



WORLD BANK GROUP

AFRICA REGION, PRIVATE SECTOR UNIT

Summary of Swaziland Investment Climate Assessment

Swaziland is a middle-income country with an economy that is closely linked to that of South Africa. It enjoyed high rates of foreign investment during apartheid, but since South Africa's democratic transition, growth and FDI have fallen.

In many areas, the investment climate appears relatively favorable in Swaziland, especially when compared to other countries in Sub-Saharan Africa. In particular, as in other middle income countries in Southern Africa, firms have few complaints about infrastructure and most aspects of regulation. Objective indicators of the investment climate are also relatively favorable in these areas—although often less favorable than in Namibia, South Africa or Botswana.

Both small, medium and large enterprises (SMLEs) and microenterprises were concerned about competition with informal firms, crime (theft), and access to finance. In addition, Swaziland has the highest rate of HIV/AIDS in the world, although firms appear to respond relatively vigorously to the problem, perhaps because modest government prevention programs encourage them to step in.

This summary note is based on a 2006 survey of 309 small, medium, and large enterprises (SMLEs) and 122 microenterprises in the manufacturing, retail, and services sectors in three locations across Swaziland. It benchmarks firm performance and measures of the investment climate in Swaziland against similar measures in other middle-income countries in Southern Africa and throughout the world.

Introduction

Swaziland's economy is closely linked to that of South Africa. Its currency, the lilangeni, is pegged to the South African Rand, 60 percent of exports are destined for South Africa, and 80 percent of imports originate there. Swaziland enjoyed high levels of growth and investment during the apartheid era, with per capita growth averaging about 2 percent per year between 1975 and 1994 and foreign direct investment levels averaging about 7 percent of GDP between 1985 and 1994. Since South Africa's transition to democracy in 1994, both have fallen. Between 1994 and 2006, per capita growth averaged about 0.7 percent per year. Between 1994 and 2000, FDI averaged about 5 percent of GDP per year, falling further to about 2 percent of GDP per year between 2001 and 2005.

About 60 percent of government expenditures are financed with South African Customs Union (SACU) receipts. Fiscal deficits have been financed by draw-downs on government financial assets, which is an unsustainable source of funding and which risks undermining investor confidence in the exchange rate parity with South Africa. Improving the investment climate will attract FDI, improve growth, and increase government tax revenues.

Competitiveness

Labor productivity is higher in Swaziland than in all but six of the 31 countries in Sub-Saharan Africa where World Bank Enterprise Surveys have been completed. Labor productivity is between 2 and 8 times for the average firm in Swaziland than for similar firms in most low-income countries in the region. Total Factor Productivity (TFP), which takes into account how much machinery and equipment a firm has, is higher in Swaziland than in any of the countries in

Sub-Saharan Africa where Enterprise Surveys have been completed other than South Africa and Namibia. However, firms in Swaziland are less productive than in many of the middle-income comparators.

Other indicators also suggest that firms are not highly competitive compared to firms in other middle-income economies. Less than 40 percent of SMLEs in Swaziland export any part of their output. Further, those that do export a large amount to other countries in SACU: 54 percent of exports are to other countries in SACU, and around 70 percent of exporters say that South Africa was their main export market. This suggests that firms are not competing well on international markets outside of Southern Africa.

Although productivity is an important element of competitiveness, it is not the only factor that affects it. Even productive firms can become uncompetitive if wages are high and firms that are not very productive can remain competitive if wages are low. Although wages in Swaziland are between two and four times higher than most low-income countries in Sub-Saharan Africa, they are close to wage levels in other lower middle income comparator countries (e.g. Thailand) and are considerably lower than in many of the upper middle-income comparator countries (e.g., Mauritius, Argentina, Namibia, South Africa and Chile).

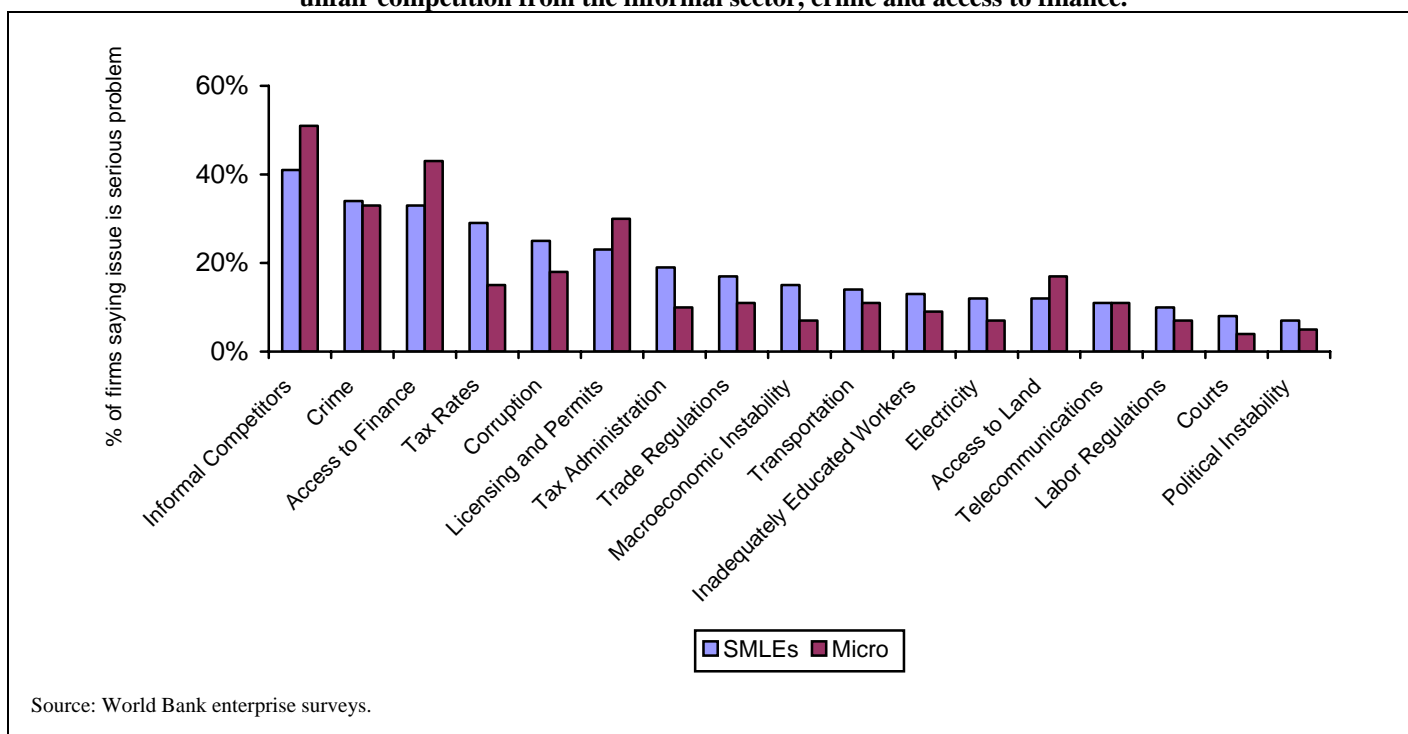
Returns to education are extremely low: earnings increase by only around 2 to 2.5 percent for each year of schooling, much lower than the 7 and 12 percent increases estimated for Botswana, Namibia and South Africa. Wages also do not increase with experience or tenure. Together with the information on productivity, this suggests that manufacturing is mostly concentrated in areas that are not skills intensive.

Constraints to the Investment Climate

Both microenterprises and SMLEs are more likely to report that competition from the informal sector; crime, theft and disorder, and access to finance are serious problems than any other area of the investment climate.

(1) *Competition from the Informal Sector:* More SMLE and microenterprise managers rated competition from the informal sector as a constraint more than any other area of the investment climate. This is likely because of the high level of informality in the country: only 75 percent of microenterprises are registered with any government agency, and tax evasion is very high. Another factor that might play a role is that microenterprises in Swaziland are closer to SMLEs in productivity than in other middle income countries. The median manufacturing microenterprise produces \$4,000 of output per worker, higher than in any Sub-Saharan African nation except Botswana. Microenterprises reported financial burdens associated with registration and labor regulation were serious deterrents from registering. In contrast, the administrative burden of being registered (like the burden of complying with tax laws) was not seen as a major barrier.

Although SMLEs and microenterprises see some obstacles differently, they have several common concerns such as unfair competition from the informal sector, crime and access to finance.



(2) *Crime, Theft and Disorder*: Firms in Swaziland are more concerned about crime, theft and disorder than firms in neighboring countries. Roughly one-third of manufacturing SMLEs cited crime and theft as a major constraint. Although the average cost of theft and security per worker (\$70) in Swaziland) is lower than in other countries in SACU, it is higher than in most of the non-SACU comparator countries. Further, because productivity is lower than in the SACU economies, it is higher as a percent of sales.

(3) *Access to Finance*: Both SMLEs and microenterprises were concerned about access to finance. Although retained earnings are the most important source of funding for short-term working capital and long-term investment in most countries, Swaziland SMLEs are particularly reliant upon it. Swazi firms are more likely to use retained earnings to finance working capital than SMLEs in almost all of the comparator countries, and they were more likely to finance new investment this way than in any of them. SMLEs in Swaziland finance less new investment and working capital through the banking sector than in comparator countries. Access to finance is also a problem for microenterprises. Only 19 percent of Microenterprises have any sort of bank credit.—although this is higher than in Botswana or Namibia.

(4) *Tax Rates*: Over one-quarter of SMLEs in Swaziland complained about tax rates, while only 15 percent of Microenterprises said the same. The low level of complaints from microenterprises probably partly reflects high levels of tax evasion. The top marginal corporate tax rate in Swaziland is 30 percent. Although this is comparable with other countries, it is far higher than in Botswana (15 percent). Moreover, other aspects of the tax code are less favorable and the overall total tax burden in Swaziland is relatively high.

(5) *Petty Corruption*: Around one-quarter of SMLEs and one-fifth of Microenterprises rate corruption as a serious problem. As well as asking firms about whether they think corruption is a problem, the Enterprise Survey also tries to collect quantitative information on bribes and informal payments to government officials to 'get things done'. Although petty corruption is a smaller problem than in most countries in Sub-Saharan Africa, Swaziland compares less favorably with other middle-income countries, including those in the region such as Botswana, Namibia and South Africa. This is consistent with other sources of information on corruption such as the Kaufman-Kraay Index and Transparency International's Corruption Perception Index. Corruption can deter foreign investors, especially those from OECD countries where bribe payments are illegal.

(6) *Worker Skills and Training*: Unlike in most middle-income countries, firms in Swaziland were not especially concerned about worker education and skills. This low level of concern is not due to high levels of educational attainment: 40 percent of workers have between 0 and 6 years of schooling, a proportion higher than in most of the middle-income comparator countries. The quality of instruction might also be a problem, as Swaziland performs worse on tests than students in several low-income countries.

(7) *Labor Regulation*: Few managers cite labor regulations as a severe constraint to doing business, and other evidence supports this. Twenty percent of manufacturing firms report that they would change their employment if labor regulations were eased, and fewer firms in the retail and services sector reported that they would do the same, lower than in comparator nations. Labor regulations are less constraining than in South Africa, China, and Mauritius.

(8) *Business Licensing and Registration*: SMLE and microenterprise managers both rated business registration and licensing as a serious problem. Evidence from the Doing Business survey supports this: starting a business takes 61 days, 13 procedures, and 41 percent of per capita income. Microenterprises were more likely to complain that the cost associated with business registration than any other barriers to registering.

(9) *HIV/AIDS*: Swaziland has the highest rate of HIV infection in the world, with prevalence rates between 21 and 45 percent and 220,000 people living with HIV/AIDS. For this reason, SMLEs in Swaziland are more active in conducting prevention activities than they are in most other countries in Sub-Saharan Africa, with 65 percent of firms conduct some sort of prevention activity. Swazi firms are the most active of all comparator countries in distributing condoms (52 percent of firms), third-highest in putting up prevention messages (43 percent of firms), and second-highest in anonymous HIV testing (17 percent of firms). Larger firms are more likely to engage in prevention activities than smaller firms. It is possible that one reason why the private sector is relatively active is to make up for the lack of prevention activities by the government. Firms report the highest rate of general absenteeism among all comparator countries, with 50 percent of workers absent due to sickness and 20 percent absent as caretakers for family members during the month prior to the survey.

Conclusion

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