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AGENDA

EBS/85/135
Correction 1

CONFIDENTIAL

June 14, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Belize - Staff Report for the 1985 Article IV Consultation
and Review Under the Stand-By Arrangement

The following corrections have been made in EBS/85/135 (5/24/85):

Page 4, para. 3, line 9: for "5.2 percent" read "5.3 percent"
line 11: for "8 percent of GDP in FY 1983/84 to 5.7 percent"
read "-2.1 percent of GDP in FY 1983/84 to 3.6 percent"

Page 8, para. 3, line 2: for "FY 1985/86" read "FY 1984/85"
footnote 1, line 5: for "a margin" read "an adjustment"

Page 10, Table 5, column 2, line 3: for "2.5" read "2.4"
column 5, heading: for "1985" read "1986"

Page 31, Table 8, line 13, stub "Overall deficit": add "(-)"
last line, stub "Overall deficit": add "(-)"
column 5: for "5.7" read "-5.7"
column 6: for "8.9" read "-8.9"

Page 32, Table 9, below "Development expenditure":

add "Transfers to Central Government -- -- -- -- -- 3.3"

last column, penultimate line: for "11.1" read "7.8"
last line: for "1.5" read "-5.5"

Page 41, para. No. 8, line 17: for "BZ\$1.8" read "BZ\$1.0"

Corrected pages are attached.

Att: (6)

Table 2. Belize: Performance Under Stand-By Arrangement

	March 31, 1984	September 30, 1984	Program Period December 31, 1984 March 31, 1985	
<u>(In millions of Belize dollars)</u>				
<u>Net domestic assets of</u> <u>the Central Bank</u>				
Ceiling			32.0	26.0
Actual	17.7	24.4	32.4	25.6
Margin under ceiling (excess -)			-0.4	0.4
<u>Net credit from banking</u> <u>system to nonfinancial</u> <u>public sector</u>				
Ceiling			71.0	67.0
Actual	66.0	67.1	68.6	67.7
Margin under ceiling (excess -)			2.4	-0.7
<u>(In millions of U.S. dollars)</u>				
<u>Public sector external</u> <u>debt (maturity of 12</u> <u>years or less)</u>				
Ceiling			21.0	20.0
Actual	...	18.7	19.0	17.5
Margin under ceiling (excess -)			2.0	2.5
<u>External payments arrears</u>				
Ceiling			5.0	4.5
Actual	6.5	6.3	6.3	5.8
Margin under ceiling (excess -)			-1.3	-1.3

Source: Central Bank of Belize.

II. Background and Performance Under Stand-By Program

After nearly a decade of uninterrupted growth, economic activity in Belize weakened in 1981-82 as the country's terms of trade worsened because of declining international sugar prices and entrepot trade activities experienced a slowdown in the aftermath of the depreciation of the Mexican peso. Real GDP growth slowed to less than 1 percent in 1981 and output declined by about 5 percent in 1982. The financial position of the public sector deteriorated, with the overall deficit increasing to 9 percent of GDP in FY 1982/83, compared with a deficit of 4 percent of GDP two years earlier. Government revenue declined and expenditure continued to rise owing to a large general salary increase in 1981 and increased defense outlays following Belize's independence. The deficit in the external current account widened in 1982, but the overall balance of payments was close to equilibrium because of large capital inflows (Table 3). Large wage increases in the sugar sector in 1980 and in the public sector in 1981 contributed to an acceleration of domestic inflation from 7 percent in 1980 to an average of about 10.5 percent in 1981 and 1982.

While inflationary pressures abated in 1983 reflecting a moderation in wage settlements as well as declining inflation abroad, the economy experienced only a modest recovery that year as output grew by 1.5 percent. In FY 1983/84 public capital expenditure was reduced by 3 percent of GDP as a result of a lack of counterpart funds, but the overall deficit of the public sector declined only marginally (to 8 percent of GDP) because of a stagnation of revenue growth and a continued increase in current expenditures. In contrast to previous years, the deficit was financed primarily by central bank credit. The continued large public sector deficit combined with declining inflows of development assistance and large outflows of private capital resulted in an overall balance of payments deficit of US\$4.8 million in 1983 and in an accumulation of US\$5.1 million in external payments arrears of the public sector.^{1/}

Against this background, the Government adopted an adjustment program in mid-1984 designed to strengthen the balance of payments and to provide the basis for a restoration of economic growth and the achievement of relative price stability. The stand-by arrangement was approved in support of this adjustment program. To achieve the balance of payments objective the program called for a reduction of the overall public sector deficit to a level that could be financed by long-term bilateral and multilateral external financing. Thus, the deficit was programmed to decline to 5.7 percent of GDP in FY 1984/85 and to 5.3 percent in FY 1985/86. Consistent with the overall deficit targets, public savings were expected to rise from -2.1 percent of GDP in FY 1983/84 to 3.6 percent

^{1/} Public entities have incurred external payments arrears because of lack of domestic resources and thus they have not been able to deposit the domestic counterpart of the arrears in the Central Bank. For this reason these arrears are not part of the international liabilities of the Central Bank.

Table 4. Belize: Consolidated Operations of the Nonfinancial Public Sector ^{1/}

			1984/85		1985/86	
	1982/83	1983/84	Prog.	Prel. Est.	Program	Revised Program
(In millions of Belize dollars)						
<u>Total revenue and grants</u>	<u>101.2</u>	<u>100.5</u>	<u>111.3</u>	<u>112.5</u>	<u>115.1</u>	<u>121.8</u>
Revenue	84.2	84.4	101.8	103.9	109.6	115.9
Central Government	(78.9)	(77.8)	(93.6)	(92.4)	(100.0)	(98.2)
Social Security Board	(5.3)	(6.6)	(8.2)	(10.4)	(9.6)	(10.3)
Public enterprises' operating surplus	(—)	(—)	(—)	(1.1)	(—)	(7.4)
Grants	17.0	16.1	9.5	8.6	5.5	5.9
<u>Total expenditure ^{2/}</u>	<u>131.4</u>	<u>128.8</u>	<u>132.5</u>	<u>126.2</u>	<u>135.7</u>	<u>141.3</u>
Current expenditure	85.2	91.9	92.6	90.8	95.7	97.4
General government	(82.4)	(87.5)	(91.4)	(90.8)	(95.7)	(97.4)
Central Government	/81.6/	/85.8/	/88.6/	/89.2/	/91.7/	/95.0/
Social Security Board	/0.8/	/1.7/	/2.8/	/1.6/	/4.0/	/2.4/
Public enterprises' operating deficit	(2.8)	(4.4)	(1.2)	(—)	(—)	(—)
Capital expenditure	46.2	36.9	39.9	35.4	40.0	43.9
General government	(27.7)	(24.6)	(31.4)	(27.4)	(30.9)	(34.3)
Central Government	/27.5/	/24.4/	/31.2/	/27.2/	/30.7/	/34.0/
Social Security Board	/0.2/	/0.2/	/0.2/	/0.2/	/0.2/	/0.3/
Public enterprises	(18.5)	(12.3)	(8.5)	(8.0)	(9.1)	(9.6)
<u>Overall balance (- deficit)</u>	<u>-30.2</u>	<u>-28.3</u>	<u>-21.2</u>	<u>-13.7</u>	<u>-20.6</u>	<u>-19.5</u>
<u>Change in external arrears ^{3/}</u>	<u>0.4</u>	<u>3.9</u>	<u>-2.9</u>	<u>-0.4</u>	<u>-1.4</u>	<u>-4.2</u>
<u>Financing (net)</u>	<u>29.8</u>	<u>24.4</u>	<u>24.1</u>	<u>14.1</u>	<u>22.0</u>	<u>23.7</u>
External financing (net) ^{4/}	18.3	8.3	28.1	12.6	31.2	24.7
Domestic financing (net)	11.5	16.1	-4.0	1.5	-9.2	-1.0
Banking system	(11.9)	(16.9)	(-4.0)	(1.7)	(-9.2)	(-1.0)
Central Bank	/0.4/	/14.0/	/3.7/	/13.5/	/-6.8/	(...)
Commercial banks	/11.5/	/12.9/	/-7.7/	/-11.8/	/-2.4/	(...)
Other	(-0.4)	(-0.8)	(—)	(-0.2)	(—)	(—)
<u>Memorandum items</u>						
Public sector savings	-1.0	-7.5	9.2	13.1	13.9	18.5
(As percent of GDP)						
Revenue	24.9	23.9	27.3	28.1	28.0	29.6
Grants	5.1	4.6	2.6	2.3	1.4	1.5
Total expenditure	39.0	36.5	35.6	34.1	34.6	36.0
Current expenditure	25.3	26.0	25.0	24.5	24.4	24.8
Public sector savings	-0.4	-2.1	2.3	3.6	3.6	4.7
Capital expenditure	13.7	10.5	10.8	9.6	10.2	11.2
Overall deficit	-9.0	-8.0	-5.7	-3.7	-5.3	-5.0
External financing	5.5	1.3	7.6	3.4	8.0	6.3
Domestic financing	3.4	5.6	-1.1	0.4	-2.3	-0.3
Change in outstanding arrears ^{3/}	0.1	1.1	-0.8	-0.1	-0.4	-1.0

Sources: Belize authorities; and Fund staff estimates.

^{1/} Fiscal year April 1-March 31.

^{2/} Commitment basis.

^{3/} External payments arrears on interest and other current payments.

^{4/} Includes changes in principal external arrears.

The monetary program of the Government was framed to be consistent with limiting the loss of net international reserves to no more than US\$2.1 million during the second half of 1984 (US\$6.5 million for the year as a whole). A 2 percentage point increase in the legal cash reserve ratio on November 1, 1984 was to absorb the existing excess reserve deposits of commercial banks at the Central Bank. By increasing treasury bill rates, which were significantly lower than rates charged by commercial banks on loans to the private sector, and by the use of moral suasion, the authorities sought to eliminate the potential pressure on the Central Bank's reserves which could result from a sudden reduction in net credit from the commercial banks to the public sector.

In the event, the Government did not adjust the interest rates for treasury bills and the commercial banks reduced significantly their holdings of bills during the last four months of 1984 in order to lend to the private sector at interest rates that were more attractive. The reduction in net commercial bank credit to the public sector allowed banks to expand credit to the private sector in 1984 by 10 percent over its level at the end of 1983, compared with the programmed rate of 6 percent. As the commercial banks reduced their holdings of treasury bills, the Central Bank increased its bill holdings and, as a result, the Central Bank exceeded its net domestic assets ceiling marginally at the end of 1984.

The larger than originally targeted reduction in the public sector deficit in FY 1984/85 was not sufficient to compensate for the shortfall in net projected external financing, and the public sector increased its reliance in domestic credit instead of reducing it as envisaged in the program. The consequence was the deviations noted above in respect of the foreign reserve objective and the targeted reduction of external arrears. In terms of the performance criteria, Belize exceeded the US\$5.0 million external payments arrears ceiling by US\$1.3 million and the BZ\$32 million ceiling on the net domestic assets of the Central Bank by BZ\$0.4 million on December 31, 1984, while the ceiling on net bank credit to the public sector and to the stock of external debt with a maturity of less than 12 years were met. On March 31, 1985, (the end of FY 1984/85), the BZ\$67 million ceiling on net bank credit to the public sector was exceeded marginally by BZ\$0.7 million, while the ceiling on external payments arrears was again exceeded by US\$1.3 million.^{1/}

^{1/} When the limit on bank credit to the public sector was originally set, it was not certain that a disbursement of BZ\$5 million under a U.S. AID Economic Stabilization Facility (USAID ESF) loan would take place as projected in the first quarter of 1985. For this reason the limit on bank credit to the public sector included an adjustment in the event that this disbursement did not take place.

III. Report on the Discussions and Program for FY 1985/86

The discussions with the Belize authorities centered on a review of the progress achieved during FY 1984/85 in the implementation of the stand-by program and on the policies that would form the basis for the establishment of the targets and limits for the period of the stand-by arrangement in FY 1985/86. The new Belize authorities, who assumed office after a general election in December 1984, stressed their commitment to the program supported by the stand-by arrangement negotiated by the previous Government. They confirmed their intention to continue to pursue policies aimed at establishing conditions conducive to price stability and a satisfactory balance of payments position with a view to achieving sustained economic growth.

The authorities' program for FY 1985/86 seeks to limit the public sector deficit to 5 percent of GDP, a ratio slightly lower than agreed upon when the program was negotiated. However, because of delays in the elimination of external arrears, the financing needs of the public sector will be now 6 percent of GDP in FY 1985/86, compared with 5.6 percent envisaged in the original program. As previously, the monetary program seeks an increase in net international reserves of US\$5 million in 1985. The target for the elimination of external payments arrears in 1985 is to be maintained and the elimination of the arrears is to be facilitated by the rescheduling of US\$1 million in arrears to a private supplier, already negotiated, and of US\$1.9 million in arrears to the State Petroleum Company of Mexico (PEMEX). The authorities expect to conclude the negotiations with the Mexican Government on the rescheduling of the arrears to PEMEX by the end of May 1985. The 1985 program is also consistent with the reduction of the outstanding external debt with a maturity of less than 12 years from US\$19 million at the end of 1984 to US\$16 million at the end of 1985.

To achieve the fiscal and balance of payments objectives of the program, the following quantitative performance criteria have been established for the remaining period of the stand-by arrangement: (1) ceilings on the net domestic assets of the Central Bank; (2) limits on the net credit from the domestic banking system to the nonfinancial public sector; (3) limits on the outstanding stock of public sector external payments arrears; and (4) limits on the outstanding external debt of the public sector with a maturity of 12 years or less (Table 5). The first criterion is to be observed at all times, while performance under the three other criteria is subject to testing at the end of each calendar quarter. In addition, the customary performance criteria on the introduction of exchange restrictions, multiple currency practices, bilateral payments agreements inconsistent with Article VIII, import restrictions for balance of payments purposes, as well as the injunction against overdue financial obligations to the Fund remain applicable during the remaining period of the arrangement.

Table 5. Belize: Quantitative Performance Criteria

	1985				1986	
	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	Mar. 31
(In millions of Belize dollars)						
Net domestic assets of the Central Bank	26.0	26.2 1/	24.1 1/	23.8 1/	22.3 1/	
Net credit from the domestic banking system to the nonfinancial public sector	67.0	69.3 1/	69.4 1/	66.7 1/	67.2 1/	
(In millions of U.S. dollars)						
Outstanding external payments arrears	4.5	2.4	--	--	--	
Outstanding external debt of the public sector with a final maturity of 12 years or less	20.0	18.0	17.5	16.0	15.0	

Sources: Tables 4 and 6; and Tables 1, 2, 3, and 4 annexed to the letter of intent.

1/ These limits will be adjusted downward to the extent by which cumulative disbursements under the U.S. AID Economic Stabilization exceeds US\$6.8 million.

Table 8. Belize: Operations of the Central Government

			1984/85		1985/86	
				Prel.	Prog.	
	1982/83	1983/84	Prog.	Est.	Orig.	Rev.
(In millions of Belize dollars)						
Revenue and grants	91.7	90.9	99.1	98.0	102.4	102.9
Revenue	78.9	77.8	93.6	92.4	100.0	101.5
Tax	(67.3)	(67.8)	(82.8)	(81.8)	(88.9)	(87.2)
Nontax	(11.3)	(9.7)	(10.5)	(9.1)	(10.8)	(13.7)
Capital	(0.3)	(0.3)	(0.3)	(1.5)	(0.3)	(0.6)
Grants	12.8	13.1	5.5	5.6	2.4	1.4
Total expenditure 1/	124.0	118.2	124.1	121.4	124.9	137.9
Current expenditure	87.3	90.5	90.9	93.2	94.2	97.6
Capital expenditure and net lending	36.7	27.7	33.2	28.2	30.7	40.3
Of which: develop- ment expenditure	(27.5)	(24.4)	(28.7)	(23.6)	(30.7)	(32.3)
Overall deficit (-)	-32.3	-27.3	-25.0	-23.4	-22.5	-35.0
Change in outstanding arrears 2/	0.4	3.9
(In percent of GDP)						
Revenue and grants	27.3	25.8	26.8	26.5	26.1	26.3
Of which: revenue	(23.5)	(22.1)	(25.3)	(25.0)	(25.5)	(25.9)
Tax revenue	20.0	19.2	22.4	22.1	22.7	22.2
Nontax revenue	3.4	2.8	2.8	2.5	2.8	3.5
Total expenditure	36.9	33.5	33.5	32.8	31.9	35.2
Current expenditure	25.9	25.6	24.6	25.2	24.0	24.9
Capital expenditure	11.0	7.9	9.0	7.6	7.8	10.3
Of which: development expenditure	(8.2)	(6.9)	(7.8)	(6.4)	7.8	8.2
Overall deficit (-)	-9.6	-7.7	-6.8	-6.3	-5.7	-8.9

Sources: Belize authorities; and Fund staff estimates.

^{1/} Commitment basis.

^{2/} On interest and current transfers.

Table 9. Belize: Operations of the Nonfinancial
Public Enterprises

(In millions of Belize dollars)

	1982/83	1983/84	1984/85		1985/86	
			Prog.	Prel. Est.	Prog.	Rev. Prog.
<u>Operating balance</u>	-2.8	-4.4	-1.2	1.1	--	7.4
Operating revenue <u>1/</u>	36.8	37.6	41.6	49.9	44.8	55.4
Operating expenditure <u>1/</u>	-39.6	-42.0	-42.8	-48.8	-44.8	-48.0
<u>Nonoperating revenue</u>	19.1	11.0	8.3	8.0	5.9	13.3
Current transfers <u>2/</u>	5.7	4.7	2.3	2.8	2.8	2.6
Capital transfers <u>3/</u>	9.2	3.3	2.0	1.0	--	6.2
Grants	4.2	3.0	4.0	3.0	3.1	4.5
Other	--	--	--	1.2	--	--
<u>Development expenditure</u>	18.5	12.3	8.5	8.0	9.1	9.6
<u>Transfers to Central Government</u>	--	--	--	--	--	3.3
<u>Overall deficit (-)</u>						
Including nonoperating revenue	-2.2	-5.7	-1.4	1.1	-3.2	7.8
Excluding nonoperating revenue	-21.3	-16.7	-9.7	-6.9	-9.1	-5.5

Sources: Belize authorities; and Fund staff estimates.

1/ Derived from financial statements of individual NFPEs with adjustments made for some transactions between the NFPEs and the Central Government.

2/ Transfers from the Central Government in the form of interest payments on behalf of the NFPEs' outstanding domestic and foreign debt, and some transfers for their current operation.

3/ Transfers from the Central Government in the form of principal repayments on behalf of the NFPEs and some domestic currency counterpart capital expenditure.

6. Notwithstanding that the fiscal deficit targets were met during 1984/85, monetary developments and the shortfall in expected external financing caused Belize to exceed its net domestic asset ceiling and the external payments arrears target at the end of 1984. During the second half of 1984 commercial banks reduced their holdings of treasury bills leading to a corresponding increase in central bank holdings of these bills and consequently to an increase in net domestic assets of the Central Bank. This, combined with the fact that the Government resorted to central bank financing, led to the program's ceiling on net domestic assets to be slightly exceeded. The US\$5 million ceiling on outstanding external arrears was also exceeded by US\$1.3 million on December 31, 1984. Available data for mid-March suggest that Belize is likely to slightly exceed its ceilings on net domestic assets, banking system credit to nonfinancial public sector and external payments arrears on March 31, 1985.

7. There was little change in economic activity in 1984 as an expansion in trade, tourism and the secondary sectors was slightly offset by a decline in agricultural output. Real GDP is estimated to have grown by about 1.3 percent versus 1.5 percent in 1983, while the inflation rate increased on average to about 4 percent, a rate slightly higher than that of the previous year. The adjustment in the current account of the balance of payments was stronger than programmed declining from 6.5 percent of GDP in 1983 to 3.5 percent of GDP in 1984. Notwithstanding this stronger current account adjustment, the shortfall in external borrowing by the public sector combined with a net private capital outflow resulted in a decline in net international reserves of US\$7.2 million, versus the original target of US\$6.5 million.

8. For 1985/86 the Government is committed to achieve the objectives of the stand-by arrangement with the International Monetary Fund of strengthening the balance of payments and establishing the conditions for sustainable economic growth and price stability. The Government is committed to achieve a budget deficit target for the nonfinancial public sector of BZ\$19.5 million, equivalent to about 5.0 percent of GDP. This is a level that can be financed with external development credits, despite the fact that a lower level of external financing is now envisaged than when the program targets were agreed upon. To ensure the achievement of this target, the savings effort of the non-financial public sector is to be further strengthened and is programmed to increase from 3.5 percent of GDP in 1984/85 to 4.7 percent of GDP in 1985/86. This higher level of public sector savings will allow a ratio of capital expenditure to GDP of 11.2 percent. While the original fiscal targets for 1985/86 were consistent with a decline in domestic financing of BZ\$9.4 million, the financial program is now consistent with only a decline of BZ\$1.0 million in domestic financing reflecting the diminished availability of external financing as well as the delays in eliminating external payments arrears. Additional program targets for calendar year 1985 call for an increase in the net international reserves of the Central Bank of US\$5 million and for the elimination of all external payments arrears by September 30, 1985. The achievement

of these external sector targets is to be facilitated by a U.S. AID loan which could be as much as US\$10 million in 1985/86. The Government will take the necessary measures to ensure that at least US\$6.8 million will be disbursed during the 1985 calendar year and to the extent that actual disbursements are in excess of US\$6.8 million, the difference will be reflected in the form of repayments to the domestic banking system.

9. Additional adjustment steps are to be taken by the Central Government to ensure the achievement of program targets in 1985/86. The stamp tax is to be increased from 8 percent to 10 percent, customs administration charges on intransit goods are to increase from 2 percent to 3 percent, and the travel tax is to be doubled. These measures will partially compensate for lower than expected yields from import duty collections, and excise taxes on spirits, beer, and soft drinks. In addition, various Government fees are to be increased to reflect more closely the cost to the government of providing some services. The expected yield of these revenue measures is estimated to be BZ\$4.2 million, equivalent to 1.1 percent of GDP. The Government will also continue to strengthen tax collection procedures and expects to maintain the improved performance in income tax collection in future years. Moreover, as part of a new understanding between the statutory boards and the Central Government, the statutory boards will transfer to the Central Government approximately BZ\$3.3 million in the form of dividend payments. However, the financial relations between the Central Government and the statutory boards concerning the debt between the boards and the Central Government and among the boards themselves, as well as the servicing of the boards' debts, still need to be formalized and the Government intends to do this during the program period.

10. The Central Government will continue to have an austere expenditure policy in 1985/86. There will be no general salary increase in the Government for a fourth consecutive year, and current expenditure (excluding interest payments) are to be held to the program target by reducing BZ\$3.1 million from the levels of expenditures originally proposed in the budget. This restraint in operating expenditures will include reductions in both wages and in personnel.

11. The Government is undertaking a review of the operations of the statutory boards with the aim of streamlining their operations and privatizing some of their activities. During 1985/86 the Government will try to ensure that the operating balances of statutory boards generate resources for their capital programs and reduce their dependence on the Central Government for the servicing of their debt. The growth of the wage bill of public enterprises is to be restrained during 1985/86. Consequently, the wage bill envisioned in their budget requests to their boards of directors is to be reduced by BZ\$1.9 million implying a real reduction of about 4 percent. The growth of current expenditures of the Belize Electricity Board is to be restrained and the operating deficit of the Water and Sewerage Authority will be eliminated by increasing collection efforts. The operating deficit of