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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 97/48

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Executive Board Attendance

S. Sugisaki, Acting Chairman

Executive Directors

Alternate Executive Directors

S.M. Al-Turki
N.R.F. Blancher, Temporary
C.X. O'Loghlin
O. Schmalzriedt, Temporary
L. Pinzani, Temporary
J.P. de Morais
O. Issaev, Temporary
A.L. Coronel, Temporary
J.A. Akhmetova, Temporary
D.G. Loevinger, Temporary
H. Javaheri, Temporary
L. Palei, Temporary
J. Shields
Y.Y. Mohammed
R.P. Watal, Temporary
A.R. Palmason, Temporary
M.B. Alemán, Temporary
A.G. Yakub, Temporary
J.P. Leijdekker, Temporary
T.-M. Kudiwu, Temporary
S. Fukushima, Temporary
O. Sein, Temporary
Song J., Temporary
O. Otazú, Temporary

W.S. Tseng, Acting Secretary
P. Cirillo, Assistant

Also Present

IBRD: P. Maisterra, Latin America and the Caribbean Regional Office. External Relations Department: P.C. Hole, Deputy Director. Policy Development and Review Department: R.H. Nord, C. Puckahtikom. Western Hemisphere Department: C.M. Loser, Director; H. Arbulú-Neira, A. Barajas, L.A. Cardemil, A. Espejo, Ewe-Ghee Lim, M. Ronci, F. van Beek. Advisors to Executive Directors: M.F. Melhem, T. Turner-Huggins. Assistants to Executive Directors: M. Kell, E. Kouprianova, J. Mafararikwa.

1. BELIZE—1997 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1997 Article IV consultation with Belize (SM/97/100, 4/23/97). They also had before them a statistical appendix (SM/97/101, 4/24/97).

The staff representative from the Western Hemisphere Department said that the budget for fiscal year 1997/98 had been recently approved by parliament. The budget included some, but not all, the revenue measures recommended by the staff. However, the expenditures had been increased relative to the staff projections. The net effect of the domestic financing requirement would remain unchanged with respect to what had been outlined in the staff report, and, in that regard, the budget did not change any of the staff recommendations or the staff appraisal.

Mr. O'Loghlin made the following statement:

> My Belizean authorities accept the broad thrust of the staff report and its recommendations. In particular, they have carefully noted its central thesis—that fiscal deficits which threaten a fall in already-limited reserves risk undermining exchange stability or driving interest rates to levels inconsistent with investment and, in either event, risk growth itself.
>
> My authorities have asked me to convey their appreciation to the staff for prompting a very thorough reflection on prospects in this year's discussions, and for their assistance in assessing policy requirements for the period ahead. Their insights and expertise, as always, have been most valuable.
>
> But I should begin by recapping the main features of recent developments. At the last Board discussion on Belize, I characterized 1995 as a good year for the economy, noting the reversal through 1995 of previously weakening trends in key economic indicators. In broad measure the same holds true for 1996.
>
> The economy expanded by some 3 percent, despite a policy-induced decline in the volume of public administration. Growth was again broadly based, with increases in output in the range of 4 to 6 percent in the primary sector, in industry and construction and in services excluding public administration and tourism (see below);
>
> Gross reserves virtually doubled through the year, to the equivalent of two month's imports, albeit with the assistance of a highly concessional official loan from abroad which was provided to afford Belize a temporary respite pending the strengthening of the balance of payments;
>
> Tight budgetary management pushed the surplus of the nonfinancial public sector on current account to 4¼ percent of GDP. The overall deficit on the public finances was maintained at little more than 2½ percent of GDP, notwithstanding receipt of the foregoing exceptional resources;

On the other hand price inflation did accelerate, reflecting both an impetus from indirect tax increases and some carry-over from the substantial increase in import prices seen in 1995. But it has since decelerated, to 4 percent year-on-year in February last; and

despite an improved trade performance the deficit on the current account of the balance of payments rose somewhat, reflecting a decline in the surplus on trade in services.

Bearing in mind the importance for macroeconomic stability of strengthening the balance of payments, it is useful to review recent developments in the current account. While the deficit rose from 1 percent of GDP in 1995 to 2½ percent last year, this was not without some positive features. The higher deficit was wholly attributable to developments in trade in services. Two main contributory factors are identifiable. Net tourism receipts, reflecting the once-off competing attraction of the summer (Atlanta) Olympic Games, fell; and U.K. military spending in its former colony, which had been declining, virtually ceased. In marked contrast, and despite a decline in the terms of trade, the merchandise trade balance strengthened through 1996 as it had done also through 1995. It is particularly noteworthy that this occurred against the background of an appreciating nominal effective exchange rate (given the peg to the dollar). Directors will also note that the weakening of the balance of payments current position in 1997 forecast by the staff mirrors a forecast increase in investment.

As to the capital side of the balance of payments, my authorities remain keenly aware of the potential consequences of undue external indebtedness. Directors will be pleased to learn that, apart from a contracted sum of Bz$3 million to complete projects set in train some time ago, all borrowing included in this year's budget will be on concessional terms.

My authorities remain committed to consolidating the public finances. They have not only strengthened the surplus on current account within the nonfinancial public sector through 1996 (as is clear from the staff report) but, in addition, achieved an outturn on the overall balance better then budgeted for a second successive year. They anticipate a similar outcome this year, as will be clear from remarks below.

Recent public sector pay developments could prompt concerns about expenditure containment. Certainly, as accurately reported by the staff, increases in civil service pay were conceded last winter. These, however, should be judged by their ultimate impact. As Table 3 of the staff report makes clear, notwithstanding the adjustments conceded, the public sector wage bill in 1997/98 will be more than one percentage point of GDP below its 1995/96 level. And, with steps being taken to apply the merit award more stringently than hitherto (new Public Service Regulations have been promulgated) the odds are that the wage bill will emerge somewhat below budget. In addition, negotiations are proceeding with the U.K. government to finalize a Financial Management Reform Project (FMRP) which, it is hoped, will begin this year.

The FMRP is focused, inter alia, on strengthening management ability to squeeze maximum efficiency and effectiveness from public spending.

Progress is also being made on the revenue side. Directors will be aware already that value-added tax was introduced last year in company with reductions in import duties under CARICOM. Measures have been taken to significantly limit the scope of exemptions from direct taxes granted to promote economic development, as noted in the staff report. In addition, my authorities are now close to concluding negotiations to employ a Pre-Shipping Inspection company in order to improve the valuation of imports for customs purposes, a step which will also free customs staff to concentrate on other enforcement activities. Estimates of potential yield have been refined as these discussions advanced, and my authorities are now confident that this measure will raise import and value-added tax revenue by close to ½ of 1 percent of GDP above the budget expectation. Further, the FMRP to which I have already referred also has a revenue dimension. One element of this is direct assistance with assessment of company tax liabilities, a step which is anticipated to boost company tax receipts by the order of 0.1 percent of GDP above the budgeted amount. Looking further ahead, the scope of the FMRP extends to questions of fiscal incentives.

Public capital spending is planned to increase significantly, primarily to further develop the infrastructure essential for business expansion. While it naturally involves an increase in domestic (counterpart) funding, this higher developmental spending essentially reflects higher (grant) financing commitments by international donors, for which my authorities are extremely grateful.

On exchange and monetary policy, my authorities stress their absolute commitment to the current BZ$/$ exchange rate. Apart from its importance as a nominal anchor, my authorities see the continuance of the longstanding 2:1 relationship as crucial to investment confidence and, thus, to the future prospects of the economy.

At end-April, reserves remained at two months' import cover. The revenue developments to which I have referred promise to reduce the public sector financing requirement closer to 2 percent of GDP this year, with a related impact on the balance of payments and, thereby, on the evolution of the reserves. Nonetheless, in the event that international reserves threaten to fall below an acceptable level, the commitment to the current rate of exchange is such that my authorities will not hesitate to increase the minimum reserve requirement in order to preserve that rate—despite the effect on the cost of credit to the private sector. As indicated in the staff report, however, the full domestic financing requirement of central government will be met by drawing down a further tranche from the deposit at the central bank of last year's exceptional overseas loan. As in 1996, central government operations will involve no borrowing from commercial banks.

I emphasized last year that the public capital program, concentrating as it does on building the necessary infrastructure for tourism, agri-, and other business expansion, is perhaps the key developmental effort under way in

Belize. It will be complemented this year with another round of tariff reductions in accordance with CARICOM commitments. While this will impose further competitive pressure on domestic producers they, with the benefit of an improving infrastructure, are proving equal to the task.

Taking a longer-term perspective, work on the Belize-Mexico electricity interconnect or will begin this year, ultimately providing both greater security of, and more competitive, energy supply. And the proposed FMRP, by providing for better financial control, more cogent management information and so on, will also lay a foundation for future commercialization—and potential privatization—of appropriate government activities.

Finally, I would like to add two brief comments. First, colleagues will be aware from the last report on delayed completion of Article IV consultations that the Board's discussion of Belize, which was originally planned by the staff for mid-March 1997, was postponed at my request. The planned date, unfortunately, coincided with my scheduled absence in Ireland in connection with the staff mission on the Irish 1997 Article IV consultations and for that reason, I sought an alternative date. April 1997 was not possible because of the usual pre-Interim press of business on the Board. In sum, the delay in bringing Belize to the Board was not attributable either to any request on my Belizean authorities' part or to any delay on the staff mission part.

Second, colleagues will be aware that this is the first Board Article IV discussion since our decision of April 24, 1997 to issue Press Information Notices (PIN)—assuming written consent from, or on behalf of, the country concerned. I am pleased to report that my Belizean authorities have already conveyed to me their agreement in principle to the issuance of a PIN after today's discussion. As the Belize PIN will be a first, my authorities have no precedent to examine, and you will also realize that the ordinary "background" element which is to be included in the PIN was not incorporated on this occasion in the staff report—for the obvious reason that the Belize staff report had been issued before our decision on pins was taken. For these reasons, unsurprisingly, my authorities wish to see the proposed text before giving final clearance. They will, of course, give the draft their immediate attention when it becomes available. In sum, my Belizean authorities are favorably disposed to this new initiative on transparency, but wish to see the draft PIN, as they have no precedents by reference to which they could make an advance judgment about clearance.

The Acting Chairman thanked Mr. O'Loghlin for his clarification and expressed his appreciation for the Belizean authorities' positive attitude toward the publication of a PIN.

Mr. Shields made the following statement:

First, on the PIN, I am pleased that the Belize authorities are taking a positive view. I certainly hope this exercise will work well and I am glad that Belize will be in a position to start it off.

On the delay, I welcome, and consider reasonable, Mr. O'Loghlin's comments on the matter. But I wonder t if we had had the Board meeting in March 1997, then there would have been a problem over the budget timing. It has now been a few months since then; the staff could presented the Board a written supplement updating the staff report, rather than the brief oral update delivered at the beginning of the meeting. Indeed, the staff report was actually issued toward the end of April when the budget proposals were known.

On the outlook for Belize, we are presented with two rather different assessments this morning. Mr. O'Loghlin's statement on behalf of his Belize authorities presents a rather optimistic view. He stresses the fact that growth continued last year. There was a buildup in reserves, and that there have been measures to tighten budgetary management. On the other hand, the staff paper accentuates a rather different aspect. The staff report was thorough and candid, quite rightly stressed that the progress in Belize has actually been limited. There was some advance in terms of fiscal measures, but then backsliding on that front. The competitive position of Belize is far from secure. And the time that has been bought by the large concessional loan from Taiwan POC has not actually been used sensibly or consistently.

The key message from the staff report is that there has to be a further significant strengthening in the fiscal position. From the comments this morning, it is clear that the latest budget has not done that. Strengthening the fiscal effort will need more measures, both on the revenue and the spending sides. Without this, as the medium-term scenarios clearly show, the international reserves position will again become very vulnerable. This will make it difficult to maintain the exchange rate peg, which I think is a critical component of the way that the economic framework of Belize has been regulated. Just because there is not any pressure on the external side now does not mean to say that there are not problems around the corner. The economy clearly remains very vulnerable to external shocks.

As noted in the staff appraisal, the strengthening that has been announced in the current administration and the reduction on the capital side will not be sufficient to eliminate the need for additional financing in the current financial year. It is also correct to emphasize that drawing down on the credit from Taiwan POC is only a temporary solution. I assume that there is not going to be any further credit, so in order to avoid sliding back to the precipice from which the loan rescued Belize, there is going to have to be determined action.

On the exchange rate peg, which is a vital component of the economic framework of Belize, I do find it worrying that at a time when the dollar against which the peg is maintained is strong, nevertheless there has been a rise in the inflation rate in Belize. It may recently have come down a bit, but there are difficult implications for Belize's competitiveness, and particularly on the tourist side. I would urge against complacency on this front, for instance by attributing last year's drop off in tourism just to the effect of the Olympic Games.

There may also be in Belize a potentially severe unemployment problem. Although at the moment we have simultaneously high unemployment and labor shortages, which suggests that the major problems at the moment are the result of labor market rigidities, I think in the future because of this competitiveness worry the issue is going to have to be addressed both by tighter economic policies and by structural change, and it is particularly regrettable that the increase last year in civil service salaries not only put an additional strain on public spending, but also set a bad lead for the private sector.

In the event that there are additional pressures on the reserves, Mr. O'Loghlin has indicated that the authorities would increase reserve requirements, but, again, this is just a temporary measure, and clearly one which will have additional adverse effects on investment, and the private sector more generally.

From these considerations, I still think it is difficult to avoid the conclusion that the Fund will once again have to consider financially supporting a reform program. As we said in the past, this would help maintain more consistency than the government has achieved over the last two years. It clearly would be a difficult thing for the government to address, particularly with elections coming next year. But I would urge them not to lose sight of the consideration that external constraints do sometimes make it easier to implement unpopular reforms. The problems and vulnerabilities that beset Belize are unlikely to go away without the authorities' eventually taking again some difficult decisions.

In this context, I can confirm that, as Mr. O'Loghlin says in his statement, the new U.K. Department for International Development is considering providing technical assistance in support of a financial management reform program. The objective of this two-year project will be to strengthen the government's capacity for sound financial management, and thereby improve the chances of putting the public finances on a sustainable footing. I think the government will maximize its chances of access both to this and other similar assistance if it demonstrates its sustained commitment to making real progress on the fiscal front.

Mrs. Coronel made the following statement:

During the period 1992–94, Belize's economy showed significant deficits both in the nonfinancial public sector operations and in the external current account position. The authorities adopted actions to correct such imbalances and they reduced them to more manageable levels in 1995 and 1996. Among these measures, the introduction of the value-added tax and the reduction of the civil service were very helpful to enhance public revenues while reducing current expenditure. Nonetheless, 1996 was a difficult year for Belize. Inflation picked up and private savings, which have been gradually falling during the last three years, further deteriorated. The challenge for the authorities now is to strengthen credibility of the economic program and set the basis for sustainable growth. An immediate need toward that end is to rebuild international reserves which are at an uncomfortably low level, and thus represents a risk for the maintenance of the exchange rate peg, particularly given the vulnerability of the economy to external shocks.

Fiscal consolidation is, of course, the needed path to achieve those targets. In this context, we encourage the authorities to undertake the policy measures recommended by the staff to reinforce tax policy, improve tax administration, and limit the wage bill. The staff paper tells us that in the absence of those measures, a significant deterioration of the public finances would occur, with negative consequences on other sectors of the economy.

We share the staff's view that over reliance on monetary policy would adversely affect credibility and limit private sector growth. With a minimum liquidity requirement currently at 26 percent, the further increase does not seem to be warranted. That does not mean, however, that monetary policy should not be tight. We wonder whether a move toward the use of open market operations would be a more efficient alternative in terms of monetary control, obviously if supported by the needed corrective fiscal actions.

The paper does not say much about Belize's privatization plans in the period ahead. I wonder if the staff could elaborate a little bit on this subject, as well as on other projects in the area of structural reforms.

Mr. Leijdekker made the following statement:

It was reassuring to read in Mr. O'Loghlin's statement that the authorities remain absolutely committed to the fixed exchange rate with the U.S. dollar. At the same time, the staff report clearly shows that the convertibility of the Belize dollar is no longer guaranteed. Belize has an imminent balance of payments problem, and the latest news on fiscal policies does not bode well for the future. I understand that tightening of fiscal policies is unpopular, given the fact that the ruling party lost in the municipal elections in March and is facing general elections next year. But it is also clear that borrowing from abroad, foreign exchange rationing and further monetary tightening can not preserve the peg indefinitely. With this in mind, I would like to make two forward-looking comments.

First, current problems stem to a considerable extent from the wage increases that were granted in 1992. I understand that the next negotiation round is starting somewhere in the course of next year, or might have started already. A strong signal from the Fund to contain (if not freeze) wages could be helpful. Possibly, a study comparing civil servant wages with those paid by the private sector could provide additional arguments.

Second, a Fund-supported program could be useful in Belize. In fact, I understood that the authorities were seriously contemplating Fund assistance last year. I presume that the windfall of the concessional loan has pushed the issue to the background. As it stands however, the loan seems to be used to postpone adjustment rather than facilitate it. Certainly after the elections, the possibility of a Fund program deserves serious consideration.

The staff representative from the Western Hemisphere Department noted that, with respect to the budget for 1997/98, approved in April 1997, some, but not all, of the measures recommended by the staff during the mission had been incorporated. The staff had been in contact with the authorities, and it was agreed that the staff projections as stated in the passive scenario in the staff report remained essentially valid. It would have been difficult to present a supplement on the recent budget because of time considerations, as figures presented in the budget required certain adjustments to be compatible with those in the staff report. In particular, the capital budget was a "shopping list"of projects and lacked an appropriate, careful assessment of the country's investment requirements, the resources available to finance public sector investment, and the existing bottlenecks in project implementation. As an example, the 1996/97 capital budget was equivalent to about 11 percent of GDP, compared with an outturn close to 6 percent of GDP.

The unemployment problem in Belize could be characterized as a mismatch between the demand and supply of skills, the staff representative continued. The labor shortage in some productive sectors was accompanied by a high level of unemployment in other sectors. The problem had arisen because the labor market was not homogenous; labor mobility was limited, and the population was concentrated in some urban areas where wages were higher. The latter reflected in part the fast increase in public sector wages. In particular, the agricultural sector had been affected, as workers preferred to remain in urban areas and those in the rural area lacked the needed skills; thus, much of the agricultural labor was made up of laborers from neighboring El Salvador and Honduras, where wages were lower than in Belize. In order to increase the supply of skilled workers, the government had continued to implement a liberal immigration policy and was working on a program of human development, including training.

The labor market problem was related to the other question regarding the competitiveness in Belize, the staff representative noted. The authorities were committed to the fixed exchange rate system and, in that context, the staff had stressed to the authorities that permanent, favorable changes in external competitiveness could only occur as a result of fiscal and wage restraint and successful structural reforms.

The authorities had not requested Fund support for an economic program because of domestic political considerations, the staff representative explained. On the one hand, officials at the Ministry of Finance did not believe that there was an immediate balance of payments need that would justify such support. On the other hand, central bank officials shared the staff view that continued growth in aggregate demand sooner, rather than later, would exert pressure on the balance of payments. All in all, the authorities would prefer to confront the eventual imbalances without assistance from the Fund, but the staff believed that the authorities would not be opposed to a Fund-supported program if the need arose. In that regard, the staff had indicated to the authorities that, if requested, the staff stood ready to assist the authorities.

Since the beginning of 1990, the Belizean authorities had aimed at increasing the role of the private sector in the economy, the staff representative remarked. In 1991, the Banana Control Board had been privatized; in 1992, the privatization of the telecommunications company had been completed, and in 1993, the electricity company had been partially privatized. Currently, 51 percent of the equity of the electricity company was in the hands of the government, and 49 percent was divided equally between the private sector and the social security scheme. Authorities would reevaluate that position in the future and perhaps they would further privatize that public enterprise. While at present there were no plans to privatize the water company, other pubic enterprises, or the social security scheme, the authorities were considering whether to privatize some services at the port authority.

With respect to structural measures, the government was emphasizing trade reform under the CARICOM scheme and continuing the liberal immigration policy, the staff representative noted. With respect to the latter, the authorities were beginning to realize that implementation of such a policy was creating pressures on certain basic services, such as health and education.

The authorities were also aiming to strengthen banking regulation and supervision, following a new law implemented in January 1996, the staff representative said. The law—based on the Basle norms—would be kept under review, ensuring compliance with international standards for supervision and regulation.

The reform of the public sector was being assisted by the U.K. Overseas Development Agency, the staff representative confirmed. In addition, a financial management reform project—also financed with resources from the U.K. Overseas Development Agency—sought to improve the public sector management with the first stage aiming to improve the budgetary process. Other areas under that project included improving tax administration, particularly of the corporate income tax. Over the long run, the authorities would like to concentrate on the water company to improve its financial position for its divestment.

Mr. Loevinger made the following statement:

> I thought Mr. Arbulu's comments raised two interesting points. First, more needs to be done, not only on the extent of fiscal consolidation, but more must be done to improve the composition of fiscal consolidation. It is troubling to hear how much public infrastructure spending has fallen. That concern did not make it into the staff appraisal, and we hope that something noting this troubling drop can make it into the Press Information Notice.
>
> Second, this was also alluded to by Mr. Shields. It seems, in Belize's case, as if we have a situation where there is a potential balance of payments problem. What staff is trying to do with their advice is to prevent the balance of payments problem from occurring, and thus prevent the need for a Fund program. And it seems to a large extent that the authorities are not taking the staff's advice. It would be interesting to hear from Policy Development and Review what is the policy regarding access under Fund programs for countries that have not been taking the Fund's advice on how to prevent the need for a Fund program in the first place. If countries know that the Fund will always be there to fill financing gaps, irrespective of whether or not they had previously followed the Fund's advice, it may cause countries to follow riskier policies.

The staff representative from the Policy Development and Review Department said that, usually, countries facing imbalances would be encouraged to approach the Fund for assistance as soon as possible, so as to minimize the severity of corrective actions. Such an approach had been followed in the case of Belize. Regarding financing access levels, in general, they would depend on the ambitiousness of the authorities' proposed policies and the balance of payments needs, although it was recognized that at times, as in the case of Belize, those needs might be repressed. An instructive example was the case of CFA franc zone countries, in which fiscal imbalances had widened significantly before the had approached the Fund for assistance In those cases, the Fund had analyzed the strength of the proposed reform program and the fiscal adjustment that needed to be made, and it had tailored access commensurate with those actions.

Mr. Loevinger considered that more needed to be done to convince the authorities to adopt the Fund's recommendations as a way of avoiding the need for a Fund-supported program in the future.

Mr. Alemán made the following statement:

> I will submit my full statement for the records. I want to ask the staff for some comments on what possible actions could be taken in order to maintain Belize's competitiveness, especially in the tourism activity, and also some comments on the removal of import licenses that are still required for 26 items. We wish the authorities every success in the future.

The staff representative from the Western Hemisphere Department pointed out that the staff recommendations had been clear. A permanent favorable change in external competitiveness would come only as a result of fiscal and wage restraint. Restrictive credit policy or external financing would only give a "breathing space"while fiscal adjustment was implemented, but monetary policy in Belize was already overburdened and the staff did not foresee another extraordinary credit, such as the one from Taiwan in 1996.

Currently, there were 26 items subject to import licenses in Belize, the staff representative continued. In 1995 the authorities had devised a timetable to phase out the requirement on six of those items by mid-1996. Import licenses for other items—mostly consumer products—were to be phased out in 1997, and on a small amount of products—essentially related to the agricultural sector—were to be phased out in 1998. However, because of the balance of payments considerations, the authorities had decided to postpone implementation of the phasing-out of import licenses. No new timetable had been approved, but the authorities intended to review their position in the next few months.

Ms. Pinzani made the following statement:

> The Belize economy is currently under the threat of multiple risks. Looking at these risks the staff advice to further tighten fiscal policy has to be supported. For a small, open economy it is indeed essential to be equipped to face the changes in the external environment. The experience of the mid-1980s and early 1990s proves that Belize is capable of grasping all the benefits of a favorable external environment, therefore, I am confident in its ability to prevent any disadvantage coming from an opposite situation.
>
> We acknowledge Belize's authorities' awareness of the need for fiscal adjustment, however, I will attempt to give a list of the risks I mentioned before, in order to further enhance this recognition.
>
> As a member of the CARICOM, Belize is bound to phase in a reduction of tariff and to phase out existing import licences. The potential

adverse effects of this process on the budget should be compensated by enlarging the basis of the newly introduced value-added tax.

The WTO ruling against the EU preferential treatment granted to banana imports from Belize poses serious limits on the country's medium-term exports capacity, unless adequate resources are found to improve export diversification and traditional product competitiveness.

The new legislation providing for the reduction of tax exemptions may not be sufficient to guarantee that the WTO will not require a further phasing out of tax holidays. Furthermore, any delay in addressing the problem of substituting market incentives for fiscal incentives in a broad range of economic activities may result in a disordered high level of divestment in the future.

In a not very competitive banking sector the increase in the banks' lending rates (certainly reflecting higher liquidity requirements) enlarges the risk of adverse selection and leaves domestic banks with the weaker borrowers. In addition, the introduction of international standards of prudential requirement may put pressure on the four commercial banks in need of more capital, and, therefore, increase their propensity to risk. This, in turn, may pose competitive pressures on the numerous credit unions that are, dangerously, still not subject to prudential requirements.

The rationing in the central bank's sale of foreign exchange, by boosting the risk of undue delays in payments for international transactions, diminishes foreign operators' confidence and jeopardizes the maintenance of one of the most important sources of projects financing for the country.

I hope the Belize authorities will correctly weigh the costs related to these risks against the ones they appear to foresee in a significant strengthening of fiscal adjustment.

Mr. O'Loghlin made the following concluding statement:

I want to thank Directors for the interest they have taken in Belize, for the effort they have put into reviewing its situation, and for their comments—which I will carefully convey to my authorities. I also wish to respond to a few specific points made by Directors, on which I hope that I can offer some useful clarification.

There has been reference to "backsliding." This feeling was prompted, I suspect, by the negotiation of pay changes late last year—despite the call by Directors at the last Belize discussion for a continued tight wages policy. In this context perhaps I should review the outcome of those negotiations. The "bottom line" is that over the three fiscal years 1995/96 to 1997/98, effective civil service pay rates will have risen by a cumulative 5 percent. In addition, to use Fund terminology, there will have been a "comparatio" increase of up to 3 percent. And the package also provides that pay rates will increase in 1998/99 by 2 percent—keeping the cumulative change to pay rates over four years to 7 percent. The changes negotiated were no "giveaway." I imagine that most of the governments represented around this table would regard an outcome of this kind over a four-year period in their own countries as a very considerable success.

Colleagues, rightly, have attached great importance to the fiscal outlook given its intimate connection with prospects for reserves, exchange rate stability and economic growth itself. In this context I would like to expand on the comments in my statement about the two revenue initiatives that are now in the final stages of negotiations—Pre-Shipping Inspections and expert U.K. help with assessment of liability to some direct taxes. I took particular care, in recent days, to discuss what these two initiatives may deliver on full implementation. The expectation of the U.K. representatives working with the Belizean Ministry of Finance is that these two initiatives, when fully in operation, should raise the combined yield of import, value-added tax, income and corporation taxes up by as much as 2¼ percent of GDP above this year's budgeted level.

Mr. Alemán touched on the lack of a firm timetable for removing quantitative import restrictions. I can understand this concern and want to confirm that my authorities remain intent on freeing-up trade. The fact that Belize is making a second round of tariff reductions this year—in line with CARICOM—evidences this commitment. As to removing quantitative restrictions, the timing has to be a matter of judgment. Belizean business has already had to face up to the competitive "shock" of peso devaluation in Mexico. This year it must also respond to the competitive implications of a second round of CARICOM tariff reductions and it seems likely to be faced with further appreciation of the trade-weighted value of the Bz$ (given the peg to the dollar). It is appropriate, I would suggest, that developments like these should influence the timing of moves on quantitative restrictions.

Mr. Loevinger expressed unease with the approach to fiscal consolidation to date, because it relied so heavily on cutting public investment—a view with which I have considerable sympathy. But I have to disagree with the implication of his accompanying question to the staff whether the degree of Fund financial support to a member should be affected if that member had a record of ignoring Fund advice. Belize does not ignore Fund advice. The record is there to show this. Indeed, there is some apparent contradiction between Mr. Loevinger's two points, the first of which—paraphrased—is that he is not entirely happy about how Belize *did* implement Fund advice to consolidate its fiscal balance.

In conclusion, may I again assure colleagues that I will faithfully report their views to my Belizean authorities

Mr. Loevinger said that he did not see a contradiction in his statement; he considered that the appropriate policy advice should be further fiscal consolidation and that public investment needed to be safeguarded.

Mr. O'Loghlin responded that, if Mr. Loevinger had intended to convey that Belize, rather than completely ignoring the Fund advice, had acted on that advice, but not to the degree that he would have wished, then he would withdraw his comment.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They observed that the fiscal measures adopted by the authorities in 1995/96, particularly the retrenchment of a significant part of the civil service, had been important steps toward correcting Belize's fiscal imbalance. However, fiscal imbalances and domestic financing requirements remained large. Such imbalances, with already limited external reserves, risked undermining exchange rate stability and prospects for sustainable growth. Directors emphasized that extraordinary external financing, such as the credit from Taiwan Province of China, could only provide temporary relief and could not be a substitute for fiscal measures to redress Belize's macroeconomic imbalances on a sustainable basis.

Accordingly, Directors viewed a further strengthening of fiscal consolidation as the priority in the period ahead. They urged the authorities to reduce the imbalance by implementing additional fiscal measures, in particular broadening the tax base, curtailing exemptions, and improving procedures for customs valuation. They also welcomed the steps taken to strengthen tax enforcement. On the expenditure side, Directors urged a more prudent public sector wage policy and, in that context, noted the contribution that the new Public Service Regulations could make in regard to merit awards. They also encouraged the authorities to finalize the Financial Management Reform Project to strengthen public management. It was also noted that the composition of fiscal consolidation should be improved, in particular by according a higher priority in future to public investment in basic social services and infrastructure.

Directors commended the authorities for reducing customs tariffs by implementing the first two stages of the CARICOM agreement. They urged the authorities to eliminate promptly existing quantitative import restrictions. Directors welcomed the introduction of measures to strengthen banking supervision and prudential regulations.

Directors were of the view that the sustainability of the exchange rate peg depended crucially on the strengthening of the fiscal position, and on wage restraint. In addition, Directors observed that, while credit tightening could help in protecting Belize's international reserves position, it could not substitute for the needed fiscal adjustment.

A few Directors urged the authorities to develop an adjustment program that could be supported by the Fund.

It is expected that the next Article IV consultation with Belize will be held on the standard 12-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/97/47 (5/9/97) and EBM/97/48 (5/12/97).

2. BELIZE—1997 ARTICLE IV CONSULTATION—POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance Over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board decides that the period for completing the next Article IV consultation with Belize shall be until May 12, 1997. (EBD/97/49, 5/2/97)

Decision No. 11499-(97/48), adopted
May 7, 1997

3. MALTA—1997 ARTICLE IV CONSULTATION—POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance Over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board decides that the period for completing the next Article IV consultation with Malta shall be until May 23, 1997. (EBD/97/49, 5/2/97)

Decision No. 11500-(97/48), adopted
May 7, 1997

4. UKRAINE—ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that, with effect from September 24, 1996, Ukraine has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/97/50, 5/5/97)

Decision No. 11501-(97/48), adopted
May 8, 1997

5. UKRAINE—EXCHANGE RESTRICTION—EXTENSION OF APPROVAL

Ukraine imposes an exchange restriction, subject to approval under Article VIII, Section 2(a), arising from the rules governing the operation of hryvnia and foreign exchange settlement and deposit accounts of nonresident individuals. In view of the circumstances of Ukraine, the Fund approves the retention of this measure until May 31, 1997. (EBD/97/50, 5/5/97)

Decision No. 11502-(97/48), adopted
May 8, 1997

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 95/88, 95/105, 96/58, and 96/76 are approved.

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/97/68 (5/6/97), by an Advisor to Executive Director as set forth in EBAM/97/67, Supplement 1 (5/8/97), and by an Assistant to Executive Director as set forth in EBAM/97/69 (5/6/97) is approved.

APPROVAL: March 18, 1998

REINHARD H. MUNZBERG
Secretary