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External Debt and Adjustment: The case of Belize 1980-1986

INTRODUCTION

Belize is a typical Caribbean economy in so far as it is open, dependent and vulnerable to exogenous shocks. The economy was founded on timber but later moved into citrus and then sugar. The latter is still the major means of support, representing 60 per cent of value-added in the primary sector and 50 per cent in the secondary sector. Of total export earnings, sugar's share is about 60 per cent. The bulk of sugar produced is exported to guaranteed markets in the United Kingdom and the United States with the balance (increasingly a significant portion) being sold on the world market. Other major commodities exported include citrus, bananas, garments, vegetables and marine produce.

The structural deficiencies present in most Caribbean economies are also very much a part of Belize. These include high levels of under and unemployment; the production of a few primary commodities; a weak manufacturing sector; an undeveloped financial market; low levels of income, savings, and investment; a shortage of capital; production for exports and consumption of imports. This last feature explains in part the existence of the vibrant distributive sector which is mainly based on imported goods. There is thus little internal dynamism – the economy being very dependent on foreign trade to generate activity.

As one would expect, the performance of the economy is closely tied to sugar with booming prices generating high export earnings and government revenues and periods of recession reflecting low export earnings and government revenues. Fluctuations in the world price of sugar – which

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are not easy to predict – still have a dominant influence on export earnings and tend to jeopardize even the most carefully devised plans for achieving orderly growth.

Like most developing economies, Belize was adversely affected by the impact of worldwide recession, high interest rates and high levels of inflation. Characterizing the economy at various points in time during the review period were inflationary pressures, a relatively low rate of growth due to poor performance of its main industry, the widening of the trade gap, increased deficits on the government's budget and declining foreign exchange reserves.

1980-1983: RECESSIONARY YEARS

During the period 1980-1983, the Belizean economy recorded a consistent decline in the rate of growth of Gross Domestic Product (GDP), reaching a low point of negative 2.0 per cent in 1983 (Table 1). This was depicted in the increasing overall deficit of the nonfinancial public sector which doubled from 4 per cent of GDP in financial year 1980-1981 to 8 per cent of GDP in financial year 1983-1984. The balance of public sector current operations also changed from a surplus of 4½ per cent of GDP to a deficit of 2 per cent of GDP during the same period. The above situation reflected the increasing financing requirements of the public sector which were satisfied by a multiplicity of local and foreign sources. On the external trade front, the economy experienced a serious deterioration in the terms of trade, particularly in 1982 (Table 1). Combined with an expansion of credit since 1979,[1] this resulted in an estimated $22.1 million loss in foreign reserves by the end of 1982.

Other factors also contributed to the development of the financial crisis, including the practice of the domestic banks of denominating domestic debts to the Government in foreign currency and linking servicing to export proceeds.

During the years 1981-1983 new sources of foreign capital to finance the fiscal deficit were tapped. In 1981, the Golden Handshake, a grant/loan from Great Britain equivalent to some $12.0 million sterling was approved. Along with the increasing flow of suppliers credit, this helped to provide much needed foreign currency until the end of 1982 when BZ$9.2 million was received under the Caribbean Basin Initiative as balance of payments support. By mid-1983, some BZ$7.6 million was received from the IMF under the Compensatory Financing Facility (CFF) following the export shortfall experienced in 1982, but the money was quickly dissipated – the new credit being essentially used to finance capital projects in the Energy and Agricultural sectors, for balance of payments support, as well as increases in wages, pensions and subsidies.

A significant portion of the deficits during that period originated from the public sector. Public sector entities like the Belize Electricity Board (BEB) and the Belize Telecommunications Authority (BTA) contracted high-cost suppliers credit. As it turned out, they were unable to service the debt. This points to the great importance of carefully screening project proposals to establish their viability and not be tempted by the ready availability of suppliers credit. It is essential that a developing country and a borrower always try to maintain a high credit standing in the international community if its plans to finance much needed growth over the medium – to long-term should not be derailed by problems associated with servicing ill-advised debt, particularly on commercial terms. The problems get needlessly complex when commercial debt of the type mentioned is contracted by different public sector agencies without a coordinated and carefully considered borrowing programme for the whole of the public sector over the long-term.

The untenable situation was reflected in a decline in net international reserves to a low of negative US$12.5 million and a build-up in external payments arrears[2] equivalent to some US$6.3 million, both at the end of 1984 (Chart A). The inflow of foreign capital was insufficient to meet the needs of the public sector and domestic banking resources were used extensively resulting in significant increases in credit especially to the public sector which grew by as much as 50 per cent in 1981 (Table 3). One major result was increased import demand and a consequential decline in the reserves position; another result was a crowding-out of private sector access to credit for consumption and investment.

The inflationary pressure created by the expansion in money supply was partially offset by the depreciating currencies of neighbouring Mexico and Guatemala, so that consumer prices did not pose serious immediate problems. But a serious balance of payments problem was evident by end 1984,[3] with the build-up in external payments arrears being one manifestation of it. The perceived country risk in lending to Belize increased accordingly.

1984-1986: THE ADJUSTMENT PERIOD

Although structural adjustment can have adverse distributional effects, the benefits associated with the economic measures that accompany restructuring substantially outweigh the costs. If the economy is to grow (especially in countries with scarce domestic resources), the argument continues, external financing is a necessity, both in the short and long run. In the short run, foreign borrowing is useful in helping the economy to cope with temporary external disequilibrium In the long run, foreign borrowing finances gross domestic investment and therefore plays a major role in development and economic growth process. To this end, it is important to match the needs for external resources to finance gross investment compatible with uses of debt for short run purposes. A justification can therefore be made for increased foreign borrowing if the funds are channelled into high yielding projects.

The authorities recognized the need for adjustment and approached the IMF for balance of payments support. A Standby Arrangement for SDR 7.125 million was agreed to at the end of 1984 with the usual recommendations for macroeconomic adjustments. The suggestions emphasized the need to use policies that would restore growth through adjustments to the structure of aggregate demand and supply while generating current account positions consistent with reduced external resource flows. The policies, implemented

to varying degrees, sought to move resources to the export sector and reduce both private and public consumption levels. The following monetary measures were effected:

- an increase on 1 November, 1984 of the cash reserve ratio by 2 percentage points from 5 per cent to 7 per cent.

Effective 28 January 1985 the following changes were made:

- an increase by 2 percentage points on the minimum lending rate from 12 per cent to 14 per cent;
- an increase by 3 percentage points on commercial banks savings and time deposits interest rates on existing minimum deposit rates; and
- an increase by 3 percentage points on Treasury Bill sales from 9.76 per cent to 12.76 per cent – subject to bank bids.

A further increase in the cash reserve ratio from 7 per cent to 9 per cent was effected 1 March 1985. Two increases of the liquid assets ratio of the commercial banks were also introduced. The first increase of 5 percentage points was effective 1 March 1985 and moved the ratio from 20 per cent to 25 per cent. The second increase was effected 1 April 1985 and increased the ratio another 5 percentage points from 25 per cent to 30 per cent.

The commercial banks were also informed that the Central Bank would consider loans to them only where it was the view of the Board that failure to approve the loans would seriously harm the banking system. The effect of these macroeconomic policies was evident in the 5.4 per cent decline in domestic credit recorded for 1985 which was followed by another decline of 4.3 per cent in 1986 (Table 3). Both private and public sectors recorded contractions in outstanding credit during these two years. Deposit growth during this period was quite impressive with real positive deposit rates being recorded. Real deposit growth (the nominal rate of growth adjusted for inflation) of 4.7 per cent and 15.4 per cent was recorded for 1985 and 1986, respectively. The expansion in deposits observed in 1985 and 1986 is explained by a combination of factors, namely, the impact of the improvement in foreign reserves following substantial inflows of capital from IMF under the Standby (BZ$15.2 million) and USAID under the Economic Stabilization Facility (BZ$24.0 million); substantial sugar receipts given improved sugar prices and the filming of a movie in early 1986 which implied an expenditure of US$5.0 million in Belize.

Policy measures also sought to increase the efficiency of the price system. Various reforms were effected which included some liberalization of trade, a restructuring of domestic prices, as well as structural changes to the financial sector, the fiscal system and public enterprises.

As far as the public sector is concerned, central government's efforts to increase the level of public sector revenue included moderate increases in the stamp tax and excise tax on goods like soft drinks, domestic beer and gasoline. A conscious effort was made to avoid significant tax increases but instead to increase tax yields by strengthening collection procedures. Austere budgets for financial years 1984-85 and 1985-86 were introduced with an obvious reduction in current expenditure in real terms (Table 4). Wages were frozen and the government consciously sought not to increase its staff. Heavy reliance was placed on expenditture control procedures introduced during financial years 1982-83 and 1983-84 for a strict implementation of the budget.

These procedures were extended to the public enterprises with the aim to manage public finances on a consolidated basis. The operations of the Belize Electricity Board (BEB) were rationalized and the purchasing policy of the Marketing Board became more cautious. A moderate wage policy for public enterprises was implemented and electricity and water rates were increased. Divesture in the banana sector also featured in the restructuring of the economy. Belize did not introduce any additional restrictions on payments and transfers for current international transactions and neither were multiple exchange practices resorted to. In fact, in order to improve efficiency, a gradual substitution of moderate tariffs for import restrictions was effected on particular

items. The items affected had been prohibited in 1982 in order to protect local industry.

STRUCTURE OF EXTERNAL DEBT

In the early part of the review period, foreign funds flowed from three main sources, namely, multilateral (Caribbean Development Bank), bilateral (Canadian International Development Agency), and suppliers credit. The financing problems existing in the early and mid-1980s saw a concomitant increase in outstanding external debt as suppliers credit grew in importance (Table 5). By 1986, however, this was reversed with concessionary loans having a larger share of total outstanding debt and suppliers credit much less than at the beginning of the review period mostly because all of these credits were repaid – in some cases before they fell due. It is important to note that where previously (in 1980) Caribbean Development Bank supplied 52 per cent of Belize's credit, by end 1986 they accounted for only 25.5 per cent. The United States government, at the beginning of the period, did not feature in a list of Belize's creditors but by the end of 1986, this bilateral source had provided some 21 per cent of outstanding foreign loans. This is illustrated in Chart B.

As far as debtors are concerned, the early 1980s was a period of significant borrowing on the part of the public sector. Expansion programmes by the Belize Electricity Board (BEB), the Belize Telecommunications Authority (BTA), the Port Authority and the Water and Sewerage Authority (WASA) figured significantly in the scheme of things. The emphasis of the government of the day was on developing infrastructure in an attempt to provide better services for the Belizean public as well as for potential foreign investors, especially those interested in producing internationally traded goods. New equipment for these projects was supplied largely through commercial and/or suppliers credit. Many of the projects proved to be costly in terms of the distributive and maintenance costs. Government met most of these costs not only because it subsidized utilities but also because it had to service most of the outstanding public sector debt.

DEBT MANAGEMENT

At the onset of the adjustment programme, the importance of a sound debt management system was recognized and, hence, the need to put a system in place that would help to monitor and manage the country's external and domestic public debt. To this end, a debt management/monitoring committee consisting of officials from the Central Bank, and the Ministries of Finance and of Economic Development was formed. The Commonwealth Secretariat was also approached to provide technical assistance, including computer software and training facilities in debt recording and management.

ASSESSMENT OF THE ADJUSTMENT PERIOD

By June 1986, the contractionary fiscal and monetary policies outlined above were in place, supported by the IMF Standby arrangement of SDR 7.125 million. At this time, both the Belizean authorities and the IMF staff were satisfied that significant adjustment had occurred. Net international reserves, which were negative in 1984, grew by US$6.6 million and US$15.9 million in 1985 and 1986, respectively. Domestic credit (net) contracted by 5.4 per cent and 4.3 per cent in both these years. The turnaround in the economy reflected increases in official and private net capital inflows (given the elimination of external payments arrears in September 1985). Official inflows in 1985 totalling some US$22.7 million originated from the Commonwealth Development Corporation (CDC), the World Bank, IMF, and United Kingdom and United States Governments. These funds were earmarked for specific sectors namely; energy, finance, insurance and multi-sector development. Private capital inflows also showed signs of increase with major expenditure on two resorts in San Pedro, of US$2.0 million; and on the establishment of two large winter vegetable complexes in the northern part of the country.

CONCLUSION

For open Caribbean economies, any serious adjustment

efforts aimed at restructuring the economy are likely to bring about an increase in the level of external debt. This is mainly due to the lack of domestic resources which characterizes these economies. However, provided that the adjustment measures are implemented in time and are adhered to; that the funds accruing from external loans are channelled into productive activities; and finally, that the debt situation is properly managed, then there should not be any problems of unsustainable levels of indebtedness.

As indicated in this paper, Belize illustrates the above proposition. The period of adjustment did indeed lead to an increase in outstanding debt mainly because of the IMF Standby of SDR 7.125 million and the USAID Economic Stabilization Facility of US$14.0 million. However, an assessment of the 'success' of the stabilization policies should be approached carefully as it is difficult to attribute the results between the macroeconomic policies implemented and the exogenous factors from which Belize benefitted during that same period. Yet, it is evident that without the adjustment measures the situation would have continued to deteriorate.

In the medium – and long-term, the adjustment efforts will need to be consolidated by the further development of the export-oriented Agricultural sector and the strengthening of other service industries such as Tourism. This is recognized in the Public Sector Investment Programme (PSIP), which lays emphasis on:

1. the development of physical and administrative infrastructure;
2. the improvement of productivity, profitability and foreign exchange earning capacity of agriculture;
3. the development of skills training; and
4. the diversification of the economy into tourism.

The creation of a project monitoring and implementation unit within the Ministry of Economic Planning and Development with a view to channelling new investment into the income generating sectors and the setting up of the debt management committee mentioned above, should provide the necessary policy and institutional framework to channel new investment into the income-generating sectors of the economy and ensure the optimum use of foreign financial resources.

Economic adjustment is thus an ongoing process, bringing together short-term stabilization measures and longer-term macroeconomic policies in a common effort to set the foundation for balance and self-sustained growth in an environment which is sometimes difficult, for smaller economies like Belize, to control. Given the international distribution of resources, part of the adjustment process has to rely on the contribution of external financial resources – hence the link that will always exist between adjustment and external debt.

FOOTNOTES

[1] This was caused by an increased inflow of insurance funds consequent to hurricane Greta in 1978.

[2] At least one loan had to be rescheduled.

[3] The current account deficit registered negative US$13.0 million and the fiscal deficit was 6.1 per cent of Gross National Product by the end of 1984.

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TABLE 1. BELIZE: SELECTED ECONOMIC INDICATORS

1980-1986

	1980	1981	1982	1983	1984	1985	1986
Growth of GDP (%) 1/		2.5	1.9	-2.0	4.1	2.5	1.6
Current Account Balance (US$M)	-10.5	-4.7	-17.4	-12.4	-13.0	-8.5	3.4
Growth of Export Value (%)	+34.9	-8.9	-20.0	9.0	11.8	-11.6	15.6
Growth of Import Value (%)	+18.9	-2.7	-9.9	-0.9	+6.0	-5.3	+2.8
Debt Service/Exports (%)		2.2	4.4	5.3	5.2	16.0	11.4
Investment (% of Income)		24.1	21.7	17.7	20.5	20.9	16.3
National Savings(% of Income		21.5	11.7	10.6	13.8	16.6	18.0
Inflation (%) 2/			6.8	5.4	3.9	3.3	0.8
Terms of Trade			-23.2	5.5	13.4	-12.5	9.6
Export prices			-25.6	2.9	14.8	-11.9	4.9
Import prices			-13.1	-2.5	1.3	0.6	-4.3
of which: fuel			-1.9	-8.8	5.4	3.6	-31.0
non-fuel			-3.4	-1.1	0.4	0.0	1.6
	1980/81	81/82	82/83	83/84	84/85	85/86	86/87
Fiscal Balance 3/ (% of GNP)		-3.9	-9.1	-6.4	-6.1	-10.2	-4.7

Sources: 1. Central Bank of Belize
2. Ministry of Finance
3. Central Statistical Office
4. IMF staff estimates

1/ GDP at constant cost (1984 prices)
2/ Based on Consumer Price Indices
3/ Cash basis

TABLE 2. BELIZE: SECTORAL ORIGIN OF REAL GROSS DOMESTIC PRODUCT

(Annual percentage change in constant 1984 prices)

	1981	1982	1983	1984	1985	1986
GDP at constant factor cost	2.5	1.9	-2.0	4.1	2.5	1.6
Primary activities	-1.3	6.2	-5.9	3.0	1.8	-4.3
Agriculture	-0.2	4.8	-6.4	2.0	-1.9	-1.3
Forestry	-18.8	22.9	-19.6	9.8	-6.4	-12.7
Fishing	10.2	2.4	10.7	4.3	2.3	-15.0
Mining	0.0	0.0	0.0	0.0	0.0	0.0
Secondary Activities	-1.3	-1.4	2.5	0.1	-0.5	4.0
Manufacturing	-4.8	-0.2	6.4	-8.3	-1.0	1.9
Electricity & Water	5.7	12.3	2.0	2.1	7.3	3.8
Construction	3.5	-8.7	-5.8	19.8	-2.6	8.3
Services	5.5	1.4	-2.0	5.9	5.0	2.9
Trade & Tourism	3.6	-10.9	-12.9	7.9	9.9	1.1
Transport	17.2	16.9	-0.7	16.2	8.9	9.1
Finance	1.3	-6.0	-8.0	1.4	5.4	-0.3
Real Estate	1.7	0.1	-0.3	2.4	3.3	2.0
Public administration	11.5	17.3	9.5	3.0	-0.5	1.9
Other services	1.9	2.8	2.7	2.8	2.6	2.9
Banking charges	1.2	-6.0	-8.0	1.3	5.4	-0.3
GDP at constant market prices		0.9	-2.5	5.6	2.6	3.9

Sources: 1. Central Statistical Office
2. Ministry of Foreign Affairs and Economic Planning
3. IMF Staff estimates

TABLE 3. BELIZE: KEY MONETARY INDICATORS 1980-1986

(Annual Percentage Changes)

	1980	1981	1982	1983	1984	1985	1986
Money Supply (M2)	14.0	15.0	4.0	19.0	6.0	0.0	17.0
Money Supply (M1)	15.6	7.0	-11.0	7.6	26.6	8.6	10.2
Central Bank Gross Foreign Assets	22.1	-16.5	-4.8	-5.6	-35.0	144.6	81.1
Net International Reserves (US$M)	4.1	0.3	-7.0	-10.4	-13.5	-6.9	9.0
Domestic Credit	15.5	24.1	19.0	15.3	11.6	-5.4	-4.3
of which:							
Private Sector	8.2	16.2	19.7	8.2	8.9	-6.5	-0.4
Public Sector	46.9	50.2	17.1	33.4	17.1	-3.3	-11.4
Savings and Time deposits	13.6	20.5	13.7	24.0	-2.6	8.2	16.3

Source: Central Bank of Belize

TABLE 4. BELIZE: PUBLIC SECTOR STATISTICS 1981/82-1986/87

(Annual Percentage Changes)

	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87
Revenue and grants	5.5	1.5	-0.7	13.4	7.9	19.5
of which:						
revenue	5.9	-2.5	0.2	24.9	8.9	16.0
Total Expenditure	12.7	7.6	-1.9	0.1	3.5	11.1
Current Expenditue	18.2	9.2	7.9	0.1	3.5	11.1
Capital Expenditure	4.3	4.8	-20.1	0.2	3.5	11.1

Sources: 1. Ministry of Finance
2. IMF staff estimates

TABLE 5. BELIZE: EXTERNAL DEBT OUTSTANDING 1980-1986

(Shares of Total)

End of Period

US$M	1980	1981	1982	1983	1984	1985	1986
Amount Outstanding	49.2 (100.0)	56.5 (100.0)	63.1 (100.0)	68.4 (100.0)	73.2 (100.0)	91.1 (100.0)	97.4 (100.0)
<u>By Creditor</u>							
Multilateral	27.8 (56.5)	28.1 (49.7)	29.9 (47.4)	33.1 (48.4)	36.2 (49.5)	42.5 (46.7)	43.2 (44.3)
Bilateral	14.1 (28.7)	14.0 (24.8)	18.9 (30.0)	18.8 (27.5)	20.2 (27.6)	33.9 (37.2)	44.2 (45.4)
Suppliers credit	7.3 (14.8)	12.6 (22.3)	12.7 (20.1)	14.8 (21.6)	12.4 (16.9)	10.3 (11.3)	6.3 (6.5)
Commercial banks	- -	1.8 (3.2)	1.6 (2.5)	1.7 (2.5)	4.4 (6.0)	4.4 (4.8)	3.7 (3.8)
<u>By Debtor</u>							
Central Government	9.3 (18.9)	11.0 (19.5)	16.3 (25.8)	18.4 (26.9)	23.7 (32.4)	40.8 (44.8)	50.4 (51.7)
Non-financial public sector	32.5 (66.1)	37.7 (66.7)	38.2 (60.6)	38.8 (56.7)	32.9 (44.9)	28.6 (31.4)	24.6 (25.3)
Financial public sector	7.4 (15.0)	7.8 (13.8)	8.6 (13.6)	11.2 (16.4)	14.0 (19.1)	18.9 (20.7)	20.1 (20.6)
Private sector	- -	- -	- -	- -	2.6 (3.6)	2.8 (3.1)	2.3 (2.4)
Memorandum item: Liabilities to the Fund	-	-	-	3.8	4.7	9.2	11.7

Sources: 1. Central Bank of Belize
2. Ministry of Finance
3. Development Finance Corporation
4. IMF staff estimates

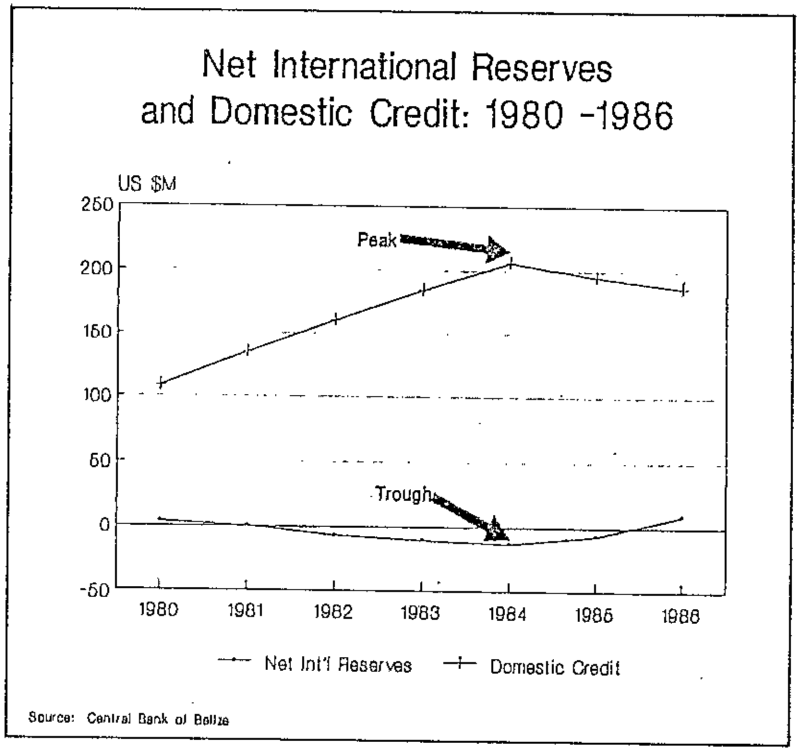
TABLE 6. BELIZE: DEBT RATIOS 1980-1986

	1980	1981	1982	1983	1984	1985	1986
Debt/GDP		31.5	36.2	30.6	37.5	46.1	45.2
Debt/Central Govt. Revenue 1/	104.0	116.5	137.5	150.3	149.4	181.1	167.6
Debt/Public Sector Revenue 2/		113.2	124.7	136.0	128.4	148.1	132.5
Debt Service Ratio 3/		2.2	4.4	5.3	5.2	16.0	11.4
Debt Service/Central Government Revenue 4/		4.8	8.6	11.1	10.2	29.2	19.5

Sources: 1. Central Bank of Belize
2. Ministry of Finance
3. Central Statistical Office
4. IMF staff estimates

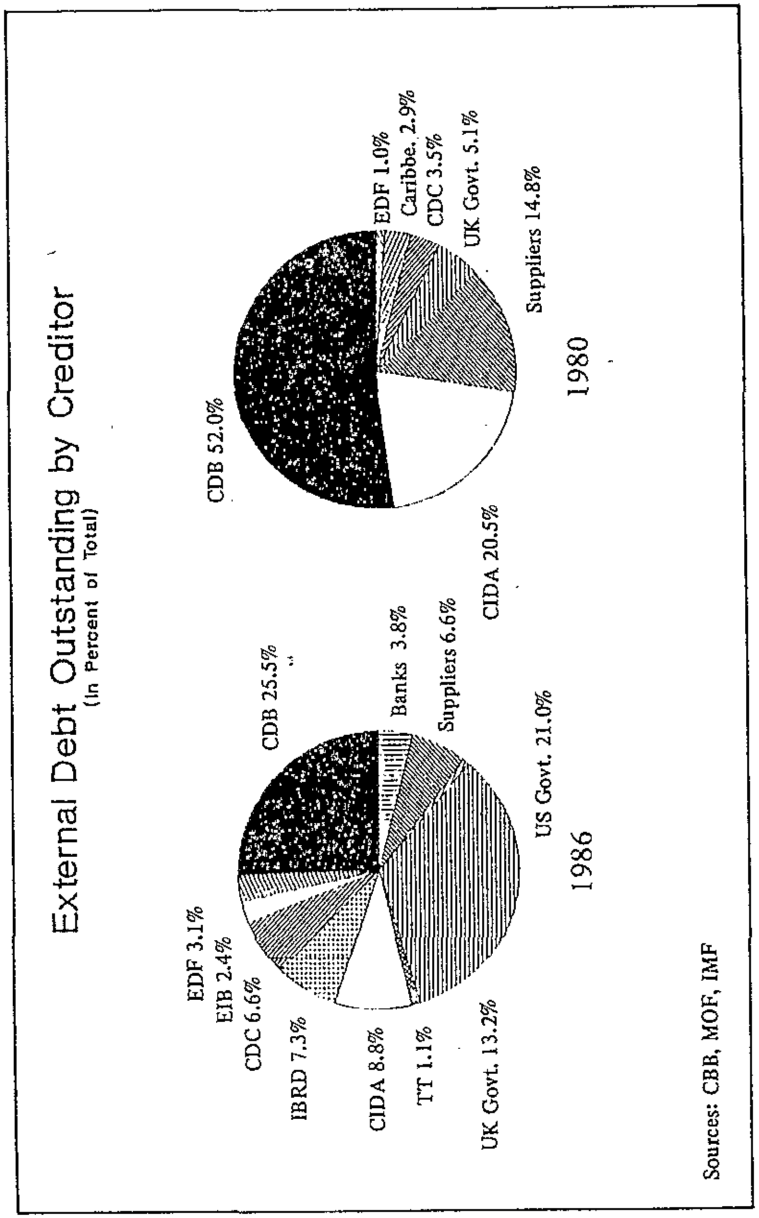
1/ Total outstanding debt as a percentage of central government revenue and grants
2/ Total outstanding debt as a percentage of public sector revenue and grants
3/ Debt servicing as a percentage of exports of goods and services
4/ Debt servicing as a percentage of central government's revenue and grants

CHART A



Source: Central Bank of Belize

CHART B



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External Debt, Capital Flight and Stabilization Policy The Experiences of Barbados, Guyana, Jamaica and Trinidad and Tobago

INTRODUCTION

This paper examines two issues. The first concerns the role played by capital flight in the growth of the external debt of the four major Caricom countries since the mid-1970s. The second concerns an evaluation of the potential effectiveness, in the Caribbean context, of the policy initiatives which are usually recommended to help curb capital flight.

Since the mid-1970s there have been significant increases in the levels of public and publicly guaranteed external debt of the four major Commonwealth Caribbean countries — Barbados, Guyana, Jamaica and Trinidad and Tobago. At the end of 1976 such debt for Barbados was insignificant, amounting to US$31 million. However, by the end of 1985 the debt stood at US$460 million. Similar debt for Guyana rose from US$296 million at the end of 1975 to US$693 million by the end of 1983. The Jamaican debt increased from US$993 million at the end of 1976 to US$3,499 million at the end of 1985. The debt for Trinidad and Tobago which amounted to US$106 million at the end of 1976 had risen to US$1,408 million at the end of 1984.

These broadly similar developments in terms of external indebtedness took place against a background of quite dissimilar developments in their respective economies. Both Guyana and Jamaica experienced protracted payments difficulties and economic stagnation during the decade of 1975 to 1985. The Barbadian economy, on the other hand, performed very well during the period from 1976 to 1980,