trade logistics and facilitation, (b) land tenure, (c) an outdated industrial forestry policy, (d) poor public-private dialogue, (e) the rising threat from climate change, and (f) a lack of adequate policy framework and instruments to address this threat.

**Beef.** The beef value chain is growing quickly, contributing 2.9 percent of total GDP and 32 percent of total agricultural GDP in 2018. Only 11 percent of beef livestock is kept under the title deed land (TDL) system, while informal beef sector activities dominate the industry. Eswatini Meat Industries Limited (EMI) is the only licensed exporter. Eswatini beef enjoys preferential tariff-free access into the European Union (EU) market through the Economic Partnership Agreement, but exports are well below the quota. In the longer run, Eswatini could expand its export market to SACU member states and through the AfCFTA, where it could export value-added meat products. The constraints to investment in the beef sector arise from the current traditional approach to cattle farming (including preference for larger and older animals) and the lack of incentives to investment in commercial production in the traditional land tenure system as well as (a) the lack of adequate meat grading systems, (b) the lack of capacity and knowledge among communal farmers, (c) the rising risk from climate change–induced droughts, and (d) the overgrazing of rangelands.

**Textile and apparel.** Textile and apparel account for 10.5 percent of the country's exports and employs over 22,000 people, 95 percent of whom are women. Since 2000, the sector has benefited from the Multi-Fibre Agreement (MFA) and the African Growth and Opportunities Act (AGOA), despite a temporary suspension from AGOA (2015–18) that resulted in 46.9 percent job loss and a shift in main export markets from the United States to South Africa. Textile exports to South Africa have doubled from US$95 million in 2011 to over $230m in 2021. To become competitive, Eswatini needs to offer more than low-cost labor and move toward a full package that involves incorporating parts of the supply chain, including design, fabric development, yarn, and fabric vertical integration. The sector is facing a number of challenges, including (a) skills shortages that require 95 percent of new hires to receive training while firms have difficulty in retaining trained workers; (b) high transport costs at the nearby port of Maputo, which forces exporters to use the port at Durban, a round trip of about 1,200 kilometers; (c) the high cost and poor supply of water (which could be worsened with climate change) and electricity to factories; (d) poor access to finance; and (e) poor compliance with environmental standards.

**TABLE ES.1 RECOMMENDATIONS**

| | Recommendations | Responsible entity | Priority | Timeframe (short: 1–2 years, medium 3–5 years) |
|---|---|---|---|---|
| **CROSS-CUTTING** | **Strengthen competition by rationalizing SOEs and strengthening sector regulations** | | | |
| | Implement the SOE restructuring framework approved by the government to revise the legal framework for separating commercial SOEs from other entities and strengthening operational performance and oversight mechanisms, as well as divesting where government involvement is not justified. | Ministry of Finance, Public Enterprise Unit | High | Medium |
| | Unbundle EPTC into separate telecommunications infrastructure and retail service operators. | Ministry of Telecommunications | High | Medium |
| | Update the legal and institutional framework on competition to strengthen capacity to enforce anticompetitive behavior. | Ministry of Finance | High | Medium |
| | Implement reforms stated in the National Energy Policy to enable private investment in renewable energy. | Ministry of Natural Resources and Energy | High | Medium |
| | Consider revising the operation and strategy of the sovereign fund in line with international good practice. | Ministry of Finance | Medium | Medium |
| | Conduct an assessment of the enabling environment and the PPP regulatory framework to identify gaps. | Ministry of Finance | Medium | Medium |

Note: EPTC = Eswatini Posts and Telecommunications Corporation;
PPP = public-private partnership;
SOE = state-owned enterprise.

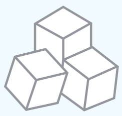
**CROSS-CUTTING**

| Recommendations | Responsible entity | Priority | Timeframe (short: 1–2 years, medium 3–5 years) |
|---|---|---|---|
| **Strengthen the trade and regulatory environment** | | | |
| Review and streamline value added tax refund procedures, eventually through joint monitoring, controls, and improved interconnectivity with South Africa. | Eswatini Revenue Authority | Quick win | Short |
| Implement the national trade single window and automate and streamline procedures to process trade licenses, permits, certificates, and other authorizations. | National Trade Facilitation Committee | High | Medium |
| Improve border management coordination at domestic (through the national single window) and bilateral levels, by developing strategies for one-stop border inspection, joint declarations, and smart borders (deployment of new technologies such as cargo tracking and tracing solutions, automatic identification, joint risk management and inspections and the exploration of biometric technology for identification and control of drivers and border residents). | Ministry of Commerce, Industry and Trade | High | Medium to long |
| Expand the preferred trade program over time through implementing a single government-authorized economic operator program aligned and mutually recognized with South Africa and Mozambique and explore expedited border procedures or dedicated trade lanes. | Eswatini Revenue Authority | Medium | Medium |
| Fast-track regulatory reforms in the investor roadmap to reduce the cost of doing business and enable efficient commercial dispute resolution. | Ministry of Commerce, Industry and Trade | Medium | Short |
| Review investment policy and assess the role of incentives in attracting FDI. | Ministry of Finance | Medium | Medium |
| Develop linkages programs connecting SMEs and large firms. | Ministry of Commerce, Industry and Trade | Medium | Medium |

Note: FDI = foreign direct investment; SME = small and medium enterprise.

| | Recommendations | Responsible entity | Priority | Timeframe (short: 1–2 years, medium 3–5 years) |
|---|---|---|---|---|
| **CROSS-CUTTING** | **Strengthen access to financial services, land, and skills** | | | |
| | Strengthen financial sector infrastructure, expand the use of credit guarantee schemes, and develop regulations to foster new financial products for SMEs. | Central Bank | High | Medium |
| | Introduce a "clearance" real-time e-invoicing system and regulations on maximum payment terms to SMEs. | Ministry of Finance | High | Medium |
| | Reform SME support programs to improve targeting in the context of the proposed restructuring of the Small Enterprise Development Corporation. | Ministry of Commerce, Industry and Trade | High | Medium |
| | Consider adopting legislation that allows use of Swazi Nation Land as collateral for loans. | Ministry of Natural Resources and Energy | High | Medium |
| | Involve the private sector in the design of skills development programs to address mismatches, create incentives for recruitment, and track results. | Ministry of Education | High | Medium |
| | Assess opportunities for deepening capital markets, including growth potential, key constraints, and a regulatory framework. | Financial Sector Regulatory Authority | Medium | Medium |

Note: SME = small and medium enterprise.



**SUGAR**

| Recommendations | Responsible entity | Priority | Timeframe (short: 1–2 years, medium 3–5 years) |
|---|---|---|---|
| **Strengthen the policy framework for renewable energy and diversification** | | | |
| Provide incentives and enabling regulations for on-farm solar power generation for irrigation. | Ministry of Natural Resources and Energy | Medium | Short |
| Investigate the likely demand and feasibility for an agro-industrial park complex adjacent to any of the sugar mills and assess potential markets for sugar by-products. | Ministry of Commerce, Industry and Trade | Medium | Short |
| **Implement best management practices to reduce costs and increase sustainability and climate resilience** | | | |
| Maintain and enhance technical and extension support and training to small growers, farming companies, and grower associations. | Ministry of Agriculture, Eswatini Sugar Association | High | Short |
| Continue developing resilience to climate change through the implementation of the Eswatini Sugar Association's seven-pronged strategy, particularly in the area of water management. | Eswatini Sugar Association | High | Short to medium |
| Promote adoption of best management practices for sugarcane production according to international sustainability standards and the use of digital tools by smallholders. | Ministry of Agriculture, Eswatini Sugar Association | Medium | Medium |
| **Optimize market access** | | | |
| Continue with advocacy efforts to optimize market access for sugar in regional markets. | Ministry of Commerce, Industry and Trade, Eswatini Sugar Association | High | Medium |

| | Recommendations | Responsible entity | Priority | Timeframe (short: 1–2 years, medium 3–5 years) |
|---|---|---|---|---|
| **FORESTRY** | **Improve public-private dialogue** | | | |
| | Encourage greater collaboration among sector stakeholders to share information, promote advocacy, and form an industry association. | Forestry Department, Ministry of Agriculture | Quick win | Short |
| | Facilitate community participation to foster value added products within the plantations. | Forestry Department, Ministry of Agriculture | Medium | Short |
| | **Investigate diversification models appropriate for Eswatini** | | | |
| | Implement production diversification models appropriate for Eswatini such as the integrated crop-livestock-forest system pioneered in Brazil. | Forestry Department, Ministry of Agriculture | Medium | Medium |
| **BEEF** | **Scale up and commercialize the production systems in traditional beef farming** | | | |
| | Implement a formal and credible grading system for beef. | Ministry of Agriculture; Ministry of Commerce, Industry and Trade | High | Short |
| | Improve extension services to enhance animal health and disease control, including upgrading and digitizing dipping systems. | Ministry of Agriculture | High | Short |
| | Support scale-up and commercialize production systems in Swazi Nation Land with pilot projects and structured education plans for activities such as breeding, grazing management, stock health, marketing, and financial management. | Ministry of Agriculture, commercial farmers, and chiefs | High | Medium |
| | Consider the use of mobile abattoirs for slaughtering. | Ministry of Agriculture | Medium | Short |
| | **Improve public-private dialogue between government and the industry** | | | |
| | Enhance stakeholder cooperation through forming a red meat suppliers organization. | Ministry of Agriculture, private sector | Quick win | Short |
| | Consider PPP models such as for extension services, dipping tank services, an improved traceability model, and the development of a grading system. | Ministry of Agriculture, commercial and smallholder farmers | High | Medium |

Note: PPP = public-private partnership.

| Sector | Recommendations | Responsible entity | Priority | Timeframe (short: 1–2 years, medium 3–5 years) |
|---|---|---|---|---|
| **TEXTILE AND APPAREL** | **Improve the supply of skilled labor** | | | |
| | Provide incentives to firms to address underinvestment in training new workers. | Ministry of Commerce, Industry and Trade; Ministry of Training and Education | High | Short |
| | Develop a training center that offers centralized training to the textile and apparel sector, with cofinancing and curriculum support from the private sector. | Ministry of Commerce, Industry and Trade; Ministry of Training and Education; Eswatini Textile and Apparel Traders Association | High | Medium to long |
| | **Move from CMT to full-package offerings** | | | |
| | Host private sector forums to understand what bottlenecks block further supply chain investments. | Eswatini Investment and Trade Promotion Authority | Quick win | Short |
| | Develop a strategy and consider incentives to attract investment in undeveloped parts of the full garment supply chain. | Eswatini Investment and Trade Promotion Authority | Medium | Medium to long |

Note: CMT = cut, make, and trim.

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