A DRAFT PREPARED FOR DISCUSSION

RECENT DEVELOPMENTS IN BELIZE AND THE IMPLICATIONS FOR THE EXCHANGE RATE

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The exchange rate of the Belize dollar has been receiving increased attention in the last two years, but particularly so following the drastic changes in the value of the Mexican peso this year and the resultant impact on trade relationship between the two countries. Questions related to the appropriateness of and the determinants of the rate of exchange between the Belize dollar and other currencies have been raised whilst some discussions have focused on policy options in the wake of recent economic developments.

The paper explains briefly recent developments in Mexico and Belize with the hope that the background will serve to stimulate discussion about the policy options open to Belize, particularly with respect to the rate of exchange.

RECENT DEVELOPMENTS IN MEXICO

The recession in the industrialized world spilled over into the oil market last year in the form of reduced demand for oil. The glut on the oil market and the subsequent deterioration in price resulted in an unanticipated decline in Mexico's export receipts and had devastating effects on the economy. The decline was reflected in the deficit in the current account of the Balance of Payments which widened from US$6.0 billion in 1980 to US$11.7 billion in 1981.

The shortfall that was caused by the unexpected fall in oil revenue was met by a rapid build-up in Mexico's short-term debt. Mexico's foreign debt in 1981 reached US$68.9 billion. High interest rates on the international capital market caused a threefold rise in the cost of debt servicing. Interest payments on Mexico's public and private borrowing abroad amounted to nearly US$9.0 billion in 1981 compared with US$2.0 billion in 1977.

The depreciation of major European currencies in 1980 and 1981 weakened Mexico's competitive position vis-a-vis the United States dollar. In addition, the economy was plagued with an inflation level of 28.7 percent in 1981 and which shot up to an annual rate of 45.0 percent by May 1982.

The impact of the fall in oil prices, rising foreign debt, high interest rates and high rates of inflation culminated in two major changes in the peso/dollar rate in 1982. The first major realignment of the peso came on February 12 when the peso was devalued by 30.0 percent against the United States' dollar. Several months later, in August, a second devaluation was accompanied by the closure of the foreign exchange market. A two-tier system of exchange rate was set up and for the first time, exchange controls introduced to monitor capital flows.

ECONOMIC DEVELOPMENTS IN BELIZE

The developments in Mexico in 1982 had immediate implications for Belize's trade with Mexico. Since May, 1976 the Belize dollar has been pegged to the United States' dollar at a rate of US$1.00 = BZE$2.00. The peso devaluation in terms of the U.S. dollar was automatically converted into a devaluation, of the same magnitude, vis-a-vis the Belize dollar.

Belize has a viable and fast-growing re-export trade with Mexico. Table 1 indicates that between 1976 and 1981, Mexico's share of Belize's re-exports had jumped from 76.4 percent to 91.6 percent. In those years also, total re-exports more than tripled, rising from $25.8 million in 1976 to $88.5 million by 1981. Estimates of earnings for 1982, however, project a $30.0 million decline which will return total receipts to the 1980 level.

After re-exports valued at $28.0 million in the first quarter of 1982, earnings dropped to about $14.9 million in the second quarter. Estimates for the second half of 1982, however, reduce sales to less than $15.0 million. Note that the total amount expected to be collected this year from the re-export trade is below earnings from Mexico alone in 1981.

Two factors militated against Belize's trade with Mexico, the first being the impact of the devaluation on prices expressed in pesos. A high percentage of Belize's exports to Mexico may be termed luxury or non-essential goods (liquor, electronic goods, cheeses, etc.). This means that the purchase of foreign exchange to meet these payments will most likely be at the freely floating rate of exchange which by the end of October, had dropped to US$1.00 = 110.0 pesos. Compounding this was the introduction of

TABLE 1

BELIZE'S RE-EXPORT TRADE

BZE$m.

Year	Total	MEXICO	
		Value	Percentage Shares of Total
1976	25.8	19.7	76.4
1977	35.1	22.1	63.0
1978	49.8	33.1	66.5
1979	60.3	46.9	77.8
1980	57.6	46.4	80.6
1981	88.5	81.1	91.6
1982[E]	58.9	N/A	N/A

Source: Central Planning Unit Estimates; Ministry of Finance and Economic Planning Trade Report

E : Estimates
N/A: not available

exchange controls in August. Re-exports allege that they have encountered numerous difficulties in getting their claims on Mexican importers settled. At the same time, there has been a noticeable build-up in Belize's imports from Mexico as residents of Belize take advantage of the price reduction (in terms of Belize dollars) for goods bought in Mexico.

Coming at the time it did, the peso devaluation and the subsequent impact on Belize's re-export trade added to the rapid decline in Belize's export earnings. Receipts for Belize's major export, sugar, dropped steeply in the last two years primarily due to low world prices. Whilst for exports to Europe under the Lome Convention the price of sugar rose from about $709.85 per ton in 1981 to $736.57 per ton in 1982, the price for exports to the United States, traditionally the largest purchaser, plunged from $1,090.56 per ton in 1981 to $660.46 per ton in 1982. In addition, sugar exporters have earned $327.94 per ton for 15,750 tons sold on the world market and expect to earn as little as $257.37 on a yet unsold 13,126 tons of sugar. As a result, although Belize's production recovered from 97,725 tons in 1981 to 105,980 tons in 1982, estimated gross earnings declined from $84.8 million to $62.3 million. The poor price performance of sugar is expected to continue into 1983. With the announcement by the United States' Department of Agriculture that the new quota for Belize's sugar exports had been reduced to 28,000 tons, Belize will have an estimated 30.0 percent of its exports that will have to be sold at the unprotected world market price.

Meanwhile the citrus industry has suffered a number of setbacks for the 1981/82 and 1982/83 crops. Disputes between processors and growers over revenue-sharing arrangements delayed the start of both seasons. Despite the delay in the start of the season last year, production reached 1,510 thousand boxes, slightly above the previous crop. Lower prices, on the other hand, reduced export earnings to $13.7 million comapred with approximately $16.0 million for the 1980/81 citrus crop. The prolonged dispute this year is expected to have more negative effects on production and possibly earnings in 1983 despite a projected increase in the world market price of citrus.

With sugar and citrus together contributing more than 50.0 percent of production and exports, the fortunes or misfortunes normally determine the extent of growth in the economy and the gap between earnings and payments. Output growth in the past two years has been very slow with real GDP rising by 1.0 percent in 1981 and not expected to be significantly different in 1982. On the other hand, the trade gap, after stabilizing since 1979, is expected to widen significantly this year. Whereas in 1981 receipts from the re-export trade more than compensated for the decline in domestic exports, a 31.0 percent in domestic exports together with 33.0 percent reduction in earnings from re-exports is expected to push the deficit up to $116.9 million. Whilst declining incomes have had a dampening effect on the level of imports for domestic consumption in 1982, it is doubtful whether, such declines in 1983 will be sufficiently large to offset or compensate for possible declines in export earnings in the absence of specific measures to reduce imports.

TABLE II

VISIBLE TRADE

BZE$m

Year	EXPORTS		IMPORTS	BALANCE OF TRADE
	Domestic	Re-Exports		
1976	68.2	25.8	161.1	-67.5
1977	89.0	35.1	180.1	-56.0
1978	109.8	49.8	212.9	-53.4
1979	113.2	60.3	263.7	-90.2
1980	154.6	57.6	299.5	-87.3
1981	146.5	88.5	323.9	-88.9
1982 E	100.8	58.9	276.6	-116.9

Source: Central Planning Unit Estimates; Ministry of Finance and Economic Planning, Trade Report

Financing for the trade deficits is normally provided by capital inflows mainly in the form of grants and loans to the Central Government. More recently, however, the deficits have provoked a steady drain on foreign reserves. From a peak level of $27.9 million at the end of 1980, reserves dropped to $18.6 million by September 1982. The 33.0 percent deterioration in foreign reserves was also reflected in the relationship between reserves and imports. In September this year, the level of foreign exchange was equivalent to less than four weeks imports compared with more than six weeks' imports in 1978.

The declining reserves also signalled the increasing dependency of the public sector on the domestic system to provide financing for its operations. From a share equal to less than 13.0 percent in 1976, financing provided by the domestic system to accomodate public sector programs is expected to exceed 25.0 percent by the end of 1982. The Monetary Authority became more deeply involved in lending to Government in 1981,

TABLE III

End of Period	Net Foreign Reserves (1) (Monetary Authority and Banks)	Imports Per Week (2)	Foreign Reserves/ Imports (%)
1978	27.5	4.1	6.7
1979	18.2	5.1	3.6
1980	27.9	5.7	4.9
1981	23.6	6.2	3.8
1982 Mar	21.4	5.3	4.0
June	26.4	5.3	5.0
Sept	18.6	5.3	3.5

Source: The Monetary Authority of Belize, Statistical Digest

(1) Adjusted for commercial banks' long-term foreign liabilities

(2) Calculation based on the total value of imports per year.

however, as it became increasingly difficult for the Authority to maintain external assets above the level set by the Monetary Authority of Belize Ordinance, 1976, the Government turned to the commercial banks. Liquidity shortages within the banking system have forced the banks to secure funds from their Head Offices to on-lend, not only to Government, but also to the private sector. Such loans are generally denominated in foreign currency and interest rates determined in relation to the Eurodollar rates. Normally, however, loans to the public sector are at very concessionary rates of interest as reflected in the low level of debt servicing. On average, servicing the foreign debt is below 2.0 percent of GDP.

Although no official index of prices is available, it is estimated that the rate of inflation in Belize this year is averaging 15.0 percent and in the wake of the success the industrial countries have had this year in reducing prices, the prospects are for a further reduction in Belize's rate of inflation.

TABLE IV

FINANCING PUBLIC SECTOR INVESTMENT

	1976	1977	1978	1979	1980	1981	1982*
Capital Expenditure	23.0	26.8	41.0	46.7	46.0	46.9	76.7
Central Government	19.3	19.7	20.7	27.0	26.5	37.3	–
Other Public Sector	3.7	7.1	20.3	19.7	19.5	9.6	–
Financing							
Domestic Borrowing (net)	2.9	6.0	6.1	1.5	9.3	12.9	19.2
(a) Monetary Authority	(0.8)	(2.2)	(1.3)	(5.2)	(-0.7)	(12.4)	(3.2)
(b) Rest of Financial System	(2.1)	(3.8)	(5.3)	(-4.1)	(7.7)	(0.5)	(16.0)
(c) Other	(–)	(–)	(-0.5)	(0.4)	(2.3)	(–)	(–)
External Financing (net)	13.4	18.0	25.0	32.3	26.6	30.3	53.6
Other	6.7	2.8	9.9	12.9	10.1	3.7	3.9

Source: World Bank Estimates

* In estimating net domestic borrowing, I assumed that credit to the public sector outstanding at the end of September, 1982 will remain constant.

IS THERE A CASE FOR CURRENCY ADJUSTMENT?

In the past two years there has been a persistent deterioration in Belize's foreign exchange reserves, as Belize's earnings of foreign exchange from all sources become more and more incapable of sustaining its demand for imports. One of the options opened to a country faced with what may be termed a "fundamental" disequilibrium in its balance of payments is devaluation.

The realignment of the Belize dollar in 1976 was a response to two developments. The most significant consideration was the emergence of the United States during the two preceding decades as the major trading partner. The second consideration related to Belize's membership in CARICOM. The general trend at the time was for CARICOM members to peg their currency to the U.S. dollar.

Towards the end of 1977, the United States' dollar began to weaken vis-a-vis sterling and this continued into 1981 when the restrictive monetary stance adopted by the Federal Reserve Board pushed interest rates in the United States, and subsequently, the dollar rate of exchange to unprecedented levels. Although interest rates in the United States are declining, the interest differentials in favour of the dollar have been maintained and the United States' dollar remains strong, returning to its pre-1977 rate of exchange against sterling.

The appreciation of the U.S. dollar in the last few years has resulted in the automatic revaluation of the Belize dollar against sterling. Because of the fixed relationship, however, there has been no change in the value of the currency to account for domestic price increases since 1976. Since domestic prices have risen upward, there has been a widening differential between the real and official exchange rates. A devaluation could reduce the purchasing power of the Belize dollar to a level that more closely reflects the effective rate.

Adjusting the rate of exchange of the Belize dollar vis-a-vis the United States dollar could help Belize to recover some of the loss of competitiveness vis-a-vis the peso and probably eliminate the 33.0 percent loss in re-export earnings this year due primarily to peso depreciation. The recovery, however, is largely dependent on the peso stabilizing or appreciating following the Belize dollar devaluation.

It is necessary for the effects of the devaluation to go beyond the re-export trade with Mexico and influence domestic consumption and production. A large percentage of Belize's exports is sold on guaranteed markets with prices negotiated in foreign currency. A devaluation would, therefore, have no impact on the foreign currency price of a demand for these exports. For exports sold on the world market, the devaluation must be sufficiently large to stimulate a demand for Belize's exports that will offset the loss of earnings that is projected to result from the present and future commodity price declines on the international market. Alternatively, the devaluation must be large enough to reduce Belize's demand for imports to the point where foreign exchange expenditures are at least matched by receipts from abroad.

One of the fears, however, is the impact that the change in exchange rate will have on production cost. Given the high import content of production, a devaluation, by increasing the domestic price of imports, will raise the cost of production unless, perhaps, such imports that go into major production industries are protected, for example, by subsidies and/or a dual exchange rate system.

One of the crucial things about altering the exchange rate is that it should allow the country to sustain, if not increase its level of growth whether it be through encouraging long-term investment capital to take advantage of the relatively cheaper cost of producing in Belize or whether it be through stimulating domestic production via the encouragement of import-substituting industries.

POINTS FOR DISCUSSION

The above discussion has only reached the periphery of the theory of exchange rates and the implications of devaluation. It is hoped that the framework provided will lead to the exploration of, among other things, such questions as (1) In a fixed exchange rate regime, how does one determine the appropriate percentage change in exchange rate? (2) In the circumstances, are there any gains to be had from a dual system of exchange rates? and (3) Would the usage of a trade-weighted basket of currencies to determine the exchange rate for the Belize dollar be recommended?