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BELIZE: A REVIEW OF PUBLIC EXPENDITURES

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Preface

This report examines the public spending system in Belize, with particular emphasis on social expenditures. The report takes as its point of departure the current need to streamline and downsize public spending to get public finances onto a more sustainable path, both in the short and the medium term.

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TABLE OF CONTENTS

Belize: A Review of Public Expenditures

1. Introduction

This study undertakes a broad-based evaluation of public expenditures in Belize in order to identify ways of enhancing economic and social gains from public services. It reviews the budgeting and financial management systems used to translate public finances into public services, with a focus on social services that meet the needs and demands of the people of Belize.

A budgeting system entails how the government finances and estimates its financial resources; determines its priorities and public services desired by the population; allocates resources to purchasing inputs to deliver these services; manages the receipt of funds and supplies these to its service delivery agencies; and monitors and reviews its performance. The effectiveness and efficiency of the government can be undermined by poor performance in any of these areas. In addition, the process of raising and spending resources can have macroeconomic consequences affecting the growth and stability of the economy.

While, as the study will show, budget system and budget performance issues themselves yield a large menu of potential budget reforms, recent adverse macroeconomic developments in Belize arising out of persistent government deficits and debt build up currently dominate the government's financial and budgeting options and affect the choices that can be made in reforming the budget system. Some immediate problems facing the Belize economy are outlined below.

1.1 Overview of Current Situation

Inconsistent Growth Rate
Belize has had a reasonably good, but inconsistent economic growth performance. Following a rapid growth period over 1987-1992, when the real economic growth rate averaged 9.5%, the economic growth rate has been more moderate, averaging only 3.1% over 1993-99, jumping up to 11.1% in 2000, and then remaining in and about the 3% to 4% range since then.[1] GDP is currently about BZ$2.1 billion or US$1.05 billion.

Over the entire period, Belize has maintained an exchange rate policy of B$2 to the US dollar which has required maintaining tight monetary policies to keep inflation in line with US dollar inflation rates and using fiscal policy as the major adjustment tool.

Budget Deficits
Another key feature has been relatively large and persistent government deficits, particularly since fiscal year 2000/01.[2] Over the period 2000/01-2003/04, the overall central government deficit was 9.3% of GDP. Given the limited domestic savings and thin capital markets, external borrowing had to satisfy the bulk of the borrowing

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[1] World Bank, *World Development Indicators 2004*.
[2] Fiscal year refers to April 1 through March 31.

requirement. Net external borrowing over these years by the Government averaged 12.6% of GDP.[3] External borrowings have included two large bond issues: a 10-year bond of US$125 million in 2002 and a 12-year bond of US$125 million in 2003. In 2004/05, preliminary outturns show that the overall deficit of government remained high at 8.5% of GDP, with 2.7% attributable to costs of re-profiling existing debts as well as raising large new external loans through private placements to fend off the possibility of a default in the short-term.

The increase in the overall public deficit has been mainly exacerbated by two factors:

1. A major public sector wage increase of up to 8% in each of the three years ending in 2005/06 which has added some 1.5% of GDP to government expenditures;
2. Growing interest expenses which have climbed from 2% of GDP in 1999/00 to 5.9% of GDP in 2005/06 along with an added 2.7% of GDP in fees and charges as costs of re-profiling and arranging external loans.

The overall government debt stock has also been increased by having to assume debts from the stalled re-privatization of Belize Telecommunications (BTL), which became tied up in international court disputes until a recent announcement that the Government will sell 37.5% of BTL shares. It still faces significant contingent liabilities as attempts are made to regain value out of the failed Development Finance Corporation (DFC) as well as covering potential losses of the Social Security Board from investments in the DFC.

Mounting External Debt

The cumulative effect of the high level of external borrowing has been a rapid build up of the external debts of the Central Government. As of December 31, 2004, actual debts being serviced by the Central Government were 91.4% of GDP of which 90% was externally financed. With the new privately-placed loans disbursed in March 2005, government debts jumped to 104.7% of GDP.

The external component of this public debt climbed fast in recent years partly due to the DFC, which has accumulated a significant portfolio of non-performing assets. The external borrowing by the public sector plus reductions in foreign reserves have contributed largely to financing the large current account deficits, averaging 19% of GDP over the 2001-04 period and depleting foreign exchange reserves to US$40 million or 0.8 months of imports at the end of 2004. According to the Budget Speech of January 2005, the current account deficit in 2004 was expected to remain at about 20% of GDP with nearly a quarter of this financed by reductions in foreign reserves.

Deteriorating Country Risk Ratings

This deteriorating economic situation led to an adverse IMF report in April 2004 and two down gradings of the country risk ratings of Belize in July-August 2004 followed by further down gradings in April and June 2005. For example, the Standard and Poor's grading of CCC minus on long term foreign borrowing means that any subsequent

[3] IMF reports and Ministry of Finance data.

rescheduling of long-term debts will be regarded as a default and Belize is effectively shut out of long-term capital markets except through costly special private placements. The Government now faces severe difficulties and increasing costs of borrowing in international capital markets, while at the same time it has a mounting need for funds.

The result of this set of financial and economic circumstances is that Belize faces a rather difficult situation: growing debts and interest charges, large trade deficits, large external debt service costs and weak growth prospects. Unless actions are taken, this situation can deteriorate, with growing prospects of government debt defaults and shortages of foreign exchange at the fixed exchange rate. In addition, sustaining social spending and other public services can become increasingly difficult.

1.2 Structure of the Report

The first part of this review discusses the current fiscal situation and identifies a targeted path of revenue and expenditure measures that will target sustainable primary surpluses for the years to come.

Before discussing more carefully the kind of measures that should be implemented to put the economy on the identified trajectory, chapter 4 and 5 sketch out trends in current expenditure allocation. Particular focus is paid to the extent of funding of the social sectors as well as the infrastructure expenditures. The overall nature and performance of social spending is highlighted and implications of the fiscal restraints and the need for budget reforms are addressed.

To achieve overall improvements in the sustainability of the government debt and current account balances will require a package of measures to enhance revenues, lower effective interest rates and introduce expenditure cuts. Various measures are suggested for short- and medium-term cost-cutting sustainable over the medium term. Then a number of major policy issues with serious fiscal impacts are discussed. This is followed by a thorough discussion of the nature of the budget system. Current practices are contrasted with trends in modern budget reforms being undertaken internationally. In particular, the need to introduce components of medium-term and performance budgeting are identified. The use of performance budgeting is reviewed and potential areas for introducing it are identified. Budget reform and measures to achieve fiscal and macroeconomic stability are positioned in the context of the broader structure and performance of the budget system.

Significant problems are found in the area of capital budgeting. In particular, weak financial and economic appraisal of projects as well as deficiencies in the presentation and accounting for capital expenditures are identified. Ways of reforming the capital budgets, improving the quality of government expenditures as well as the overall presentation of the budget estimates are recommended. Given the need for fiscal restraint arising out of the government and trade deficit situation, the slow down in spending, particularly capital expenditures, provides an opportunity for the Government to focus on the quality of capital expenditure projects. The following section identifies a number of

immediate budget estimation and expenditure control issues needed to be addressed urgently.

Finally, the next section discusses the main challenges of the civil, or "public," service and put forward a set of recommendations on how to improve efficiency in this sector.

A final section summarizes the major findings and recommendations of the report. These include strengthening the preparation of the budget through improved estimation procedures based on detailed actual information underlying the major expenditures such as those on personnel, pensions, debt service and utilities. The need to strengthen the budget analysis capacity within the Ministry of Finance is identified. Reforms of the capital budgeting process are laid out in some detail. The enhanced transparency of the budget through improved classification and presentation of both the detail and summary estimates is brought out. Some improvements in budget implementation are noted concerning the release of funds to ministries.

In addition, a set of reforms concerns more fundamental changes in the budget process that would improve the ability to deal with the range of medium-term policy issues facing Belize, starting with the recovery from its current financial crisis. These changes focus on the introduction of key elements of medium-term budgeting and the related amendments to the budget cycles. In addition, consideration is given to the selective introduction of performance budgeting to improve service delivery. Finally, the need for capacity building is identified both to plan and implement the reforms.

2. Recent Trends and Current Status in Government Revenues and Expenditures

2.1 Recent Fiscal Trends

Central government revenues and expenditures have in the last three years moved back to patterns similar to the mid-1990s. Table 2.1 summarizes revenues and expenditures for the Central Government of Belize for 1998/99 through 2005/06. Some marked differences in the patterns may be seen. As in the mid-1990s, higher tax revenues are now supporting higher current expenditures relative to GDP. Grants and non-tax revenues, on the other hand, have fallen over the period.

Rising Current Expenditures

Current expenditures have risen significantly over the past three years to an estimated 26% of GDP in 2004/05 and around 25% in 2005/06, more than 6 to 7% of GDP higher than around five years ago. Wages and salaries have risen again to levels in the late 1990s and even somewhat higher at 10.9% of GDP. Most importantly, interest charges have more than trebled over the past five years to 8.6% of GDP in 2004/05 (including 2.7% in fees and charges in debt arrangements) and at least 6.5% in 2005/06. The combination of wages and salaries, pensions and interests now cost 19.1% of GDP and form at least 76% of current expenditures, leaving little for operations and maintenance, training and grants to government agencies.

Fluctuating Capital Expenditures

Major changes have occurred in capital expenditures over the period. While current expenditures as a share of GDP have been relatively stable in the range of 17.5% to 21.4% of GDP up to 2003/04, and then rising sharply to 26% and 25% in the last two years; capital expenditures have fluctuated enormously from 6.1% to 15.2% of GDP, and were down to 5.3% in 2005/06 (base case). Capital expenditures are mainly development project expenditures, but also include non-development activities, grants, net lending and other irregular current expenditures. They peaked in 2001/02 at 15.2% of GDP with a combination of emergency expenditures for post hurricane recovery and high expenditures funded by foreign donor agencies and other domestically financed expenditures. Donor funded capital expenditures have declined over the past five years to below 3% of GDP in 2005/06.

Chronic Budget Deficits

Overall total expenditures have exceeded revenues and grants by significant margins in all years over the period 1998/99-2005/06 in Table 2.1. Overall deficits peaked at nearly 10% of GDP from 2000/01 through 2002/03 before privatization receipts and averaged 7.6% of GDP including these receipts. Even when emergency spending is removed, the overall deficits as share of GDP were above 6% of GDP. These high deficits have resulted in high primary deficits (overall deficits excluding interest charges) in all the years through 2003/04, which have contributed to the growing debt burden, and, by the end of 2004/05, have resulted in the Government having to service a stock of debt over 104% of GDP. Starting in the latter half of 2004/05, the Government has started implementing fiscal restraint programs to reduce the deficits – mainly raising tax revenues and cutting domestically financed capital expenditures. In 2004/05, the primary balance was close to zero. For the first time in 2005/06, it is estimated that the Government will generate a primary surplus that will help contain growth in the debt burden.

2.2 Current Fiscal Situation

Before focusing on the fiscal adjustments required to reduce the debt build up, it is important to establish a base case of the estimated budget for 2005/06. This is needed to have a starting point for incremental policy measures in the short-term in 2005/06, as well as over the medium term. Table 2.1 gives first the approved estimates of the Government that were voted on January 21, 2005. The GDP estimates have been reduced from those announced in the budget reflecting downward adjustments made by the National Statistical Office from 2002 onwards. These revisions result in estimates of GDP in 2005/06 some 3.6% lower than the previous ones.

The "Reconfigured" budget estimates in Table 2.1 include a number of policy measures introduced by the Government after the approval of the budget estimates for 2005/06. These include the full wage rate adjustment and 1% cut in the environmental tax, increases in the estimated grant receipts, and cuts in capital and recurrent O&M expenditures that the Ministry of Finance has negotiated with the ministries and departments amounting to 0.8% of GDP. Hiring and wage scale increments have also

been frozen, but no estimates of the consequences are included in the budget estimates yet. The increases in the unit tax on beer of 50%, announced in June 2005, and the increases in the transfer taxes on property are also not included. Also, the interest expense of 5.5% of GDP in these estimates does not include any interest or other premium charges that the Government will have to pay over 2005/06 on the special Belize Sovereign Debt (Cayman) Limited arranged as a private placement by Bear Stearns and disbursed in March 2005.

The IMF "Passive" case represents the estimates made by the IMF of 2005/06 financial operations that exclude all government policy measures aside from the wage settlement and cut in the environmental tax. These estimates include re-estimations of tax revenues in line with expected economic growth over the year. These estimates may be too conservative, but given the tight fiscal circumstances, they provide a more realistic base estimate of tax revenues. The IMF Passive case estimate includes interest expenses of 7.2% of GDP, which consists of the interest and premium charges expected on the new private placement as well as a share of a transfer payment made to the DFC to cover interest expenses on certain debt serviced by this institution.

Table 2.1
Belize Central Government financial operations, cash basis, summary, 1998/99-2005/06

	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05 *Revised*	2004/05 *Prelim*	2005/06 *Approved*	2005/06 *Reconfigured*	2005/06 *IMF passive*	2005/06 *Base case*	2005/06 *Base case plus*
Revenue and Grants	**24.1**	**22.5**	**22.3**	**24.7**	**23.0**	**23.3**	**23.6**	**23.5**	**26.5**	**26.6**	**25.1**	**25.4**	**25.4**
Revenue	23.0	20.9	20.9	23.7	22.0	22.1	23.4	22.8	25.8	25.5	24.2	24.2	24.2
Tax revenue	19.3	17.5	17.6	18.5	19.2	19.4	20.0	20.3	23.1	22.8	21.6	22.2	22.2
Grants	1.2	1.6	1.4	1.0	1.0	1.2	0.2	0.7	0.7	1.1	0.9	1.1	1.1
Total expenditures	**27.9**	**31.1**	**31.2**	**33.7**	**31.7**	**31.5**	**28.2**	**32.1**	**29.5**	**29.3**	**31.6**	**31.2**	**30.3**
Current expenditures	**19.3**	**19.2**	**17.5**	**18.5**	**19.3**	**21.4**	**21.8**	**26.0**	**22.8**	**23.1**	**25.1**	**24.4**	**25.0**
Wages and salaries	10.0	9.8	9.0	9.2	9.2	9.6	10.4	10.4	10.4	10.9	10.8	10.9	10.9
Pensions	1.3	1.4	1.1	1.3	1.4	1.3	1.7	1.6	1.6	1.7	1.8	1.7	1.7
Interest	1.9	2.0	2.4	2.9	3.9	5.0	4.5	8.6	5.5	5.5	7.2	6.5	6.5
o/w Fees and charges								2.7				-	
Other	6.1	6.0	5.0	5.0	4.8	5.4	5.1	5.5	5.3	5.1	5.3	5.3	6.0
Capital expenditures and net lending	**8.5**	**11.9**	**13.7**	**15.2**	**12.4**	**10.1**	**5.8**	**6.1**	**6.8**	**6.2**	**6.5**	**6.8**	**5.3**
Capital expenditures II (domestic financed, including environmental exp, grants and net lending)	3.5	5.1	3.2	8.1	5.8	5.5	2.1	2.5	3.7	3.5	3.5	3.7	2.6
Capital expenditures III (foreign financed)	5.0	6.7	7.4	5.0	5.7	4.6	3.6	3.6	3.0	2.7	3.0	3.0	2.7
Emergency expenditures	-	-	3.1	2.1	0.9	-	-		-	-		-	
Unidentified expenditures (+)/revenue (-)	0.4	(3.0)	0.7	0.9	0.7	(0.4)	-		-	-		-	
					(8.7)	(8.2)							
Overall balance	**(4.1)**	**(5.6)**	**(9.7)**	**(9.8)**	**(9.7)**	**(8.2)**	**(4.5)**	**(8.5)**	**(3.0)**	**(2.6)**	**(6.5)**	**(5.8)**	**(5.0)**
Primary balance	**(2.2)**	**(3.6)**	**(7.3)**	**(6.9)**	**(5.8)**	**(3.1)**	**0.0**	**0.0**	**2.4**	**2.8**	**0.7**	**0.7**	**1.6**
GDP FY *(millions BZ $)*	1,404.5	1,518.3	1,684.0	1,766.5	1,880.3	1,980.5	2,052.9	2,053.0	2,167.4	2,167.0	2,167.0	2,167.0	2,167.0
Privatization receipts			3.5	0.3	2.5	(4.1)	2.0						3.2
o/w Belize Telecommunications						(5.8)							3.2

Source: IMF and Ministry of Finance, Government of Belize. (References to IMF and the Government of Belize generally refer to unpublished data provided in the course of the work process)

The Base Case adjusts the "Reconfigured" case for the revenue reductions expected by the IMF. It includes the increases in grants expected by the Government. Total revenues decline from 26.5% to 25.4% in the approved estimates. These exclude the beer and property transfer tax changes announced in June 2005. On the expenditure side, the Base Case, includes the wage settlement costs and increases the interest expense by 1% of GDP for the interest and premium charges on the new Belize Sovereign Debt (Cayman) Limited private placements, but it leaves the full transfer payment to the DFC as a transfer payment and excludes all the added expenditure cuts that the Ministry of Finance has negotiated.

The "base case plus" gives the final base case that is used as the starting point in the analysis of fiscal and debt adjustment in this report. See appendix A for a thorough analysis of debt sustainability and the required fiscal path. The base case plus includes the expenditure cuts in the capital and O&M budgets that the Ministry of Finance has negotiated. It also shifts the BZ$19 million allocated in the capital expenditures II[4] to a transfer expenditure in the current expenditures to yield a more realistic estimate of the residual capital expenditures II available for further cuts. This case also shows as privatization receipts the 3.2% of GDP that the Government intends to recover from the sale of 37.5% of BTL shares during 2005/06. Compared to the 2.4% of primary surplus expected in the approved estimates, the base case plus expenditure adjustments estimate a primary surplus of 1.6%, which is shown to be inadequate to contain or reduce the debt stock of the Government.

3. Financial Crisis and the Need for Adjustment Measures

3.1 Current Debt Situation

The Government has been building up a large stock of debts over the recent years. As of December 31, 2004, Table 3.1 shows that actual debts being serviced by the Central Government were 91.4% of GDP of which 90% was external financed. This was up from 85.8% of GDP a year earlier. By March 2005, government debts had risen further to 104.7% as it took on a further 13.3% of GDP in debts with the disbursement of the special Belize Sovereign Debt (Cayman) Limited.

In addition, as of December 31, 2004, publicly guaranteed external debt still stood at 10.5% of GDP, down from 19.5% a year earlier as the Government had assumed some guaranteed debts during 2004, but raising the overall public debts to about 115% of GDP at the end of the fiscal year 2004/05. The Government is already servicing part of the guaranteed debt through budget transfers to the DFC through the capital expenditure component of the budget. Moreover, the presence of guaranteed debts over and above the debts being directly serviced through the budget tends to raise the risk premium on interest rates that the Government pays on its debt. The larger and more risky the guaranteed debt, the higher the risk premium the Government pays on the direct debt it is

[4] Capital II expenditures refers to domestically financed capital expenditures, while capital III refers to donor financed capital expenditures.

servicing. The consequences of the Government assuming more of the guaranteed debt is examined in appendix A.

These external debts have risen from relatively large and persistent government deficits, particularly since 2000/01. Over the 2000/01-2003/04 period, the overall central government deficit was 9.3% of GDP. Primary balances have until this year also been negative, indicating the current operations of the Government have been adding to the debts. Over 2000/01-2003/04, for example, large primary deficits in the range of 3.1% to 7.3% of GDP were incurred. Preliminary outturns for 2004/05 indicate a primary balance of zero. To reduce the debt stock, however, significant primary surpluses will be required to pay down the debt stock and pay the interest charges.

Approved estimates for 2005/06 show a primary surplus of 2.4%, while in the base case plus it is estimated at 1.6% of GDP. The adequacy of such primary surpluses is investigated in appendix A. We are particularly concerned with the ratio of debt to GDP. As the economy grows, even with the same amount of debt, the ratio would begin to decrease reflecting the increased capacity of the economy to service the same stock of debt. If the ratio continues to increase, however, as has been the case for the last five years, the debt-to-GDP ratio and the effective interest rates will rise, and the ability of the economy and the Government to service its debts will become more difficult or even infeasible.

Table 3.1
Composition of Government of Belize Debt and Effective Interest Rates

PART A: Central Government Debt

Type of Debt		Central Government Debt at 31/12/2003	%GDP	Share of Central Government Debt	Average interest rate		Central Government Debt at 31/12/2004 plus new Private Placements before 31/03/05	%GDP	Share of Central Government Debt	Average interest rate
		BZ$ thousands					*BZ$ thousands*			
Donor Agencies										
(Multi- & Bilateral)	Central Government	523,653	26.4%	30.8%	3.9%	1.20%	571,276	27.8%	26.6%	3.9%
	Financial Agencies	69,501	3.5%	4.1%	3.3%	0.14%	65,721	3.2%	3.1%	3.3%
External Commercial	Central Government	893,043	45.1%	52.6%	10.1%	5.29%	1,037,552	50.5%	48.3%	9.9%
	Financial Agencies	18,909	1.0%	1.1%	6.2%	0.07%	11,209	0.5%	0.5%	6.2%
	Belize Soverign Debt Private Placement					0.00%	273,366	13.3%	12.7%	10.4%
Domestic		193,800	9.8%	11.4%	5.4%	0.62%	189,800	9.2%	8.8%	7.6%
Total		1,698,906	85.8%		7.3%		2,148,924	104.7%		7.9%

Source: Government of Belize, Ministry of Finance

PART B: Publicly Guaranteed External Debt

Type of Debt	Debt at 31/12/2003	%GDP	Debt at 31/12/2004	%GDP
	BZ$ thousands		*BZ$ thousands*	
Publicly Guaranteed External Debt	384,200	19.5%	218,200	10.5%

Source: International Monetary Fund

Given the limited domestic savings and thin capital markets, external borrowing has been undertaken to satisfy the bulk of the borrowing requirement. In fact, Table 3.2 shows Gross national Savings dropping below 5% in recent years. Net external borrowing by the Government over 2000/01-2003/04 averaged 12.6% of GDP.[5] These large capital

[5] IMF reports and Ministry of Finance data. References to IMF and the Government of Belize generally refer to unpublished data provided in the course of the work process.

inflows plus reductions in foreign reserves have financed large current account imbalances, averaging 19% of GDP over 2001-04. Foreign exchange reserves were down to US$40 million or 0.8 months of imports at the end of 2004 as nearly half the reserves were used to finance a quarter of the current account deficit (Table 3.2).

Another notable perspective is that the large foreign savings inflows since 1999 have financed domestic demand that has exceeded domestic production in the range of 12% to 21.6% and supported large trade deficits in the same range as a share of GDP. Table 3.2 shows that these imbalances can be reduced if the total demand is decreased in 2005 and 2006 through cuts in private and government consumption through tax increases and government expenditure cuts that would yield primary surpluses around 5% of GDP. At the same time, the high stocks of external debt leave the country with high net factor payments mainly from the interest expenses in servicing the public sector debt amounting to more than 7% of GDP aside from the costs of any foreign financing of the private sector.

Even if the trade deficit is brought down to 3% of GDP in 2006, for example, net capital inflows of over 8% and net transfers of about 4% would be required to sustain the foreign reserves and cover the current account deficit. This will require continued support from bilateral and multilateral donors as well as net financial investments (portfolio and foreign direct investment as well as commercial borrowing) in the private sector. Over time the Government will need to generate significant primary surpluses to be able to pay the debt and reduce net factor payments to make, as well as free up, public funds to finance public sector service delivery and infrastructure rather than simply pay interest expenses.

The combination of high external debts, high interest payments, large current account deficits and low foreign reserves has resulted in the Government facing increasing difficulties and higher costs of borrowing in the international capital markets, while at the same time it has an increasing need for funds.

Table 3.2 Belize National Accounts and Balance of Payments, Summary Aggregates, 1990-2006

(Percentage of GDP)

		1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	*2004*	*2005*	*2006*
Income, Demand and Savings:																		
Gross National Disposable Income (GNDI)	*E=C+D*	101.6	104.7	102.6	101.4	95.7	98.4	99.2	98.1	95.7	103.3	105.9	97.3	96.4	95.4	*93.9*	*93.2*	*95.0*
Net Transfers (NT)	*D*	3.2	7.2	5.9	5.0	-0.5	1.8	2.9	1.6	-0.1	9.0	12.7	6.0	4.6	4.5	*3.90*	*2.24*	*3.8*
Gross National Income (GNI)	*C=A+B*	98.4	97.6	96.7	96.5	96.3	96.5	96.3	96.5	95.8	94.3	93.2	91.4	91.8	90.9	*90.0*	*91.0*	*91.2*
Net Factor Receipts (NFR)	*B*	(1.6)	(2.4)	(3.3)	(3.5)	(3.7)	(3.5)	(3.7)	(3.5)	(4.2)	(5.7)	(6.8)	(8.6)	(8.2)	(9.1)	*(10.0)*	*(9.0)*	*(8.8)*
Gross Domestic Product (GDP)	*A*	100	100	100	100	100	100	100	100	100	100	100	100	100	100	*100*	*100*	*100*
Total Demand or Absorption	*F=G+H*	**97.8**	**110.5**	**108.2**	**110.1**	**102.6**	**101.1**	**100.3**	**102.9**	**104.3**	**112.3**	**121.6**	**118.7**	**114.0**	**113.7**	***112.7***	***107.5***	***103.0***
Final consumption expenditure	*G*	70.7	81.9	80.3	80.0	82.1	79.4	80.0	82.8	85.3	87.7	92.0	94.0	90.0	93.2	*91.4*	*87.2*	*82*
Gross capital formation (I)	*H*	27.2	28.6	27.8	30.1	20.5	21.7	20.3	20.1	19.0	24.5	29.6	24.7	24.0	20.5	*21.3*	*20.3*	*21.0*
Gross National Savings (GNS)	*I=E-G*	30.9	22.8	22.3	21.4	13.6	19.0	19.2	15.2	10.3	15.6	13.9	3.4	6.4	2.2	*2.5*	*6.0*	*9.2*
Balance of Payments:																		
Current account balance	*J=E-F=S+B+D*	**3.7**	**(5.8)**	**(5.5)**	**(8.6)**	**(6.9)**	**(2.8)**	**(1.0)**	**(4.9)**	**(8.7)**	**(8.9)**	**(15.7)**	**(21.3)**	**(17.6)**	**(18.3)**	***(18.8)***	***(12.9)***	***(8.0)***
Foreign Savings	*K= - J=L-M*	(3.7)	5.8	5.5	8.6	6.9	2.8	1.0	4.9	8.7	8.9	15.7	21.3	17.6	18.3	*18.8*	*12.9*	*8.0*
Net Capital Inflows	*L*	(1.3)	2.0	5.5	6.1	6.1	3.3	4.3	5.0	6.4	12.7	21.9	20.1	17.8	15.3	*14.4*	*15.8*	*8.2*
Change in Total Reserves	*M*	2.4	(3.7)	(0.0)	(2.5)	(0.7)	0.5	3.2	0.2	(2.2)	3.7	6.2	(1.3)	0.3	(3.0)	*(4.4)*	*2.9*	*0.2*
Total reserves minus gold	*N*	16.9	11.8	10.2	6.9	5.9	6.1	9.1	9.1	6.4	9.7	14.8	12.9	12.4	8.6	*3.9*	*6.6*	*5.0*
Current Account:																		
Exports of goods and services (X)	*O*	62.2	53.9	54.5	51.0	49.6	48.0	49.8	52.6	52.4	54.9	52.0	50.8	52.6	53.5	*49.2*	*49.4*	*49.4*
Goods exports	*P*	31.3	28.2	27.1	23.5	26.8	26.6	26.6	29.5	26.9	29.0	25.5	31.7	33.5	32.0			
Imports of goods and services (M)	*Q*	60.1	64.4	62.7	61.1	52.2	49.2	50.1	55.5	56.7	67.2	73.7	69.4	66.6	67.3	*61.9*	*56.9*	*52.4*
Goods imports	*R*	45.6	49.9	47.1	44.7	39.7	37.2	35.6	43.1	42.1	45.9	48.5	56.3	54.0	53.2			
External balance on goods and services (X-M)	*S=O-Q=F-A*	**2.2**	**(10.5)**	**(8.2)**	**(10.1)**	**(2.6)**	**(1.1)**	**(0.3)**	**(2.9)**	**(4.3)**	**(12.3)**	**(21.6)**	**(18.7)**	**(14.0)**	**(13.7)**	***(12.7)***	***(7.5)***	***(3.0)***
Net Factor Receipts (NFR)	*B*	(1.6)	(2.4)	(3.3)	(3.5)	(3.7)	(3.5)	(3.7)	(3.5)	(4.2)	(5.7)	(6.8)	(8.6)	(8.2)	(9.1)	*(10.0)*	*(9.0)*	*(8.8)*
Net Transfers (NT)	*D*	3.2	7.2	5.9	5.0	(0.5)	1.8	2.9	1.6	(0.1)	9.0	12.7	6.0	4.6	4.5	*3.9*	*3.6*	*3.8*

Source: 1990-2003, World Bank Development Indicators; 2004-2006, IMF estimates and authors

3.2 Sustainable Primary Surpluses

In this context of deteriorating country risk ratings, the adjustments required to reduce the debt stock and regain economic stability are immediate. In appendix A an analysis of the debt build-up and the required actions to be undertaken in order to reach a more sustainable path is conducted. It is clear from that analysis that it is critical to raise the primary surplus from its current estimated base case of about 1.6% to over 4% in 2005/06 and to over 5% over the medium term. Based on the options and constraints faced by the Government, a targeted trajectory for primary surpluses is presented in Table 3.3. The primary surplus has to increase to 4.2% in 2005/06, then rise to 5.5% by 2008/09 and remain there in the subsequent years. This is consistent with the analyzed sustainable debt adjustment. The issue is, therefore, the identification of feasible short-term and medium-term fiscal adjustment policies that will achieve these primary surpluses in a sustainable fashion.

In the short-term, there is limited scope for expenditure cuts without damaging public services. Thus, most of the measures are designed to become gradually more effective in 2006/07 and subsequent years. Excluding saving from reduced interest charges, current expenditure reductions after three years should be at least 2% of GDP by 2008/09 with most of the reductions coming from cuts in personnel emoluments (PE). A target for non-interest current expenditure reductions could be 1.4% of GDP in 2005/06 (or 0.6% above the base case plus expenditure cuts of 0.8% already made), and 2% or more in expenditure cuts in subsequent years. When added tax revenues of 2% are included, the additional expenditure reductions needed to raise the base case to about 4.2% of GDP in 2005/06, 4.8% of GDP for 2006/07, and 5.3% of GDP in 2007/08 and 5.5% in subsequent years are given in Table 3.3 below. From 2008/09 onwards the savings in personnel emoluments should allow gradual cut backs in the tax measures by about 0.5% of GDP each year. By 2011/12, when personnel emoluments should be reduced from 10.9% to 8% of GDP, the revenue increases can be completely phased out.

Table 3.3
Target Primary Surpluses Relative to the Current Base Case
(Percentage of GDP)

	Initial Primary Surplus	Revenue Increase	Expenditure Decrease	Target Primary Surplus
2005/06	1.6	2.0	0.6	4.2
2006/07	1.6	2.0	1.2	4.8
2007/08	1.6	2.0	1.7	5.3
2008/09	1.6	1.7	2.2	5.5
2009/10	1.6	1.2	2.7	5.5
2010/11	1.6	0.7	3.2	5.5
2011/12	1.6	0.0	3.9	5.5

While tax revenue issues are covered in a separate report, it is important to note that merely achieving the target total revenues and grants target for 2005/06 will require significant tax effort by the authorities and compliance by the taxpayers. To achieve the approved revenues and grants target of 26.5% (which is 1.8% of GDP above the maximum achieved since 1998/99) will require a major increase in tax revenues. Achieving a further 2% above the Base Case target raises the target for revenues plus grants to 27.4%. This may be achievable with an enforceable tax such as an import surcharge. Given Belize already has a relatively high tax burden, however, as expenditures are reduced, the overall tax effort can be moderated.

4. Trends in Expenditure Allocations

4.1 Allocation Patterns of Current Expenditures

Before looking into the cost-cutting and other sustainability-oriented measures the Government will have to undertake over the short and medium term, this section reviews the composition of current and capital expenditures by the Central Government of Belize over the past decade. Then, section 5 will discuss the current status of social spending and social indicators in Belize.

Unfortunately, the detailed composition of actual expenditures is not readily available. To make comparisons of the trends of current expenditures over time, the approved estimates are used. However, it should be noted that systematic tendencies to underestimate personnel emoluments, public utilities, pensions and interest charges exist.[6]

Table 4.1 gives the distribution of approved expenditures on groupings of various budget items expressed as a share of GDP for 1995/96 through 2005/06. The total expenditures on current operations are identified as personnel emolument, travel and subsistence, material and supply, operating and maintenance, public utilities, contracts, rents and leases, contribution and subsistence, and grant expenditures. The remaining items in the category of current expenditures are training expenditures, pensions, payments to retired public servants, and interest expenditures. Table 4.2 gives the distribution of the approved estimates of expenditures on the current operations of the Government. Some important features are noted below.

- The overall pattern of expenditures on the current operations has been relatively stable over time both in terms of share of GDP and their distribution across items. This reflects a fairly mechanical incremental year-to-year line item budgeting process that has largely replicated the structure of the Government.
- There has been a significant change over time in personnel emoluments, falling from 10.8% of GDP 1995/96 to 9.0% in 2001/02 and then rising again to 10.5% in 2005/06. These fluctuations in personnel emoluments largely explain the

[6] For a more thorough discussion of the underestimation issue, please contact Vibeke Oi (RE2/RE2) vibekeo@iadb.org to obtain a copy of the original version of this report.

fluctuations in total expenditures on current operations, which follow a similar pattern of falling from 15.8% of GDP in 1995/96 to 13.4% in 2001/02 and then rising again to 15.5% in 2005/06.

- Another notable trend emerges in the expenditures on pensions. Pension and *ex gratia* payments rise to 1.6% of GDP by 2005/06 compared to 1.2% in earlier years. As will be noted below, the rise started earlier in that pension costs were systematically underestimated in previous years. This underestimation was partly due to pensions rising in line with the pay scale increase starting with adjustments in 2003/04.
- Most importantly, however, is the sharp rise in interest charges. Prior to 2001/02, interest as a share of GDP had remained constant at 2.2% of GDP. By 2005/06, interest charges had risen to 5.3%, more than double its earlier burden.
- The combined expenditures on personnel emoluments, pensions and interest rise from a low of 12.6% of GDP in 2001/02 to 17.4% of GDP in 2005/06, or as a share of total current expenditures, rise from a low of 70% to 77% by 2005/06.

4.2 Excessive Share of Personnel Emoluments in Current Expenditures

The dominance of the public sector wage bill on government expenditures is striking. As apparent from table 4.2, personnel emoluments have stood at about 68% of total expenditures on current operations. Thus, the ability of the Government to deliver services is limited by the bulk of expenditures going to the wage bill rather than supplying resources to these public servants to deliver services.

It has to be recognized, however, that about one third of government expenditures are devoted to education and three-quarters of these are on the wages of teachers, school administrators and support staff. At the same time, the Government provides some support for the operation and maintenance of schools through grants. The remainder of expenditures on operations and maintenance, borne by schools themselves, are not included in the government budget. To remove this bias, the approved expenditures of the Ministry of Education are excluded from the distribution of approved expenditures on items for current government operations in table 4.3 for the years 2003/04 through 2005/06. Consequently, the share of personnel emoluments in the remainder of current expenditures falls but still remains high at 63%. A more efficient wage share is commonly regarded to be below 50% as would be clear from the international comparison below.

International Comparison of Personnel Emoluments

Using data from the IMF Government Financial Statistics (GFS) database, some comparisons can be made of the shares of expenditures on employee compensation out of current expenditures. Using data available for years during 1990-2003, Table 4.4 gives the shares of employee compensation out of total expenditures for a selection of countries. The first set is for central government accounts, and the second for a limited number of countries giving the consolidated accounts for all levels of government. The shares in the latter set are expected to be higher, as typically a certain share of central government expenditures are devoted to transfers to lower levels of government. For

example, employee compensation for the United Sates Central Government is 13%, but for all levels of government in the United States it is 26%. This makes a fairer comparison with Belize, which is closer to a single level of government, local governments still being relatively small.

The employee compensation shares of total expenditures in Table 4.4 are given in descending order. Belize, based on GFS data for 1990-97 tops the list of 52 central governments with a share of 56%. It is hard to make strict comparisons between governments because of differences in organizational structures, degrees of privatization, the use of special purpose agencies, and multiple levels of government. Nonetheless, it is clear that Belize is at the highest end of the distribution. Commonly regarded as an efficient government, Singapore has a ratio of only 30%. Similarly, the Central Government of Korea has a ratio of only 15%. Australia, again often regarded as having an efficient government, has an employee share of only 26% for all levels of government.

Table 4.1
Approved Estimates of Belize Central Government Current Expenditures by Item, 1995/96 - 2005/06
(Percentage of GDP)

	Personnel Emoluments	Travel & Subsistence	Materials & Supplies	Operating & Maintenance	Public Utilities	Contracts, Rents & Leases	Contributions & Subscriptions	Grants	Expenditures on Current Operations	Training	Ex Gratia Payments & Pensions	Interest	Total Current Expenditures
1995/96	10.80%	0.20%	0.80%	0.90%	1.10%	0.20%	0.30%	1.50%	**15.80%**	0.10%	1.30%	2.20%	**19.50%**
1996/97	9.60%	0.20%	0.80%	0.90%	0.80%	0.20%	0.30%	1.40%	**14.20%**	0.10%	1.20%	2.20%	**17.70%**
1997/98	10.00%	0.20%	0.90%	0.90%	1.00%	0.20%	0.30%	1.50%	**14.90%**	0.10%	1.40%	2.20%	**18.50%**
1998/99	10.00%	0.20%	1.00%	0.90%	1.40%	0.20%	0.30%	1.50%	**15.40%**	0.10%	1.30%	2.20%	**19.10%**
1999/00	9.60%	0.20%	0.90%	0.70%	1.30%	0.20%	0.30%	1.40%	**14.60%**	0.10%	1.20%	2.20%	**18.10%**
2000/01	9.10%	0.20%	0.90%	0.60%	1.20%	0.20%	0.20%	1.40%	**13.70%**	0.10%	1.20%	2.40%	**17.30%**
2001/02	9.00%	0.20%	1.00%	0.50%	1.20%	0.20%	0.20%	1.20%	**13.40%**	0.10%	1.10%	2.70%	**17.40%**
2002/03	9.00%	0.20%	0.80%	0.50%	1.30%	0.20%	0.20%	1.20%	**13.40%**	0.10%	1.20%	2.90%	**17.60%**
2003/04	9.40%	0.30%	0.80%	0.70%	1.20%	0.20%	0.20%	1.30%	**14.00%**	0.10%	1.20%	3.20%	**18.50%**
2004/05	10.10%	0.20%	0.70%	0.70%	1.20%	0.30%	0.20%	1.40%	**14.90%**	0.10%	1.10%	3.60%	**19.70%**
2005/06	10.50%	0.20%	0.70%	1.00%	1.10%	0.30%	0.20%	1.40%	**15.50%**	0.20%	1.60%	5.30%	**22.50%**

Table 4.2
Distribution of Approved Expenditures on Current Operations by Belize Central Government, 1995/96 - 2005/06

	Personnel Emoluments	Travel & Subsistence	Materials & Supplies	Operating & Maintenance	Public Utilities	Contracts, Rents & Leases	Contributions & Subscriptions	Grants	Expenditures on Current Operations
1995/96	68.30%	1.50%	5.10%	5.90%	7.00%	1.20%	1.70%	9.30%	100.00%
1996/97	67.90%	1.40%	5.80%	6.10%	5.70%	1.20%	2.00%	10.00%	100.00%
1997/98	67.60%	1.40%	5.90%	5.90%	6.50%	1.20%	1.80%	9.80%	100.00%
1998/99	64.80%	1.30%	6.30%	5.80%	9.30%	1.20%	1.90%	9.50%	100.00%
1999/00	65.90%	1.70%	6.00%	4.70%	9.10%	1.20%	1.90%	9.50%	100.00%
2000/01	66.40%	1.70%	6.40%	4.20%	8.90%	1.30%	1.40%	9.90%	100.00%
2001/02	66.80%	1.60%	7.10%	3.90%	8.90%	1.20%	1.30%	9.10%	100.00%
2002/03	67.00%	1.70%	6.20%	3.80%	9.70%	1.40%	1.30%	8.90%	100.00%
2003/04	67.30%	1.90%	5.40%	4.90%	8.80%	1.40%	1.30%	9.10%	100.00%
2004/05	67.90%	1.60%	4.80%	4.80%	8.30%	2.00%	1.50%	9.10%	100.00%
2005/06	67.80%	1.50%	4.40%	6.60%	7.30%	2.10%	1.40%	9.00%	100.00%

Source: Approved Estimates of Revenues and Expenditures of Government of Belize, Various Years, 1995/96-2005/06

Table 4.3
Distribution of Approved Expenditures on Current Operations by the Belize Central Government with and without Expenditures By Ministry of Education, Sports & Tourism, 2003/04 - 2005/06

	Personnel Emoluments	Travel & Subsistence	Materials & Supplies	Operating & Maintenance	Public Utilities	Contracts, Rents & Leases	Contributions & Subscriptions	Grants	Expenditures on Current Operations	Share of Total
Total										
2003/04	67.3%	1.9%	5.4%	4.9%	8.8%	1.4%	1.3%	9.1%	100.0%	100.0%
2004/05	67.9%	1.6%	4.8%	4.8%	8.3%	2.0%	1.5%	9.1%	100.0%	100.0%
2005/06	67.8%	1.5%	4.4%	6.6%	7.3%	2.1%	1.4%	9.0%	100.0%	100.0%
Education										
2003/04	74.8%	0.1%	0.2%	3.5%	0.0%	0.0%	0.0%	21.4%	100.0%	33.8%
2004/05	74.8%	0.1%	0.1%	3.4%	0.0%	0.0%	0.0%	21.6%	100.0%	33.1%
2005/06	75.4%	0.1%	0.2%	2.9%	0.0%	0.0%	0.0%	21.3%	100.0%	31.8%
Total excluding Education										
2003/04	64.2%	2.2%	6.6%	8.2%	11.0%	3.2%	2.1%	2.6%	100.0%	66.2%
2004/05	64.6%	2.4%	7.1%	5.4%	12.4%	3.0%	2.2%	2.8%	100.0%	66.9%
2005/06	63.3%	2.7%	7.9%	5.9%	13.0%	2.2%	2.0%	3.0%	100.0%	68.2%

Table 4.4
Employee Compensation as share of Current Expenditures
Average shares for available data over 1990-2003

Central Government Expenditures		Consolidated Government Expenditures	
Belize	56%	Colombia	59%
Namibia	52%	Bolivia	46%
Morocco	47%	South Africa	41%
Cyprus	45%	Mauritius	41%
Ecuador	44%	Thailand	38%
Portugal	43%	Lithuania	30%
Mauritius	43%	Switzerland	28%
Thailand	42%	Australia	26%
Dominican Republic	40%	United States	26%
Trinidad and Tobago	39%	Chile	22%
Costa Rica	37%	Czech Republic	11%
Guatemala	37%		
Seychelles	37%		
Philippines	35%		
Bolivia	34%		
Uruguay	33%		
Zambia	33%		
Botswana	32%		
Jamaica	32%		
Kenya	31%		
Singapore	30%		
Lithuania	30%		
Turkey	29%		
Egypt	28%		
Nicaragua	27%		
France	24%		
Belgium	24%		
Sri Lanka	22%		
Venezuela, Rep. Bol.	22%		
Indonesia	21%		
Peru	20%		
Colombia	19%		
South Africa	19%		
Israel	19%		
Italy	19%		
Spain	17%		
Austria	17%		
Ireland	15%		
Germany	15%		
Korea	15%		
United States	13%		
Denmark	13%		
Canada	13%		
Uganda	12%		
Switzerland	12%		
New Zealand	11%		
Czech Republic	11%		
India	11%		
Finland	10%		
Norway	9%		
Brazil	8%		
Sweden	8%		

Source: IMF GFS

4.3 Patterns of Capital Expenditures

Table 4.5 presents the approved estimates of capital expenditures over 1998/99 through 2005/06. In total, approved estimates have varied between about 21% and 34% of total expenditures or 6% and 10% of GDP, with peak capital expenditures approved in 2000/01. Generally over this period, about 50% of capital expenditures have been domestically financed (capital II expenditures) and the remainder financed by donor agencies (capital III expenditures).

The initial impression one gets is that the Government is making a significant contribution of about BZ$140 million per year to total investment; gross fixed capital formation in the economy has been around BZ$450 million per year over this period. A closer inspection, however, reveals that "capital expenditures" actually include a large range of development projects along with certain transfers and net lending to government agencies and some irregular current expenditures on administration. Also, some of the development projects involve training and institutional development (investments in human and social capital) rather than investments in physical capital.

Table 4.5
Approved Estimates of Capital Expenditures, 1998/99-2005/06
(BZ$ millions)

	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Capital II expenditures	49.2	68.7	54.4	62.6	73.5	60.8	52.3	68.1
as % of total expenditures	12.3%	15.2%	10.9%	12.6%	13.7%	11.0%	9.6%	10.6%
as % of GDP	3.5%	4.5%	3.2%	3.5%	3.9%	3.0%	2.5%	3.0%
Capital III Expenditures	47.9	70.5	114.6	73.4	83.9	77.3	70.3	65.8
as % of total expenditures	12.0%	15.6%	23.0%	14.8%	15.7%	13.9%	12.9%	10.3%
as % of GDP	3.4%	4.6%	6.8%	4.2%	4.5%	3.9%	3.3%	2.9%
Capital II + III expenditures	97.1	139.2	169	136	157.4	138.1	122.6	133.9
as % of total expenditures	24.3%	30.8%	33.8%	27.4%	29.4%	24.9%	22.4%	20.9%
as % of GDP	6.9%	9.2%	10.0%	7.7%	8.4%	6.9%	5.8%	6.0%
Recurrent expenditures	302.2	312.1	330.3	360.2	377.9	417.1	424.4	506.4
Total expenditures	399.3	451.3	499.3	496.2	535.3	555.2	547.0	640.3
GDP (FY)	1,404.5	1,518.3	1,684.0	1,767.5	1,883.1	2,005.2	2,120.8	2,247.3

Source: Government of Belize Approved Estimates, various years, BSO and IMF

Compared to the fairly steady patterns of current expenditures, capital expenditures have had significant fluctuations over short periods of time. They have clearly been used as the major tool in fiscal adjustment in the economy.

Approved versus Actual Capital Expenditures

Further inspection of capital expenditures estimates and actuals from various sources also reveals significant gaps between approved estimates and actuals. Table 4.6 shows the approved budget estimates for 2000/01-2004/05, then the approved estimates (including supplementaries) and actuals from the records of the Ministry of Finance, and finally the

actuals as reported by the IMF in the financial operations of the Central Government. Significant differences exist between the estimates and the actuals, with the latter generally higher than the former.

Table 4.6
Capital Expenditures, Approved and Actual, 2000/01 - 2004/05

	2000/01	2001/02	2002/03	2003/04	2004/05
Capital II expenditures			*(BZ$ millions)*		
Approved Estimates (a)	54.4	62.6	73.5	60.8	52.3
Approved Estimates + supplementaries (b)	59.0	63.2	67.9	67.4	59.3
Actuals (b)	54.0	76.8	98.4	77.4	*49.0 (d)*
IMF Cap. II Exp. (c)	54.4	105.7	92.2	65.1	
IMF Net lending (c)	0.0	37.0	16.7	43.9	
Capital III expenditure			*(BZ$ millions)*		
Approved Estimates (a)	114.6	73.4	83.9	77.3	70.3
Approved Estimates + supplementaries (b)	75.0	109.4	104.1	77.3	70.3
Actuals (b)	182.8	109.7	79.9	90.6	*74.5 (d)*
IMF Cap. III Exp. (c)	124.1	88.3	107.2	90.0	
Emergency expenditures (c)	0.0	0.0	16.7	0.0	
Total capital expenditures			*(BZ$ millions)*		
Approved Estimates (a)	169.0	136.0	157.4	138.1	122.6
Approved Estimates + supplementaries (b)	134.1	172.5	172.0	144.7	129.7
Actuals (b)	236.8	186.4	178.4	168.0	*123.5 (d)*
IMF Cap.Exp.(c)	178.5	194.0	199.4	155.1	
IMF Net lending (c)		37.0	16.7	43.9	
Emergency expenditures (c)			16.7		
IMF Unidentified expenditure (+)/ revenue (-) (c)	12.6	15.4	12.7	-7.9	
Total capital expenditures			*% GDP*		
Approved Estimates (a)	10.0%	7.7%	8.4%	6.9%	5.8%
Approved Estimates + supplementaries (b)	8.0%	9.8%	9.1%	7.2%	6.1%
Actuals (b)	14.1%	10.5%	9.5%	8.4%	5.8% *(d)*
IMF Cap.Exp.(c)	10.6%	11.0%	10.6%	7.7%	
IMF Net lending (c)		2.1%	0.9%	2.2%	
Emergency expenditures (c)			0.9%		
IMF Unidentified expenditure (+)/ revenue (-) (c)	0.7%	0.9%	0.7%	-0.4%	

(a) Approved Budget Estimates of Government of Belize, or BSO

(b) Ministry of Finance data

(c) IMF estimates

(d) Revised estimates of Government of Belize

In addition, the IMF reports a different pattern of actuals in each year over this period from the Ministry of Finance. In aggregate, the IMF reports higher total expenditures over the four-year period (capital expenditures + net lending), 2000/01-2003/04, by some

9% and, if the unidentified expenditures or revenues are all attributed to capital expenditures, then the gap opens up to about 13.5%. Some of the year-to-year differences between the Ministry of Finance and IMF probably arise from differences in accounting conventions. If some expenditures are being captured on a commitment-basis or if payments by check are being made rather than reflecting when cash is actually disbursed, then differences in timing in reporting may arise. Aggregating accounts over a number of years tends to reduce the significance of these timing differences; nevertheless the IMF data is still showing significantly higher expenditures, particularly in capital II expenditures.

This data suggests a need for careful review of how capital expenditures are being accounted for, controlled, and reported.

4.4 Capital Expenditures in More Detail

The capital expenditure category comprises the following broad sectors (as categorized by the Ministry of Finance):

- **Social Sectors**: Health and environment, education, youth and sports, human development including social welfare services, and national development including Social Investment Funds (SIF).
- **Economic Sectors**: Agriculture, fisheries, commerce and industry, natural resources including forestry, tourism, culture, and enterprises.
- **Infrastructure Sector**: Public works - mainly roads and bridges, energy and communication, housing and transport.
- **Miscellaneous**: Categorized as "others" and comprising of such sundry items as highways, rural electrification, rural development projects, assistance to municipalities, tertiary education including universities, and health reform projects.
- **General Administration**: Office of the Governor General, Judiciary, Legislature, Office of the Prime Minister, Ministry of Finance, Ministry of Foreign Affairs and National Emergency Management Organization (Nemo), Ministry of Foreign Trade mainly dealing with investment promotion and public information, Ministry of Home Affairs, Attorney General's Ministry, and Ministry of Local Government and Labor.

Table 4.7 below gives a summary of capital expenditures by major sectors during the past five years. These expenditures are expressed both as percentage of GDP and percentage of total expenditures.

In nutshell, capital expenditures as percentage of GDP have been falling during the last five years and, as a result, capital expenditures in almost all the sectors have declined over the years. Thus, the capital budget as share of total expenditures has fallen from over 40% to about 20% over this period. However, the share of social spending in the capital budget has increased from about 20% to about 38%. As a result, social capital expenditures have remained relatively stable as a share of GDP in the range of about 2% to 3% and total social expenditures (current + capital) have lingered around 8% to 10% of GDP.

Capital expenditures have not followed the repetitive pattern of recurrent expenditures. In part, capital expenditures have played a major role in fiscal adjustments in response to changing macroeconomic circumstances. Major reductions in capital expenditures have been used to restrain government spending.

The data used in this part of the analysis is derived from the actual monthly releases made to different ministries by line items for the period April 2000 to November 2004 as maintained in the Ministry of Finance and made available for this study. The total expenditures for 2004/05 have been extrapolated from the expenditure figures for the first eight months of the year by augmenting the numbers by 50%. The yearly capital expenditure amounts obtained in this fashion are considerably lower than the capital expenditure figures acquired from the IMF country reports and Ministry of Finance numbers reported elsewhere (see Table 4.6 above.). This discrepancy needs to be reconciled by the Ministry of Finance.

Table 4.7
Trends in Actual Capital Expenditures by Broad Sectors, 2000/01-2004/05

Capital II Expenditures					
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**
I. SOCIAL SECTORS (% of GDP)	0.90%	0.90%	1.00%	0.80%	0.70%
As % of Total Expenditures	*2.80%*	*3.00%*	*3.30%*	*2.70%*	*2.30%*
II. ECONOMIC SECTORS (% of GDP)	0.40%	0.90%	0.80%	0.50%	0.40%
As % of Total Expenditures	*1.50%*	*3.20%*	*2.70%*	*1.60%*	*1.30%*
III. INFRASTRUCTURE (% of GDP)	0.80%	1.40%	1.60%	1.20%	0.60%
As % of Total Expenditures	*2.70%*	*4.80%*	*5.20%*	*4.10%*	*1.90%*
IV. OTHERS (% of GDP)	0.40%	0.10%	0.10%	0.04%	0.00%
As % of Total Expenditures	*1.20%*	*0.20%*	*0.30%*	*0.10%*	*0.00%*
GENERAL ADMIN. (% of GDP)	1.10%	1.30%	1.90%	1.40%	0.90%
As % of Total Expenditures	*3.70%*	*4.40%*	*6.20%*	*4.90%*	*3.20%*
TOTAL (% of GDP)	**3.30%**	**4.40%**	**5.20%**	**3.90%**	**2.60%**
As % of Total Expenditures	***10.70%***	***15.40%***	***17.40%***	***13.30%***	***8.70%***
Capital III Expenditures					
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**
I. SOCIAL SECTORS (% of GDP)	2.20%	1.30%	0.70%	1.40%	1.70%
As % of Total Expenditures	7.20%	4.70%	2.40%	4.90%	5.60%
II. ECONOMIC SECTORS (% of GDP)	0.70%	0.50%	0.60%	0.50%	0.30%
As % of Total Expenditures	*2.40%*	*1.60%*	*2.10%*	*1.80%*	*1.10%*
III. INFRASTRUCTURE (% of GDP)	4.30%	2.80%	1.30%	1.50%	1.00%
As % of Total Expenditures	*14.20%*	*9.90%*	*4.40%*	*5.30%*	*3.40%*
IV. OTHERS (% of GDP)	1.30%	0.20%	0.10%	0.01%	0.00%
As % of Total Expenditures	*4.40%*	*0.60%*	*0.20%*	*0.03%*	*0.00%*
GENERAL ADMIN. (% of GDP)	3.80%	1.70%	1.60%	1.00%	0.60%
As % of Total Expenditures	12.40%	5.80%	5.20%	3. 6%	1.90%
TOTAL (% of GDP)	**10.90%**	**6.30%**	**4.20%**	**4.50%**	**3.50%**
As % of Total Expenditures	**36.20%**	**22.00%**	**14.10%**	**15.50%**	**11.90%**
Total Capital Expenditures					
	2000/01	**2001/02**	**2002/03**	**2003/04**	**2004/05**
I. SOCIAL SECTORS (% of GDP)	3.00%	2.20%	1.70%	2.20%	2.30%
As % of Total Expenditures	*10.00%*	*7.70%*	*5.70%*	*7.50%*	*7.90%*
II. ECONOMIC SECTORS (% of GDP)	1.20%	1.40%	1.40%	1.00%	0.70%
As % of Total Expenditures	*3.80%*	*4.80%*	*4.70%*	*3.40%*	*2.40%*
III. INFRASTRUCTURE (% of GDP)	5.10%	4.20%	2.90%	2.70%	1.60%
As % of Total Expenditures	*16.90%*	*14.70%*	*9.60%*	*9.40%*	*5.30%*
IV. OTHERS (% of GDP)	1.70%	0.20%	0.10%	0.10%	0.00%
As % of Total Expenditures	*5.60%*	*0.80%*	*0.50%*	*0.20%*	*0. 0%*
GENERAL ADMIN. (% of GDP)	4.90%	2.90%	3.40%	2.50%	1.50%
As % of Total Expenditures	*16.20%*	*10.20%*	*11.40%*	*8.40%*	*5.00%*
TOTAL (% of GDP)	**14.20%**	**10.70%**	**9.50%**	**8.40%**	**6.10%**
As % of Total Expenditures	***46.90%***	***37.40%***	***31.50%***	***28.80%***	***20.50%***

4.5 Economic and Social Infrastructure

With the importance of growth and poverty alleviation as core objectives for economic development, the degree of emphasis being put on expenditures on infrastructure and social sectors in Belize is a key concern. Infrastructure development and investment in human capital through education, training, improved health services, and health care delivery have been identified as the cornerstones of the poverty alleviation strategy in Belize.[7] The Government has been planning a number of measures that would particularly help achieve these objectives:

- Infrastructure investment with specific focus on rural development.
- Construction of housing shelters and human settlement.
- Reform of primary education system.
- Construction of new school facilities.
- Employment training for youth and adults.
- Targeted funding for school text books, materials and equipment.
- Water and sanitation projects in both rural and low income urban areas.
- Targeted funding for water projects in deprived communities.

Public Sector Investment Program

The Public Sector Investment Program (PSIP) has been the key instrument through which the Government targets the economic and social infrastructure development. It pursues a set of investment projects based on their socio-economic development potential. The PSIP is financed mainly through the funds received from international donors with some counterpart funding from the Government. For instance in 2002-03, the international funding accounted for US$95 million with US$20 million as the Government's contribution.

The following priority sectors have been targeted in this context:

- Economic Services: Agriculture, business development, environment, tourism.
- General Public Services: Public buildings such as fire stations.
- Infrastructure: Bridges, electricity, housing, roads, streets and drains.
- Public Administration: Administrative reform, security and civil rights, transportation.
- Social Services: Culture, general education, health, poverty and welfare.

From an analysis of capital expenditure allocations over the past several years, however, it becomes apparent that there is a lack of consistent approach to investing in physical and social infrastructure that would help achieve these objectives.

Social Spending through the SIF and the SSF

Over the first four years of this decade on average 15% of social expenditures under the capital budget (Capital II + Capital III) were made through the Social Investment Fund (SIF), which is a statutory body created by the Government to cater to the basic human

[7] Ministry of Economic Development, Government of Belize, "Medium Term Economic Strategy 2003-2005", July 2002.

needs of the poor sections of society. The SIF provides resources for community based projects that address social and economic needs; develop and deliver basic services and infrastructure to the poor and needy; finance small scale projects such as basic infrastructure, health, education, social services and income generation activities; and manage ongoing projects under the Basic Needs Trust Funds (BNTF) grants program.

The bulk of SIF finances come from international donors with counterpart funds from the Government, particularly to support recurrent expenditures, and occasionally some contributions are also received from the beneficiary communities.

Significant additional social expenditures occur outside of the central government budget through the Social Security Fund (SSF), managed by the Social Security Board (SSB), which disburses about 2.1% of GDP annually. These expenditures include short-term health benefits for employment-related disabilities and illness and income support for unemployment arising from ill health as well as a pilot primary health insurance program in parts of Belize City. As discussed further below in section 5, if this program is expanded nationally, overall SSF expenditures will expand significantly, possibly doubling from its current level.

4.6 Detailed Trend Analysis of Social, Economic and Infrastructure Sectors

Social Sector Expenditures

The expenditures on social sectors such as health, education and human development are presented in the table below.

Table 4.8
Total Capital Expenditures on Social Sector

	2000/01	2001/02	2002/03	2003/04	2004/05
SOCIAL SECTORS (% of GDP)	**3.00%**	**2.20%**	**1.70%**	**2.20%**	**2.30%**
As % of Total Expenditures	***10.00%***	***7.70%***	***5.70%***	***7.50%***	***7.90%***
HEALTH & THE ENVIRONMENT					
As % of GDP	0.30%	0.40%	0.30%	0.30%	0.40%
As % of Total Expenditures	*1.10%*	*1.20%*	*1.10%*	*1.00%*	*1.40%*
EDUCATION, YOUTH & SPORT					
As % of GDP	1.70%	1.30%	0.90%	1.00%	1.00%
As % of Total Expenditures	*5.50%*	*4.50%*	*3.00%*	*3.30%*	*3.40%*
HUMAN DEVELOPMENT					
As % of GDP	0.20%	0.10%	0.10%	0.10%	0.10%
As % of Total Expenditures	*0.50%*	*0.40%*	*0.40%*	*0.30%*	*0.30%*
NATIONAL DEVELOPMENT (SIF)					
As % of GDP	0.90%	0.40%	0.40%	0.80%	0.80%
As % of Total Expenditures	*2.90%*	*1.50%*	*1.30%*	*2.90%*	*2.80%*

Source: Ministry of Finance, monthly releases, extrapolations by the authors

The expenditures under health and environment are clubbed together but a scrutiny of the various expenditure items under this head in the budget indicates that the bulk of expenditures are on health related projects and programs. Capital II expenditures on health have been around 0.3% of GDP while Capital III expenditures have varied between 0% and 0.13% of GDP. The combined capital expenditures have been small and declining over time from 0.34% in 2000/01 to about 0.29% in 2003/04 and are projected to rise to 0.42% in 2004/05. This trend of declining investment, unless reversed, is likely to create serious problems in the health care sector in the country.

The Capital II expenditures on education (including youth and sports) have been in the same range as health and have varied between 0.16% and 0.37% of GDP. Capital III expenditures have been comparatively higher ranging from 0.52% to 1.36% of GDP. Consequently, the total capital expenditures on education have been comparatively higher than the expenditures on health and have varied between 0.89% and 1.65% of GDP.

Capital II expenditures on items of human development that includes social welfare services, women and youth affairs, and community services has been around 0.1% of GDP while Capital III expenditures have been even smaller, continuously declining and have been reduced to zero since 2002/03. The Capital II expenditures on projects/ programs of national development including Social Investment Funds (SIF) and provision of basic needs has stood at about 0.16% of GDP while Capital III expenditures have been at about 0.67% in most years.

Economic Sectors

The trend in capital expenditures on economic sectors such as agriculture, natural resources, tourism and culture, and fisheries and commerce/industries is given in table 4.9.

Table 4.9
Total Capital Expenditures on Economic Sectors

	2000/01	2001/02	2002/03	2003/04	2004/05
ECONOMIC SECTORS (% of GDP)	**1.20%**	**1.40%**	**1.40%**	**1.00%**	**0.70%**
As % of Total Expenditures	***3.80%***	***4.80%***	***4.70%***	***3.40%***	***2.40%***
AGRICULTURE					
As % of GDP	0.40%	0.30%	0.30%	0.30%	0.10%
As % of Total Expenditures	*1.30%*	*1.00%*	*1.10%*	*1.00%*	*0.40%*
NATURAL RESOURCES					
As % of GDP	0.30%	0.60%	0.70%	0.20%	0.30%
As % of Total Expenditures	*1.10%*	*2.10%*	*2.50%*	*0.80%*	*1.00%*
TOURISM, CULTURE & ENTERPRISE					
As % of GDP	0.40%	0.40%	0.30%	0.50%	0.30%
As % of Total Expenditures	*1.40%*	*1.60%*	*1.10%*	*1.50%*	*0.80%*
FISHERIES, COMMERCE & INDUSTRY					
As % of GDP	0.03%	0.04%	0.03%	0.02%	0.04%
As % of Total Expenditures	*0.10%*	*0.10%*	*0.10%*	*0.10%*	*0.10%*

Source: Ministry of Finance, monthly releases, extrapolations by the authors

The Capital II and III expenditures on agriculture have been around 0.3% of GDP in most years but fell to 0.11% in 2004-05. On natural resources total Capital II and III expenditures have declined from around 0.6%-0.7% of GDP in 2001/2002 and 2002/03 to 0.24% in 2003/04 and 0.31% in 2004/05. On projects/programs of tourism, culture and public enterprises, total capital expenditures have been generally around 0.4% of GDP but they decreased to 0.25% in 2004/05. Finally, fisheries, commerce and industries have received a very small share of funding from the capital budget and the expenditures have varied between 0.02% and 0.04% of GDP.

Infrastructure Expenditures: An analysis of capital expenditures on infrastructure sectors such as energy and communications, public works (roads and bridges), and housing and transport is presented below.

Table 4.10
Total Capital Expenditures on Infrastructure

	2000/01	2001/02	2002/03	2003/04	2004/05
INFRASTRUCTURE (% of GDP)	**5.10%**	**4.20%**	**2.90%**	**2.70%**	**1.60%**
As % of Total Expenditures	***16.90%***	***14.70%***	***9.60%***	***9.40%***	***5.30%***
ENERGY & COMMUNICATION					
As % of GDP	0.00%	0.00%	0.01%	0.10%	0.10%
As % of Total Expenditures	*0.02%*	*0.00%*	*0.02%*	*0.20%*	*0.20%*
PUBLIC WORKS					
As % of GDP	2.70%	3.40%	2.10%	2.50%	1.40%
As % of Total Expenditures	*8.90%*	*12.00%*	*7.10%*	*8.60%*	*4.70%*
HOUSING & TRANSPORT					
As % of GDP	0.70%	0.60%	0.60%	0.10%	0.10%
As % of Total Expenditures	*2.40%*	*1.90%*	*2.10%*	*0.40%*	*0.40%*

Source: Ministry of Finance, monthly releases, extrapolations by the authors

The expenditure on energy programs/projects has been virtually non-existent both under Capital II and Capital III categories. This should be a matter of concern since the lack of proper planning in the energy sector might create a bottleneck in the general economic development in the country. Currently, Belize imports all its electricity supplies as well as its oil-based fuels.

Capital II expenditures on public works that primarily includes roads and bridges have been fluctuating considerably between 0.36% and 1.3% of GDP. The Capital III expenditures on these programs/projects started at a considerably higher level of 2.35% of GDP, but have gradually decreased over time and stood at 0.9% in 2004/05. Thus the total expenditures have been comparatively at a high level ranging between 2.1 to 3.4% of GDP, but they declined considerably in 2004/05 and stood at 1.4% of GDP. Both Capital II and III expenditures on housing and transport have been small and declining and the total expenditures in 2004/05 stood at 0.1% of GDP.

In conclusion, there is no systematic trend either in social sector, infrastructure or economic sector projects and programs. This is an indication of a lack of long-term strategy and a systematic approach to capital investments in the economy.

5. Social Expenditures: Effectiveness and Prospects

This section reviews the extent and nature of social spending by the Government and analyzes trends in some of the available social indicators to give an assessment of the effectiveness of social spending. It then looks at the problems of linking the social indicators to actual expenditures in the context of the budget and management systems used by the Government. Finally, it considers the prospects for future social spending and possible reforms of budgeting in light of both the fiscal adjustments that the Government needs to undertake in the medium term, and the need for budget reforms already identified earlier in the report.

5.1 Status of Social Expenditures

Social expenditures by the Government are undertaken through three channels:

1. Direct budget expenditures through the Current and Capital Expenditures.
2. Capital expenditures initiated through the Social Investment Fund.
3. Expenditures outside of the budget through the Social Security Fund.

Direct Current Expenditures
Direct current expenditures form the backbone of social spending, amounting to about two-thirds of total social spending. These expenditures cover the spending by the ministries responsible for education, youth, health, human development and local government services (including rural and community development). During 2000/01 through 2003/04 about 32% of current expenditures or 6% of GDP were on social spending. In 2004/05 and 2005/06, this share of the approved current budget rose to 38.9% and 36.6%, respectively. If these expenditures were actually made, these would amount to about 8.5% of GDP. While actual expenditures are likely to fall slightly below these approved amounts, there appears to be a marked increase in social spending. To some extent these increased expenditures reflect the recent significant increases in the pay scales of public servants, including teachers and health workers.

Education receives two-thirds of social spending under current expenditures. Out of this 75% finances teacher and administrative support staff, while a further 20% forms grants to schools and other educational institutions. The funding of the fuel for school buses is another significant expense. Health spending receives some 28% of the social expenditures under the current budget. Again 75% of this spending goes towards health professionals and administrators and a further 21% is used to purchase medicaments and other health supplies.

Direct Capital Expenditures
Social spending through the capital expenditures forms about half of the remaining social expenditures, or about 2.3% of GDP. As noted, "capital expenditures" are somewhat of a

misnomer as they include a range of current expenditures including grants to individual and institutions as well as expenditures on the formation of physical capital.

Nearly half the capital expenditures on the social sector goes to education (1% of GDP), about one-third goes to the Social Investment Fund (0.8% of GDP), and health receives about 15% (or 0.4% of GDP). The 2005/06 approved estimates show increased allocations to these sectors. A large part of capital expenditures (about 0.3% of GDP) goes as grants to the University of Belize and to fund tertiary level scholarships. A major new venture is a project to develop the technical and vocational training sector (about 0.8% of GDP). The Health Reform Project is the dominant capital expenditure in the health sector.

Social Investment Funds (SIF)

The Social Investment Fund (SIF), as discussed earlier in section 4.5, is used as the key vehicle for channeling funds to small-scale, community demand-driven rural infrastructure projects, including schools, water systems, clinics, roads, bridges, etc. The SIF works in co-ordination with local government officials and relies on line-ministries to fund operational costs where a community does not have the financial capacity. The SIF is a useful channel for donor agencies to target aid to poor rural communities.

Management of the SIF

The SIF is managed by the SIF directorate in the Ministry of National Development. The directorate has a skeleton field staff of one officer looking after two districts. The SIF focus has been mainly rural areas, although it has now begun to consider requests from needy sections in urban sectors as well. The SIF mandate is to create infrastructure, but not fund the provision for service delivery. As such, it only finances capital expenditures, while the recurrent operating and maintenance expenditures have to come from the respective social sector line ministries. The SIF has entered into a memorandum of understanding with each of the five ministries for this purpose: health, education, rural development, local government and human development.

The SIF activities are coordinated by a committee comprising representatives of the five line ministries, Women's Commission, Youth for the Future, private sector (Chambers of Commerce and Industry), and non-government organizations.

The SIF works in close conjunction with the local bodies – town boards and village councils. The communities bring their problems and project proposals to the SIF field staff. Project priorities are determined by holding meetings with the communities. The SIF has been regularly training the village community officials so that they become qualified for doing needs assessment and set up priorities. The SIF may also be approached directly by a public representative, a political leader or a line ministry for funding a specific project. The SIF has no explicit regional distribution formula for allocating its funds. Based on interactions with communities, an annual list of priority projects is prepared. The list along with the details of each proposal is sent to line ministries to ascertain whether they would be able to provide funds for operations and maintenance once the facilities are in place.

The ministries approve a proposal if it is in keeping with their own mandate and if they have funds to support the operations and maintenance of the proposed project in addition to their own ongoing and new schemes. After the respective line ministries clear the proposals, they are submitted to the SIF board for final approval.

Source of Funding

SIF funds mostly come as loan from the World Bank, DFID, IDB, and CDB (Caribbean Development Bank). The loan is made available to the Ministry of Finance and is repaid as part of the general debt repayment by the Government. The SIF generally makes a five-year perspective plan for raising funds and implementing projects.

The SIF works through a reimbursement process, the departments and agencies first spend money and then claim reimbursement. The SIF has begun to include the first year's operations and maintenance as part of the infrastructure costs so that a project does not suffer due to a possible time lag in providing operating and maintenance costs (O&M). The local governments try to collect partial or full user fees from the beneficiaries wherever feasible, for instance, in case of drinking water. This is clearly a step in the right direction and would help make the programs sustainable in the long run.

Past Performance

The funding in the past has mainly gone into building schools, hospitals, pharmacies, rural roads and bridges, walkways, drainage, low cost housing, community markets, providing drinking water and sanitation especially after the rural water and sanitation department was abolished, distributing of livestock, skills training, training for village council workers etc. The SIF administration has been creative in developing contracting procedures for its projects given their relatively small size and the scarcity of contractors in Belize. Effective contracting of construction has been achieved by breaking down the construction tasks into subcomponents manageable by small scale contractors.

The SIF expenditures on different activities during the past five years (1999-2003) are given in the table below.

Table 5.1

SIF Programs, Actual Expenditures (1999 - 2003)

(BZ$ thousands)

	1999	2000	2001	2002	2003
Activity					
Water & Sanitation	1,113	1,795	900	2,514	2,117
As % of total	26.7%	29.0%	22.0%	39.0%	37.6%
Social Services	220	176	165	45	519
As % of total	5.3%	2.8%	4.0%	0.7%	9.2%
Education	1,743	1,945	1,300	1,764	2,092
As % of total	41.7%	31.5%	31.8%	27.3%	37.1%
Health	385	538	45	329	420
As % of total	9.2%	8.7%	1.1%	5.1%	7.5%
Economic Infrastructure	19	190	46	560	416
As % of total	0.5%	3.1%	1.1%	8.7%	7.4%
Agriculture	-	-	-	30	2
As % of total	0.0%	0.0%	0.0%	0.5%	0.0%
Housing	-	-	-	1,201	66
As % of total	0.0%	0.0%	0.0%	18.6%	1.2%
Micro-Enterprise	313	1,163	552	-	-
As % of total	7.5%	18.8%	13.5%	0.0%	0.0%
Organizational Strengthening	-	31	48	9	-
As % of total	0.0%	0.5%	1.2%	0.1%	0.0%
Institutional Support	382	343	1,034	-	-
As % of total	9.1%	5.5%	25.3%	0.0%	0.0%
TOTAL	**4,175**	**6,181**	**4,090**	**6,452**	**5,632**
As % of GDP	**0.3%**	**0.4%**	**0.2%**	**0.4%**	**0.3%**

The bulk of expenditures have been directed to sectors such as water and sanitation and education, accounting for about 75% of the total expenditures in 2003. Social services, health and economic infrastructure have received a modest share of the allocations. Over time, some sectors were dropped, such as institutional support and micro-enterprise and some new activities have been added, for instance agriculture and housing. Also, the allocation of funds for this category of projects has remained relatively stable as share of GDP. Since these projects focus on rural and economically backward sections of society, this trend needs to be maintained.

Current Expenditures on Operating and Maintaining SIF Works

A scrutiny of current expenditures reveals that there is no separate line item for operations and maintenance of SIF works in the budget for Ministry of National Development or any of the five ministries that have signed a memorandum of understanding with the SIF directorate, viz. health, education, rural development, local government and human development. Also, there is no system in place for tracking down the O&M expenses of SIF funded projects and programs in the respective ministries and it is difficult to get data on such expenditures. To ensure that these projects continue to provide services to the needy sections of society, a system for monitoring the O&M expenditures in the respective ministries should be put in place. Also, the Ministry of National Development should monitor these expenses on an annual basis by calling upon the respective ministries to report these expenditures to them by individual projects/works.

Social Security Fund

The final important channel for social spending is the Social Security Fund (SSF) managed by the Belize Social Security Board. The SSF raises around 2.8% of GDP annually through payroll contributions[8] and spends some 2.1% of GDP in benefits. The benefits are divided into long-term, employment injury, and short-term benefits plus administrative expenditures. Based on the actuarial review of SSF for 2002, some 31% of spending went on administration costs.[9] The remainder was disbursed as benefits: long-term benefits formed 24% of SSF expenditures or 0.51% of GDP; employment injury benefits formed 14% of expenditures or 0.3% of GDP, and the remaining 30% went on short-term benefits, including half of this amount, 15% or 0.32% of GDP going on a pilot National Health Insurance (NHI) scheme.

The active registered beneficiaries by 2002 were 63,100 with the number growing at 3% per year. The long-term benefits for insured persons include a retirement pension or a lump sum retirement grant for those not qualifying for a pension, invalidity pension for disabled persons below retirement age, survivor's pension and a funeral grant. Employment injury benefits include an injury benefit for those with a temporary incapacity to work for work-related diseases or injuries, a disablement benefit for those with permanent disabilities and medical care and attendance allowances.

[8] Contributions out of payroll are 8% of insured earnings up to a maximum weekly amount of BZ$320. This is divided so that 4.5% funds long-term benefits, 2% funds employment injury benefits and the remaining 1.5% funds short-term benefits.

[9] Belize: Sixth Actuarial; Review of the social Security Scheme (as of 31 December 2002), by H.P. Montas (Actuarial Consultant), November 30, 2003.

Short-term benefits include a sickness benefit for those temporarily incapable of work, maternity benefits for 14 weeks covering pre- and post natal periods, and a lump sum maternity grant. In addition, an unfunded pilot National Health Insurance (NHI) program has been run in Belize City since 2001, covering primary health care and screening programs. This pilot program should have been funded by a further 1.5% of insured earnings. Without this added inflow of funds the reserve fund for short-term benefits are declining. While the actuarial report anticipated that the NHI would discontinue drawing upon SSF by mid-2004, this is not the case. To fund a countrywide NHI would require an additional 5% contribution from insured earnings. Currently the short-term branch of the SSF is compromised and at risk of becoming insolvent.

5.2 Trends in social indicators

Belize is an upper middle-income country at the lower end of the per capita income range[10] with a small (280,000 people), but fast-growing population. The population growth rate is nearly 3% per annum. Currently, Belize has a very young age structure with some 38% of its population aged 14 and below and only 5% aged above 65 years. While the fertility rate is declining (down from 5.4 births per woman in 1982 to 3.1 in 2003), and the population is gradually aging (in the early 1980s, 46% of the population was aged 14 or below), for the medium term this young demographic age structure will dominate public expenditure demands. The Government will continue to focus its social spending on education and training services in order to service the demand of the dominant young age group.

A review of the social and economic development indicators[11] for Belize shows that it is at or above the international average for upper middle-income countries on many indicators, but there are a few vulnerable areas. A life expectancy at birth of 71 years exceeds the average for these countries of 69 years. Its gross primary enrollment rate is 122% compared to an average of 106% for the group average. Girl attendance at school is at or above the level of boy attendance. However, Belize has only 91% of its population with access to improved water sources compared to the average of 93%. Two areas where the development indicators are currently significantly below average are (i) the infant mortality rate at 33 per 1,000 births is 38% higher than the average of 24 for upper middle income countries, and (ii) the adult literacy rate of 77% is 15% below the group average of 91%. Consequently, some trends in the health and education sectors are reviewed to assess the likelihood of these unfavorable indicators persisting.

Health Sector

Within the limitations of the available data for the health sector, there are indications that health sector inputs and services have improved in recent years. During 1998-2002, total spending on health by the public and private sectors as a share of GDP rose from 4.9% to 5.2% and external resources rose from about 3% of expenditures on health to 8%. The number of physicians in Belize has increased from around 0.6 per 1,000 persons during the early 1990s to about 1 per 1,000 persons by 2000. Data for 1998-2001,[12] show that

[10] Upper middle-income range in 2003 is defined as per capita Gross National Income in the range from $3,036 to $9,385.

[11] World bank Development Indicators 2005.

[12] Government of Belize, Abstract of Statistics, 2004 .

the number of health workers (physicians, dentist, nurses, community health workers, pharmacists and social workers) is growing as fast or faster than the population. Immunization rates for preventable diseases, which were generally in the range of 80% to 90% in the 1990s, have risen to over 90% since 2000. The issues of whether these positive trends can be sustained and whether government expenditures are effectively managed in the health sector are addressed below.

Education

In the area of education, significant improvements are evident. The World Bank Development Indicators report gross primary school enrollment increasing from 112% in 1990 to 122% in 2002, and net primary school enrollment going up from 94% to 99% over the same period.[13] These indicators point to a significant improvement in future adult literacy rates from the current level of 77%. Even if there is no adult literacy training, as the current young generations succeed the older ones, the literacy rate should rise to around 90% and possibly higher. Primary school completion rates have shown some improvement from around 67.7% in 1998/99 to 73.3% in 2003/04, but there is clearly significant room to raise these rates further.

The World Development Indicators (WDI) show even better improvements in secondary school enrollment rates. The gross secondary school enrollment rate rose from 44% in 1990 to 78% in 2002 and the net secondary school enrollment rate rose from 31% in 1990 to 68% in 2002 .[14] Interestingly, while in primary schools girl enrollment rates are higher than those for boys by a small margin, in high schools this margin is over 10%. About 84% of primary school graduates enter secondary school, but completion rates have only been in the 58% to 63% range with no upward trend.

Post-secondary education has significant scope for development. The most recent data (2003/04) shows 61,938 primary school students, and 15,359 secondary school students, but only 4,2735 students in tertiary education and a mere 429 in vocational education in 2002/03. As noted above, the major new institutional development project identified in the area of education concerns the development of technical and vocational training.

While the education indicators show positive trends, there are some indicators that raise concerns about the efficiency of government spending, particularly in the large primary education sector. For example, over 1998/99-2003/04, the number of primary school teachers has grown faster than the number of primary school pupils such that the average class size has 26.4 to 23.4 pupils per teacher. In addition, WDI data shows a decline in the share of trained teachers in primary education over 1999-2002. These indicators raise concerns about possible declining cost-effectiveness of the primary education sector, particularly considering the large real pay increases awarded to the public sector, including the teachers, over the last three years.

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[13] The Ministry of Education reports lower levels of primary school enrollment in recent years: typically a gross primary enrolment of 103% and net primary enrolment of 90%.

[14] The Ministry of Education shows lower levels of enrollment rates: in 2003/04, it gives gross secondary enrollment rates of 59% and net secondary enrollment rates of 44%.

5.3 Sustainability and Cost-effectiveness of Social Expenditures

Fiscal Stress and the Sustainability of Social Programs

The sustainability of the improvements in social indicators achieved over the past decade is being challenged by the fiscal crisis. This challenge will continue to come both from the difficulties in sustaining social spending programs in the face of fiscal stress and from the expected slower economic growth rates that will likely have per capita income stagnant over the medium term. Improvements in social indicators come both from government social spending and from private spending. WDI shows that about half health spending is private and that private health spending has grown faster than public expenditures in recent years. Similarly, in the education sector, families have to take decisions about how much to invest in education – the expected benefits tend to decline under slow growth conditions, but this may be offset by the short-term opportunity of cost of education declining if there are few current job opportunities. Periods of economic downturn are often used by people facing difficulty in getting jobs to gain further education that will improve their job prospects when the economy recovers again.

It is not expected that the Government will need to or intends to roll back its social spending programs as it deals with the current fiscal crisis. It will have little or no opportunity to fund major new ventures out of its own resources in the social sectors. If a policy of wage restraint and attrition is followed to bring the wage bill under control, this could have beneficial effects on the efficiency of the primary schools. As noted, it appears that the growth in the number of primary teachers has been out stripping the growth in pupils and that there is a need to upgrade the average quality of teachers. Cost savings and efficiency gains may well be achievable in the primary schools. By contrast, hiring restraints are likely to have adverse effects in the secondary and post secondary education as well as in the health sector. In secondary schools, the number of teachers is growing at the same rate as the student population. However, the completion rates in secondary schools needs to increase and the quality of teachers needs to be upgraded. Now, some 40% of teachers are neither trained teachers nor university graduates.

In managing the size of the public sector personnel complement, it will be particularly important to identify key positions in the social sectors where staffing level need to be maintained or even increased. For example, in secondary schools priority should be given to replacing untrained teachers that leave the service with trained graduated teachers to raise the average staff quality. Similarly, in the health sector, a priority list of key skills is required to target new hires at skill shortage areas.

The fiscal measures that the Government will need to apply to regain macroeconomic stability will restrain implementing any new programs. In particular programs that require incremental personnel and current expenditures, unless these can be organized in largely self financing ways, will suffer. While the donor community may be able to assist the Government in planning new ventures in areas such as technical and vocational training, for example, these will need to be organized to operate in largely self-financing fashions over the medium term.

Another social area that will be adversely affected by the need for fiscal restraint is the implementation of the proposed National Health Insurance (NHI) program to finance

basic primary health services on a national basis. As discussed above, a pilot program in Belize City is currently being financed out of the short-term funds of the Social Security Fund (SSF) without any corresponding contributions from the beneficiaries. This is running down the short-term fund reserves. Proper operation of this fund would require beneficiaries to make additional payroll contributions of about 5%. This will be difficult to introduce over the next three years, as the Government should be raising added tax revenues of around 2% of GDP this year and in each of the next two years before phasing out these increases over about a further three years. This will make introducing added payroll contributions difficult without considerable marketing of the potential gains to the beneficiaries of the NHI.

This project, therefore, should either be transferred from the SSF to the regular government budget expenditures or the current beneficiaries should start to pay contributions, which could be phased in over a number of years. The Government should reimburse the SSF for any shortfall between expenditures and contributions. The second approach would be more consistent with the commitment of the Government to introduce a NHI and would test the value that the beneficiaries place on the services being provided before it is rolled out to the rest of the country.

Cost-effectiveness: Performance Budgeting and Management

In many cases it is difficult to relate changes in social spending to changes in social indicators. This also means that it is difficult to come to any conclusions about the cost-effectiveness of social spending. In some areas there is considerable detail about social program performance, but there is no information about unit costs or the relations of government spending to the social performance. For example, there are detailed statistics about schools, teachers, pupils and examination results, but there is no information about the unit costs of educating students on average or across different types of schools. While the Ministry of Education funded many major inputs into schooling (salaries, transport, etc), it did not have records of the costs of schools and no reporting of school accounts appears to be required.

Performance budgeting and performance management require the measurement of services delivered and, if feasible, social and economic outcomes achieved as a result of spending programs. This allows the cost effectiveness of programs to be assessed and resources more efficiently allocated. Given the fiscal restraint that the Government will need to display in coming years, there is urgency in moving to phase in performance budgeting and management to ensure that social spending is as cost effective as possible.

In the health sector, preparations for performance budgeting are underway under the Health Reform Project; unit cost estimates are being prepared and the Belize City Hospital will be put under a performance contract. This can be contrasted with the situation at Belize University, which still has a long way to go in instituting performance budgeting. The University operates as a separate corporate entity from the Government and receives large subventions from the budget (including added funds to cover salary increases in line with the public sector and payment of pensions of its employees), but is not required to account for the use of the public funds or subjected to any performance requirements for the receipt of these funds.

The Social Investment Fund (SIF) has formed an important vehicle for channeling donor funds to demand-driven community development projects. The SIF has been responsive and innovative in its approaches to getting projects delivered. Over the long run, however, the SIF needs to be brought more into the main stream of budgeting and planning in two respects: First, most of its projects rely on government revenues to sustain recurrent expenditures. While agreements are reached with ministries to provide this funding, ideally this should become more integrated into the regular capital budgeting process. Second, local governments should be developed and institutionalized such that a more uniform level of service can be developed and maintained across all communities, not just those that have the capability of demanding the attention of the SIF.

6. Short-term Fiscal Adjustment Measures

The Government needs to quickly increase its primary surplus to over 5% to reduce its debt burden and interest costs over the medium term, and also to avoid risks of default or having to go back into the external debt markets and borrow at high interest rates of over 15% as it has recently done. Essentially it has to reverse the years of high primary deficits that contributed to the debt build up.

Obtaining sustainable fiscal adjustments is never an easy task and usually takes time, but Belize is in a financial crisis situation that demands immediate action. Ideally, fiscal adjustments that reduce government consumption are more sustainable and growth promoting than revenue enhancements that squeeze the private sector, the engine of growth over the long run. While expenditure cuts are always possible, making them sustainable and significant in magnitude takes time as it involves changing the medium-term work plans and expenditure allocations in the government budget. This involves changing staffing and organizational patterns over the medium term and therefore takes planning and time.

Raising revenues quickly is also difficult. It requires putting in place enhanced administrative and compliance capacity. In the short run, however, it is always technically, if not politically, feasible to raise rates on existing tax bases. This is especially the case for indirect taxes where increased rates can have positive revenue collection impacts within a month or two. Any revenue measures taken in the short run can be moderated or phased out over the medium term as more permanent expenditure cuts in the wage bill and interest expenses are achieved.

Given the Government has already made some expenditure cuts in the capital and operations and maintenance expenditures (about 0.8% of GDP), and given the fact that major target for expenditure cuts is the wage bill where the Government has just resolved a protracted labor dispute over the pay scale increases, in the short-term the Government appears to have limited options on the spending side and will need to resort to tax increases to make a significant impact on the primary surplus. All measures it takes in the short-term, however, should have some vision of the desired medium-term adjustments that are more in line with sustainable and desirable policy positions.

For raising the primary surplus from the existing base case of 1.6% to a minimum of 4.5% or an increase of 2.9%, a combination of revenue and expenditure measures is required. It is expected that out of this increase in primary surplus, revenues will need to account for at least 2% of GDP.

6.1 Revenue Measures

Tax measures will be discussed in a separate report, but a potential list is provided here:

1. Import duty surcharge of 5% on broadest possible import base. This could yield about 2% of GDP and would help constrain imports and lower the current account deficit, reducing the foreign exchange payment risk Belize currently faces.
2. Increases in excise duties. The Government has already announced a 50% increase in the unit tax on beer.
3. Improved enforcement and compliance measures for existing taxes.

Other revenue measures could include enhanced efforts to collect value out of DFC assets and identification of outstanding privatization options. Environmental protection programs that involve either sale of protected lands or debt-for-equity swaps for additional protection provided to environmentally sensitive areas, can generate revenues to write off external debts. Such programs, however, if not already in the planning stages, take time to design and implement.

6.2 Expenditure Measures

Expenditure reduction and restraints are already being undertaken by the Government, but will be repeated here and possible added savings identified that have not already been reflected in the estimates.

1. Freeze or limit new hires to a specified number (under 50) in designated crucial positions within essential services or top management. This will shave at least 0.1% of GDP off the wage bill.
2. Review all proposals for creating positions in the Government to determine their priority in the context of being financed in the 2006/07 budget and whether any positions expiring in 2005/06 or subsequent years should be sustained.
3. Eliminate all pay scale increments that arise out of annual performance evaluations for 2005/06 and phase increments back in gradually over the medium term. This will save up to 0.4% of the wage bill and reduce the bases for pension payments.
4. Previous public servants will not be hired on contract within two years of their leaving the public service or until rules are in place that restrict their access to added net pension rights and defer pension payments until they stop working for the public sector on contract.
5. Public pensions to retirees should be limited such that the combination of their public pensions and social security do not exceed their final average salaries for existing retirees and 75% of this amount for new retirees.
6. Impose controls on utility usage, especially telecommunication expenditures.

7. A further 0.2% of GDP should be cut from the capital expenditure II budget. All new capital expenditures should be suspended where they have not been subjected to appropriate investment appraisals.

7. Medium-term Fiscal Adjustment Measures

Belize faces a range of economic and expenditure policy issues that are unlikely to be solved or managed successfully without taking a medium-term perspective on its budget policy and practice. It can be argued that a lack of a medium-term budget policy contributed to the current financial crisis in Belize. Application of medium-term budget policies over the five years would have predicted the current problems, and hence, actions could have been taken to avoid them. While the new management in the Ministry of Finance has restored and improved budgeting procedures, there are still problems with the overall budget process in its ability to support cost-effective service delivery, to plan for major new programs such as national health insurance and to deal with economic crises such as the one Belize currently faces.

This section presents a set of medium-term fiscal adjustment measures that may help in surmounting the current financial difficulties faced by Belize. First, required expenditure-reducing measures will be discussed. These will largely consist in containing labor expenditures. Next, some major policy issues that the Government needs to tackle in the medium term to achieve sustainable high primary surpluses will be briefly discussed. In addition, these measures must be accompanied by a general modernization of budgeting practices, such as introduction of capital expenditure appraisal, medium-term budgeting, and performance budgeting. These measures should improve service delivery and support more rapid economic growth that will improve the Government borrowing capacity. Budgeting procedures will be discussed in section 8 through 11.

7.1 Expenditure-reducing Measures

In considering measures to achieve positive primary balances over the medium term, the option of a major layoff from the public service is not included. The major staff-reduction exercise in 1997/98 left a negative political legacy. The current Government has publicly rejected the layoff option, which would likely exacerbate its political problems following the labor dispute over the attempt to delay the final stage of the pay scale increases. Rapid layoffs are not only politically costly, but are also often financially costly as they typically involve major severance and gratuity payments. The focus here is on achieving sustainable changes in the cost structure of the Government. This often requires gradual implementation of changes over the medium term. While rapid employment changes are not advocated here, persistent and systematic restructuring of public sector employment is at the core of the recommendations below.

The package of deficit reduction measures could include:

1. Reduction of personnel emoluments as a share of GDP through:
    a. Reductions in total staff (negative net hires of about 1% per year with limiting new hires to critical positions) by restricting new hires to at most 50 persons in critical identified positions.

   b. Hiring restrictions apply to all types of hires: contract, established and unestablished.
   c. Restricting access to merit-based bracket increases.
   d. Reviewing staffing priorities and levels, especially with respect to unestablished officers.

2. Improving pension forecasting, and rationalizing and restructuring the public pensions to reduce costs.

3. Containing the costs of contract hiring.

4. Capital II expenditure cuts and restructuring.

5. Public utility cost forecasting and restraints.

6. Merging ministries and departments to reduce overheads and improve co-ordination.

7. Other fiscal reforms to improve fiscal responsibility: systematic wind-up of the DFC and improved investment policy for SSB and the reporting of all debts guaranteed by the Government.

8. Introduction of national health insurance.

Each of these measures is now considered in more detail.

Reduction in Personnel Emoluments

Reduction in personnel emoluments (PE) provides the prime target for costs reductions given the recent rises in the PE costs arising from implementation of the pay scale increases (rising from 9% to 10.9% of GDP) and the high share (68%) of PE in current operation costs. PE reduction can be achieved through restraints in hiring below the attrition rate and through wage restraints. Currently, merit increases lead to bracket increases which result in annual wage drift of about 3 to 4% arising from bracket increases of about 6% in the lower pay scales to about 3% in the high pay scales. Quotas on the share of public servants that achieve bracket increases from year to year can assist with reducing the PE cost over the coming years. Restrictions on bracket increases should be politically saleable given the major pay increases that have been implemented over the past three years.

Assuming a targeted reduction in the PE to GDP (Y) ratio, R, growth in R can be given by

g_R = Growth in average wage rate (g_W)
+ Growth in numbers at average wage rate (g_N)
- Growth in GDP (g_Y)

where the growth in numbers at average wage rate is given by

g_N = New hires rate *($W_{new}/W_{average}$) - Attrition rate * ($W_{attrition}/W_{average}$)

To reduce R from 10.9% to 9% requires a reduction of 17.4% or at least 5.5% per year over 3 years and assuming that wage drift is restricted to 1% per year on average over this period and that the wage weighted attrition rate is 2%.

$$g_R = -5.5\% = 1\% (g_W) + g_N - 5\% (g_Y)$$

$$g_N = -1.5\% = \text{New hires/N* } (1.25) - 2\% (1.0)$$

New hires/N = 0.4% (or about 50 new hires out of the total employees supported by the budget in 2005/06 of about 12,000, including teachers).

To verify and implement this policy, first, requires that the Government determine its staff attrition rate (number of staff leaving the service annually through retirement, death, disability, resignation, compulsory terminations, etc. relative to the total size of the public service) and the wage rates of these staff relative to the average. This information is not currently known by the Public Services Commission, the Ministry of Finance or the Accountant General. Second, the Government needs to identify critical positions to be filled. Only these positions should form new hires or replacements within the quota of about 50. These positions would include top management and constitutional positions, and positions in essential services (security, health etc.). Strict control over hiring starting 2005/06 could reduce R by about 1% or save about 0.1% of GDP. Reducing wage growth will only become effective later unless a decision point in bracket increases is still available before 2005/06.

Following the 8%/6% annual pay scale increases over the three years through 2005/06, stricter control should be applied to merit increases in order to restrain wage drift. For example, restrict the share of officials in a ministry that can move up wage brackets in a year to zero in 2005/06 and then increase by 10% each year for about five years till 50% can qualify for merit increases. In the short-term, given the recent pay scale increases, all bracket increases should be suspended. For moral reasons and to sustain the performance system, some 10% should qualify in the second year and then higher shares in subsequent years. Compared to the example above, this would result in a 6.5% reduction in the wage bill to GDP ratio over the first year and additional but somewhat smaller reductions in subsequent years.

In the second and subsequent years, to counter the tendency towards a gap in mid-level employees where top positions are filled and there are many junior and support staff, but not mid-level workers critical to program management, consideration could be given to adding such mid-level managers to the list of critical positions for new hires.

As discussed earlier, Belize has had a history of high expenditures on personnel emoluments. Arguably, the process of reduction in the wage bill should be continued for a further two years at least till it is reduced to about 8% of GDP or about one-third of total expenditures.

While any major mass layoffs are not advocated, it is important that the Government starts a systematic process of reviewing the priority and costs of unestablished and contract employees and the need to renew their employment contracts when they come up for renewal. Unestablished officers form some 25% of the civil service (excluding teachers) and officers on contract about 3%, but are among the higher paid officers in the service.

At the same time, as the aggregate cost of personnel is adjusted, it is equally important to adjust the skill mix. Good governance generally depends on brains rather than brawn (or quality rather than quantity of personnel) so that attention needs to be paid to developing the recruitment and human resource development strategies to have the professional and managerial skills appropriate to the public sector. Given that many of these are peculiar to the public sector, the required specific skills need to be developed within the Government, and cannot necessarily be readily procured from the private sector.

Pensions

Improving the forecasting of pensions and restructuring pensions will reduce deficits and save costs.

Underestimation

Pensions (including *ex gratia* or gratuity payments) have been underestimated in recent years with fair regularity. This results in higher than expected deficits as the overrun only becomes apparent late in the year when it is difficult to undertake offsetting cost reductions. The Government needs to get data on the frequency of new retirees and others leaving the service that qualify for pension or gratuity payments. In addition, the death rate of pensioners is not known. This data is necessary to forecast pensions and gratuity payments more accurately. The Accountant General had promised to produce data on the number of pensions in pay in each year since 1999 to assist in forecasting the growth in pensioners. This data is not available yet.

Integration of Public Pension and Social Security

To reduce the size of public pension payments, the public pension scheme should be integrated with the social security scheme. Public pensions, as a pay-as-you-go (PAYG) scheme, should only pay the excess of pension promises not covered by social security. This prevents pensioners from receiving unnecessarily high pensions. For example, under current arrangements, pensioners can receive combined pensions in excess of their pay while working. This puts an unnecessary burden on the current budget. Note that the public pension system is unfunded, whereas the social security is a funded scheme. With integration, in no case will a retiree take home less than the accrued public pension benefits or lose the value of contributions made to the social security scheme. To restrict any apparent retroactivity, the following approach is suggested to deal with existing and new pensioners:

- For pensioners receiving the pension, limit the sum of public service pension and social security pension to 100% of the pensionable earnings base for public pensions (highest last three years) plus subsequent base adjustments.
- For new pensions to be paid in 2005/06, limit pension payment such that the sum of public and social security pension is a maximum of 75% of the pensionable earnings base for public pensions.
- For subsequent years, for new pensions, full integration should be applied – reduce public pension paid by amount of social security pension payments. The public pension will only cover pensionable earnings not covered by the social security.

The Government needs to undertake an urgent study of both the growth of pensions in pay and the extent of excessive pension payments in the system in order to determine the

extent of the pension savings through application of the pension limits recommended above. Excessive combined pensions are likely to arise with long-term service employees with about 25 years or more of pensionable employment in the public and social security systems. The number of such employees can be expected to start rising quickly with the aging of the public service.

Funded vs. Unfunded Pension Scheme
The Government has already taken a decision to consider the introduction of a funded pension scheme in place of the current unfounded, PAYG scheme. Various options and various transitional arrangements can be considered. One approach is to consider a funded defined contribution pension for young (under 30) and all new employees with age-indexed contributions. Such a scheme would have combined employer-employee contributions increase by age group to mirror normal savings patterns. This would also lower the upfront cash cost of phasing in a funded pension scheme. Initially for about 5 years, all pension contributions could be invested in government debt instruments of at least one-year maturity. Over time a more diversified portfolios should be permitted and even a degree of individual choice over the investment policy may be allowed. An alternative approach is to fully fund the past service liability of the public pension system with zero coupon bonds of terms designed to match the expected profile of pension payments and then to fund all incremental liabilities with current contributions. Either approach will lead to a higher current demand for funds that will need to be timed to match increased borrowing capacity of the Government as it emerges out of the current debt crisis.

Rationalization of Pension Eligibility
While considering reform of the funding of the pension scheme, the membership of the scheme needs to be rationalized. Currently a number of anomalies exist – university staff members are still receiving public pensions as members of a separate corporation. Partially funded teachers receiving 70% of their pay from the Government only receive 70% of their pensions, but have no options to top up this amount, whereas fully government funded teachers receive full pension rights. There are no adjustments to the pay or pensions for public servants rehired on contract. This point is dealt with in the next item.

Contract Hiring
Contract hiring is needed to give flexibility to access professional skills, but there is a need to contain the costs of rehiring public servants. Rules should be in place that either require 1-2 year gap before former public servants can be rehired on contract and receive pension; or that deduct pension payments out of contract payments; or that defer all pension payments until the employment with the public sector is completed. This can be achieved by reducing the contract and gratuity payments by any public pension received, but crediting the person for any forgone pension rights that would have been accumulated in public service if the person had remained in service. Clearly no added pension rights would be awarded if the contract contains provisions for an equivalent gratuity payment.

Capital Expenditures
Reductions in domestically financed capital II expenditures can be achieved by limiting expenditures to amounts to cover counter part funds, grants and net lending that are

essential to sustain other government agencies, amounts to complete ongoing essential projects, and amounts for self-supporting or revenue raising projects. In addition, where possible, government financed projects should seek financing or refinancing with low interest rate donor funds. All other projects should be deferred or canceled. All new government-financed projects should undergo cost-benefit analysis to ensure their financial feasibility and economic attractiveness. Already the Ministry of Finance has made cuts of about 0.2% of GDP out of the capital II expenditures as well as similar amounts out of the operating and maintenance current budgets. Further cuts of another 0.2% of the GDP could be made out of the capital II expenditures budget.

Public Utility Costs
Improvements need to be made to the forecasting of public utility (electricity, lighting, water and telephone) costs and to restraining the cost of utility usage. In recent years, utility cost forecasting has added to the deficit. In addition, the central payment of most public utilities leads to a lack of control over spending, particularly on telephone usage. It is recommended that actual costs of utilities (not approved estimates) be used as the basis of forecasting costs. In addition, it is recommended that public utility costs, particularly telecommunications costs, be allocated to cost centers to make managers more responsible for restraining unnecessary public utility usage and for obtaining improved cost effectiveness.

Merging Ministries and Departments
In recent years, the Government had up to 25 ministries and separate departments with their own budgets. Currently, it has some 21 ministries and departments. This is a high number for a small country. Overhead or administrative costs can be reduced and greater program co-ordination achieved through merging of ministries. The Government should aim to reduce the number of ministries and departments to a maximum of fifteen over the medium term. This type of restructuring is often most easily achieved following an election when new ministers are being appointed, but the rationale, planning and budgeting for such reorganization needs to take place in a medium-term framework.

7.2 Some Policy Issues with Severe Fiscal Impacts

Completion of Privatization, Stabilization of the Social Security Fund and Winding-up of the Development Finance Corporation.
The Government has to draw up a strategic plan that takes into account the size and timing of the fiscal consequences of completing the privatization of the telephone company. The Government should also prepare a plan for bearing in possible losses suffered by the Social Security Board (SBB) when winding up the DFC. Also, SSB will need to reduce its exposure to the DFC and recently privatized state corporations. It will need to employ more professional fund managers either directly or indirectly, and publish its detailed fund portfolio in publicly accessible media. While work is ongoing in winding down the activities of the DFC and the Government having to assume growing amounts of DFC liabilities, no identifiable, transparent and irreversible process has been put in place to oversee the winding up process. Until the Government actually appoints some independent commission or bankruptcy court to oversee the winding up of the affairs of the DFC, it is hard for the public to be convinced that the process has really started and will be carried through to completion in the best interests of the public.

Introduction of National Health Insurance

Both the 1998 and the 2003 Manifestos of the present Government included the introduction of national health insurance programs. To date, a pilot primary health program has been operated in parts of Belize City out of the short-term funds of the Social Security Board without added funds being raised.[15] This expenditure should be brought into the central government budget until the SSB can raise the appropriate premiums to finance national health insurance. The SSB needs to run all its programs on an actuarially sound basis.

A national program to support primary care would require additional contributions of about 5% of insured earnings. It will be a challenge to educate and convince the public to assume the burden of additional social security contributions. Given the pressures to raise taxes to reduce government deficits and debt, increases in social security contributions will need to be phased in over time and balanced with the immediate tax revenues needed for deficit reduction and the people's willingness to pay.

8. Dimensions and Directions of Modern Public Sector Budget Reforms

The Belize budget system is fairly narrow in the range of budgetary tools used to improve public expenditure performance. This section serves to introduce and outline some of the major dimensions of budget reform being used internationally. Few governments use all these budget procedures and not all the procedures apply equally to all parts of government activities. The art of budget reform lies in adopting elements of budget reform as they may suitably apply to the size, style, capacity, and different functions and agencies of a government. These reforms have the potential to render the public sector performance more productive (effective) and economical (efficient).

8.1 Budgetary Tools

Macro Framework

Presently, the Belize Government does not develop either a macro framework or a strategic budget policy before initiating the budget cycle. Developing a macro framework during the early stages of the budget cycle will help the Government adopt a medium-term perspective and ensure consistency between economic growth, stabilization objectives and its fiscal policy. It will push the Government towards determining the tax and debt capacity of the economy and set its expenditure ceilings over the medium term. Clearly, forecasting the revenue and debt capacity will be crucial. The need to undertake a medium-term fiscal adjustment program in the context of debt reduction is currently an issue of major concern in Belize.

Given the Government does not have a strong macro-economic and fiscal analysis and planning unit, the effort to develop this framework should be led by a joint committee Chaired by the Ministry of Finance that should include members from Finance, National

[15] Currently contributions to the Social Security Fund from employment income are 8% of insured earnings up to a weekly maximum of insured earnings of BZ$320. The 8% contribution is divided into 4.5% going to long-term retirement benefits (including funeral, death and survivors benefits), 2% to employment related illnesses and injuries, and 1.5% to short-term benefits such as support for maternity and loss of employment income for medical reasons.

Development and the Central Bank. While a macro and fiscal framework gets updated on a quarterly basis as new economic performance data become available, it is important to establish the initial framework in the first half of the financial year in order to provide the parameters for budgeting over the remainder of the year.

Given that grants and loans finance from donors make up about 10% to 15% of total expenditures, it will be important to consult with the donor community concerning their funding commitments to Belize over the medium term. Clearly, the better defined and more credible the macroeconomic and budget policies of Belize are, the easier it is for the donor community to commit themselves to medium-term programs.

Strategic Budget Policy

Adoption of a strategic budget policy during the early budget preparation process reflects the priorities of the Government, particularly in respect of changes in policy that will require added resources or displace existing programs over the medium term. Such policy changes should arise out of a priority determination process, be consistent with the medium-term fiscal framework and have realistic cost estimates. The budget policy statement provides explicit direction to all levels of government for the detailed preparation of the budget within the stated priorities and policies.

In Belize, government priorities are not systematically formulated and translated into budget policy. It is left to the line ministries to see whether the stated government policies are formulated in their programs and for the cabinet to see whether the draft budget reflects the ruling party's mandate. The present government has constituted a 'Public Finance Committee' of selected cabinet ministers that scrutinizes the draft budget before it is approved by the full cabinet. Next, the broad proposals are shared with the social partners – trade unions, business bureau, and chambers of commerce and industries and finally it is submitted to the congress/senate.

To give clear direction on budget priorities, it would be useful if the Minister of Finance can make a public statement of the Strategic Budget Policies of the Government about four to six months ahead of making a detailed budget and financing statement prior to a new financial year. This statement should follow a period of public and internal discussions about Government priorities. At this stage, the focus would need to be on the nature of macroeconomic and fiscal adjustments required to raise revenues, cut expenditures, lower the effective interest rate on government debt and induce higher economic growth. In later years, the focus could be more on changes in expenditure policy related to pensions and health insurance. A statement of budget policy should not merely announce government priorities, but should be based on realistic estimates of the costs of new policies and how these will be absorbed into future budgets through revenue growth and/or expenditure reallocations.

Medium-term Budgeting

Belize has been following a one-year budget cycle and needs to move towards medium-term budgeting within the medium-term fiscal framework and strategic budget policies. The Ministry of National Development has a Social and Economic Analysis and Research Unit, which does prepare a three-year medium-term economic strategy, but it is an independent exercise not integrated into the budgeting process. Without medium-term

planning and budgeting, the Government finds it difficult to adapt and adjust cost structures and tends to remain committed to repeating the status quo. Introduction of medium-term budgeting will

- ensure that financing is available for completion and operation of capital projects.
- phase out existing commitments such as planned incremental changes in staff numbers or quality.
- phase in new programs and help adjust to economic imbalances.
- create flexibility by identifying discretionary or uncommitted funds that will become available in future years through revenue increases or through completion of current projects.

The introduction of a medium-term framework into the budget system in Belize will take a persistent effort over a number of years. These efforts must go hand in hand with the adoption of a Medium-term Macroeconomic and Fiscal Framework and the presentation of Strategic Budget Policies.

Moreover, forecasts must be based on accurate information about costs and expected trends. The costs of items such as pensions and gratuities and interest payment should be forecasted based on changes in underlying determinants. In the case of pensions, for example, forecast should be based on information about new retirees, expected expiration of old retirees and actual payment to existing retirees. In future, unit costs of services and other activities should be computed and these should form the basis of performance or output-based budget estimates. In later years, focus should be put on presentation of the budget in a way that shows the quantitative output targets and the budget allocations to meet these targets.

Cash versus Accrual Budgeting

The current practice in Belize is "cash only budgeting" and not "accrual-based budgeting". Commitments are only included in the sense that project-related financial commitments (recurrent costs for ongoing projects and contracts) are included in the budget. Since the budget is cash based, supplier's credits or payables are not included. The departments keep track of payables including overdue debts or pending bills, but there is no system of maintaining accounts payable or controlling any unplanned build up of accounts payable. In addition, the stocks of unpresented or undrawn checks at the end of a fiscal year are not reported. This can cause problems in reconciling borrowing requirements with the calculated overall deficit.

Guarantees and Contingent Liabilities

Guarantees or other contingent liabilities are not provided for in the budget as explicit line items and have to be added to the budget as unfunded supplementaries. In the past, the main government guarantees have been for the public debt. More recently, however, the decision of the Government to assume guarantees extended by the DFC has resulted in creation of immediate and large liabilities.

Extra-budgetary Funds
Extra-budgetary expenditures should be eliminated or made transparent to allow for reallocation of resources during times of budget stress.
The DFC has acted more as an extra-budgetary agent than an independent development bank. Aside from guaranteeing DFC debts, the Government has on-lent funds to the DFC. In addition, the DFC has also relied heavily on financing from the Belize Social Security Board (BSSB). This soft lending has allowed the DFC to undertake financially unviable projects and simultaneously undermined its capacity to mobilize private sector capital and the credit rating of the Central Government.

Currently, other extra-budgetary expenditures include the Belize Tourist Board, which is supported by the 9% tax on hotel accommodation but neither the revenues nor expenditures are reported in the Belize budget. Another off-budget expenditure is the pilot primary health insurance program in Belize City being supported by the BSSB without any corresponding premiums collected by the BSSB to support this activity.

The Social Security Fund (SSF) is kept outside the budget. This is also true of other boards created by the Government, such as the Sugar Board and, as mentioned the Belize Tourist Board. Their finances do not form part of the general budget. Any subventions or grants given to these boards are, of course, shown in the budget. The Social Security Fund is managed by the Social Security Board (SSB), which is an independent body. Although the Ministry of Finance is the line ministry for the SSB, its operations are distanced from the Government.

Recently, the social security fund has given some bad loans and has also extended guarantees to some private sector loans, which have created misgivings and agitation among the public. The Government has committed itself to making the SSF whole in case of any loss suffered through these transactions – a contingent liability not provided for in the budget.

Line Item Budgeting versus Program and Performance Budgeting
Performance budgeting and management would enable the Government to achieve cost-effective delivery of services. The essence of performance budgeting is the allocation of funds to achieve specific output targets required to achieve broader program outcomes coupled with the organization and management structure that can hold managers accountable for the cost effective use of funds. Currently, Belize follows the line item budgeting which focuses on authorization and control of releases, commitments and payments on line items or groups of line items within programs.[16] This practice is followed to ensure that expenditures remain within the lesser of voted authorizations and actual releases, and to prevent the build up of overdue debts. "Vote book" controls are used to link voted authorizations to payment of outstanding debts and new commitments.

The budget for a ministry or agency is actually broken into broad "programs" and "cost centers." However, these sub divisions are more for expenditure allocation and

[16] It should be noted that the Government actually employs a dual budgeting system; the capital budget is separated and budgeted differently and separately from the recurrent budget. The "incremental line item" characterization applies strongly to the recurrent budget, but less so to the capital budget which has been less stable over time in size and content.

authorization than for performance budgeting and management. The budget does footnote some functions or objectives of the program or cost center, but these are not quantified or turned into performance objectives. Many cost centers are also identified with an office in a specific location rather than with the resources to achieve specified program outputs in that location, region or country as a whole. The line ministries do not include performance goals or benchmarking of indicators along with their proposals. The departments sometimes use norms (e.g. population) to justify their demands, but there is no systematic approach at tracking the performance of different programs and agencies. Justifications for proposed expenditures are submitted in general terms.

Unit cost estimates ideally require estimates of accrued costs of the resources used to deliver specific services. Moreover, performance budgeting and management requires the identification of service delivery cost centers for related programs and sub-programs and formation of a management structure that can direct the organizational units to produce measurable outputs and minimize unit costs. For example, a health program could set targets of delivering a minimum number of vaccinations to a target population at unit cost within prescribed limits. Monitoring of performance is integral and essential to this approach. Also, performance incentives and/or contracts can be used.

Currently, there is multiplicity of program agencies to address the same problem. For instance, four departments -- Education, Health, Human Development and Public Service -- have chalked out separate schemes for tackling the problem of HIV AIDS. Clearly a coordinated program would be more effective and also save costs. Also, the health status of a population is affected by outputs of the education system, public information, infrastructure, as well as the activities of a ministry of health. Thus a program-based approach in budgeting would allow the Government to adopt an overall strategy that would augment the outcomes and improve the performance in the health sector.

Thus, the Government needs to identify programs and cost centers in a way that reflect output targets. More systematic program budgeting would allow the Government to enhance the co-ordination of all activities across different ministries that service the same economic outcomes. It would also help remove duplications, create synergies, and select cost-effective packages of activities.

For example, a program for performance budgeting purposes could be "all infectious disease control programs" with subprograms for major disease control programs. Each subprogram would have targets expressed in terms of persons treated or cured. The budget for each subprogram would be allocated to the activities in various locations required to achieve the outputs. The objectives under each program would move from being footnotes as in the current estimates to being headline targets, and in the budget outturn, to being actual output achievements. This style of performance budgeting and management is well suited to programs with quantifiable targets such as health, education, utility, construction, or transport services, but not so well suited to general administration, policy, planning and co-ordination functions. The latter generally have to be evaluated in terms of the quality of the input effort and the overall final outcomes.

Most ministries are aware of the need for more performance-oriented budgeting and some line agencies do use more sophisticated allocation criteria. Ministry of Health is possibly

at the most advanced stage as it has been undertaking studies and preparatory work to implement elements of unit costing and performance budgeting and management under the Health Reform Project. The Ministry of Agriculture has developed an "unofficial" program budget. Also, the Ministry for Public Works does use more sophisticated allocation criteria within its line items. For instance, it allocates road maintenance funds based on traffic volumes, age, weather, and other wear-and-tear factors to determine the type and timing of routine road maintenance. Generally, however, both the Ministry of Finance and the line ministries conduct little or no budget analysis that includes estimation of unit costs of major services (such as the cost of education to different levels and in different locations).

Introduction of Performance Contracts

A common approach to encouraging public sector performance budgeting is to set up quasi-autonomous government agencies (or special purpose corporations) that receive public subventions and that are given a degree of management independence to achieve well-defined performance targets. In other words, the public funds are accompanied by performance targets and/or contracts for the agency and its top managers. Belize has started to use this type of corporatization of some public services, for example, the establishment of Belize University and Belize City Hospital under separate boards of directors, but to date it has not imposed performance contracts on these institutions to justify the subventions. Belize City Hospital will be subject to performance contract in 2005/06 and subsequent years.

This approach has not been used as yet to encourage improved performance from Belize University or some 30 grant-aided high schools and colleges and a further 9 government-funded high schools and colleges. Currently, these government-aided institutions are not even required to submit their books of accounts that could be used to estimate the total expenditures on health and education services that would form the basis of establishing performance criteria to improve the efficiency of service delivery and establish unit cost and cost effectiveness benchmarks.

Launching Performance Budgeting in a Phased Manner

It is recommended that the introduction of performance budgeting is undertaken in a range of selected programs and institutions where its application is feasible and likely to be effective. These should include:

1. All hospitals with appropriate management capacity.
2. All universities, technical colleges and high schools with appropriate management capacity (likely to be those in urban areas).
3. Road maintenance and related administrative services.
4. Water services.

In all other service delivery areas, managers should be required to identify their major service delivery programs, the outputs of the programs, the activities and inputs required to achieve these outputs, and the accrued unit capital and current costs of the outputs. This basic information should form the basis of setting appropriate output targets for programs consistent with the budget allocations for the programs.

8.2 Building Systems and Capacity

Finally, the development and implementation of enhanced budgeting systems will require considerable effort over a number of years. Both human capacity and systems will need to be developed and put in place. Capacity building will be required in a number of specific areas:

1. Technical areas: Macroeconomic planning; monitoring, controlling and forecasting tax revenues, personnel expenditures, pensions and gratuities, debt and interest charges.
2. Performance budgeting and management procedures.
3. Project appraisal methods and institutional arrangements.

Some initial capacity building should be conducted amongst a cadre of mid- and senior level managers to allow them to better lead the medium-term planning, studies and reforms. In turn, a product of the medium-term studies and plans should be more detailed specifications of the capacity building needs to implement the reform over the medium term.

9. Improvements to the Budget Preparation Cycle and Releases of Budget Funds

Budget making in recent years (prior to the change in management in the Ministry of Finance in late 2004) seems to have been an unilateral exercise without much communication between the Ministry of Finance and line ministries. The Ministry of Finance has generally made decisions without actively involving the other line ministries or agencies in the Government. It appears that over the previous two or more years, actual face-to-face discussions of ministerial and other agency budgets broke down with the Ministry of Finance making budget cuts without consultation.

While the preparation of the 2005/06 budget saw a return to the practice of consultation between the Ministry of Finance and line ministries, there is a need for more continuous consultation concerning the priorities, outputs and costing of the outputs of ministries. The objectives of such an exercise are two-fold: (i) to help ministries improve the efficiency and effectiveness of their expenditure programs; and (ii) to allow undertaking more rational decisions when the Ministry of Finance is advising the Government on changes in allocations between programs in different ministries at the time of finalizing budget estimates for approval.

The Ministry of Finance sends a budget call every year on October 1, asking the line ministries to submit their budget proposals on a given format within a period of six weeks. After the proposals are received, separate discussions are held with each ministry and this whole exercise takes about two more weeks. After the initial round, further consultations are held on phone if deemed necessary.

The Ministry of Finance also prepares an estimated budget for each ministry based on its previous year's expenditures, and then it is compared with the submissions from the various ministries. If the ministry's demand is lower, it is accepted without discussion. If

it is larger than the Ministry of Finance estimate, an agreed number is reached through consultations or simply imposed by the Ministry of Finance.

9.1 The Budget Preparation Cycle

To introduce components of a medium-term budget into the budget preparation cycle as well as upgrade the quality of line item estimates, the budget cycle needs to start earlier and include new steps. The following rough cycle of activities could be considered:

First Quarter of Financial Year

- Closing of books for previous financial year and preliminary estimates of actual expenditures and closing debt, checking and other cash balances.
- Initiation of releases and any new financial management procedures for new financial year.

Second Quarter of Financial Year

- Preparation of macroeconomic and fiscal framework for following financial year and at least two and up to four additional out years, depending upon whether a three or five years rolling budget is to be prepared. Particular focus would be on determining total revenue and borrowing capacity and targets. Estimates should include available donor grant and loan funding. Key players would be the Ministry of Finance, the Ministry of National Development and the Central Bank.
- Consultations within and between ministries on government priorities and potential major new program initiatives or changes in policy. Program committees for human development sectors and for economic and infrastructure sectors could be used as vehicles to structure discussions and planning. Consultations should also be held with the social partners, development partners (donor agencies) and other interest groups. As far as possible, these discussions should be in the context of the macroeconomic and fiscal framework.
- Identification of discretionary or uncommitted funds in future years due to revenue increases, growth in borrowing capacity, completion of existing projects, and termination of low priority activities. Allocation of discretionary funds to new priority initiatives as well as existing high priority activities, where possible supported by cost-benefit analysis and always supported by financial feasibility analysis.[17]
- The two components (the macroeconomic and fiscal framework and the new budget policy initiatives) should be packaged by the Ministry of Finance as a Strategic Budget Policy Statement for Cabinet level approval.

Third Quarter of Financial Year

- Presentation to Assembly of a Strategic Budget Policy.
- Updating macroeconomic and fiscal framework based on any new market information.

[17] In the case of non-self supporting projects, financial feasibility depends upon the budget resources being available over the life of the project. This means that the projected discretionary revenues can absorb the capital and operating costs of the new project or program.

- Issuance of budgeting instructions to ministries (ceilings, priorities, etc. consistent with the Strategic Budget Policy Statement).
- Line ministries prepare detailed multi-year budgets.

Fourth Quarter of Financial Year

- Line ministries present draft budgets to Ministry of Finance and fine-tuning of budgets are negotiated. Any overdue debts expected at the end of the current financial year should be identified and budgeted separately from the funds allocated to new commitments. Payment of these debts should be met by a ministry out of its overall budget ceiling for the next financial year.
- Preparation of final budget and related documents.
- Presentation and approval of budget estimates and financial statements.

It is important to note that the above process requires the expenditures on new and ongoing projects to be estimated over the medium term. New projects can only be absorbed into the budget if room exist to absorb both the capital and current operational expenditures of the project over the medium term. New projects have to be well prepared and approved for potential inclusion early in the budget process at the point of identifying and allocating uncommitted funds over the medium term. This means that projects cannot be parachuted into the budget at the last minute and generally cannot enter the budget during a financial year, other than in the case of national emergencies.

9.2 Management of Budget Releases to Ministries

During the brief time available for this overall budget review, the financial management procedures used in budget implementation were not reviewed in detail. Nevertheless issues arose out of discussions with various ministries.

Releases for the recurrent budget are monthly and set at 1/12 the annual amount for each two-digit line item within a cost center of a ministry. This system provides predictability in the flow of funds, but it causes problems in cases where (a) a ministry has definite seasonal patterns in its spending (e.g. school buses only require fuel during the school year, not during vacation periods); and (b) the bulk purchases of supplies (e.g. office supplies, pharmaceuticals, uniforms) reduce transaction costs and allow pricing discounts. Rather than changing the overall release policy, the Ministry of Finance should negotiate exceptions or make quarterly or other seasonal releases for fuels and supplies.

If overdue debts are identified and budgeted separately, as discussed above, then funds for these should be released in the first month of the year.

Excessive itemization, line item controls, and numbers of costs centers makes reallocation of funds somewhat inflexible. Cost centers in the current budget are largely regional offices rather than service delivery programs. A move towards performance budgeting would reorganize the budget into service delivery programs and allow greater budget flexibility to managers within a program to meet or exceed the service delivery or output targets within the program.

10. Reform of Capital Budgeting

Capital Expenditures on Non-development Works

As is clear from the categorization of capital expenditures in the analysis in section 4, a fairly significant share of the capital expenditures used to be on non-development works in the departments of Legislature, Judiciary, Public Service, Defense, and the offices of the Governor General and the Prime Minister. In 2000/01, capital expenditures in such departments stood at 5% of GDP out of a total capital expenditure of 14% of GDP, which equaled almost 35% of the total. In 2004/05 it stood at about 1.5% out of a total of 6% capital expenditures, which is about 25% of the total.

In the 2005/06 budget, total capital expenditures are proposed at BZ$146 million. Under Capital III, there is no provision for ministries such as Home Affairs, Defense, Attorney General etc. and the entire allocation is made to economic, social and infrastructure sectors. Under Capital II, the total capital expenditure for non-development works is at BZ$32 million which is 22% of the total capital expenditures. Thus the share of capital expenditures for development activities has been increasing over the years. This is a welcome trend.

Misclassification of Expenditures

Another major problem is the misclassification of current expenditures as capital expenditures. Current expenditures include grants made to local governments, educational institutions and other government agencies, general administration and other services, and supplies. To some extent it appears that the Capital II budget is used to fund one-time or irregular current expenditures, but many also appear to be recurring in each year. This type of wrong categorization tends to artificially inflate the capital expenditures and reduce the current expenditures. Examples of this kind of misclassification may be seen in all the five years from 2000/01 to 2004/05 both for Capital II and Capital III expenditures, although Capital III expenditures have fewer cases of this kind of wrong categorization.

Scrutiny of Capital Expenditures under Category II and III

To get a correct picture of capital versus current expenditures in the budget, it would be necessary to scrutinize the disaggregated items under Capital II and III expenditure activities, identify the current expenditure items that have been wrongly included in the category of capital expenditures and move them to the right category. Also, wherever an activity has both the capital and current expenditure components, the tendency to book the entire expenditures under capital expenditures category should be discontinued.

Project Appraisal for all Government Investment Expenditures

The current practice for choosing new capital expenditures is simply to take all the proposals to the cabinet and let it decide by consensus. There is no institutional arrangement for conducting analysis of projects/programs either by the Ministry of Finance (MoF) or the Ministry of National Development (MoND) for such decision making. The MoF only puts the proposals together for the cabinet. Any cost-benefit analysis should be done at the ministry/department level, but may require technical assistance from the MoND and/or the MoF.

Thus, in terms of selection and implementation of project/program, mainly a top-down approach is being adopted by the line ministries since they have to deal with the political exigencies and accommodate what the ministers and congressmen want. The SIF, on the other hand, adopts a bottom-up approach and its projects/programs are demand driven. However, SIF projects/proposals also do not undergo any rigorous financial or economic appraisal.

The current budget crisis is causing drastic cuts in capital project expenditures and will continue to do so for a number of years. This slow down in the project pipeline offers an opportunity to develop project appraisal requirements and screening procedures to ensure that capital expenditure proposals are subjected to financial, economic, and stakeholder analyses thus maximizing the benefits to the economy from such expenditures.

Some Specific Steps to Improve the Capital Budgeting Process

1. The declining trend of the overall capital investment is a matter of concern. Since the amount of Capital III investments will always remain uncertain, the aim should be to limit the extent of current expenditures and divert funds to Capital II projects and programs so that a minimum threshold of expenditures on capital investment is maintained annually.
2. The present pattern of capital expenditures, particularly in social and infrastructure sectors, reflects a lack of any strategic planning in these vital sectors of the economy. There is a need to conduct a detailed assessment of the prevailing gaps in physical infrastructure and social sectors and have a long-term strategy for investment.
3. The investment in health sector, in particular, needs to be enhanced since its current level is quite low and has been declining. Continued inattention to this sector might lead to major problems. The future of this sector needs to be reviewed in conjunction with the introduction of any national health insurance program.
4. Similarly, there is a need for better planning in the energy sector since inadequate energy is likely to create a bottleneck in the overall economic development, particularly with dependence on foreign electricity supplies.
5. It is not only necessary to enhance and maintain a certain level of capital expenditures from year to year, but adequate provision in the current expenditures for operations and maintenance of the facilities created is essential. It is better not to make capital investment in the first place than create structures and services and then neglect their operations.
6. To optimize the economic benefits of the capital investments, there is a need to replace the present *ad hoc* system of project/program selection by an institutional arrangement in which each project and program over a certain minimum outlay is subjected to an appraisal process by the respective ministry, the MoND and finally by the MoF. This may be done by creating appraisal units in the ministries dealing with infrastructure projects and social programs and in the MoND and in the MoF. The unit in the MoND would focus on assisting *ex ante* appraisals, conducting *ex post e*valuations, and monitoring the project implementation and performance, while the MoF unit would focus on the approval and integration of projects into the capital and current budgets, particularly in the context of medium-term budgeting.

The MoF should also provide guidelines for the preparation of feasibility appraisals, project approvals and budget integration.

7. The next step would be to create a system of *ex post* appraisal of projects/ programs and evaluation of outcomes of these activities to draw lessons for the future and also ensure that the capital investment is not only creating structures, but is leading to the desirable goals of economic development.
8. Finally, a capacity building program for the personnel in the units involved in appraisal and evaluation in the various ministries is necessary so that the persons involved can be suitably trained in the techniques necessary for such appraisal and evaluation.

11. Improving Estimation and Expenditure Control Procedures

11.1 Improving the Accuracy of Budget Estimates

There is little deviation between the budget proposed and the budget passed by the parliament because the party in government has majority in both the Houses of Parliament. The members of the legislature hardly ask for any additional information or analysis and the budget is generally passed without much deliberation.

There are deviations, however, between budget passed and budget executed as is borne out by the long list of supplementaries. The supplementary amounts may look big but these are mostly transfer from one head/department to another. There are hardly any increases or decreases in the overall budget size and this is mainly because of revenue constraints. Yet, the problem of underestimation of expenditures is significant. To improve allocation and restore control and monitoring of expenditures this problem must be addressed.

Actual budget performance data and budget supplementary appropriations should be used to eliminate the problem of underestimation of items in the current expenditure category. Generally, insufficient use has been made of actual budget performance data and budget supplementary appropriations in current year-to-date (YTD) accounts. Often budget estimates are based on prior year's approved estimates rather than the actuals, not taking into account revisions in particular made through supplementaries. In the past, revised estimates were typically based on six months of actual expenditures in the year to date scaled up by a factor of two. This process ignored YTD expenditures beyond six months, seasonal patterns of expenditures and actual expenditures beyond 6 months that might indicate more accurately the total expected expenditure in the current year. Specifically, the estimation of personnel emoluments, pension, interest payments, and expenditure on public utilities needs improvement.

Personnel Emoluments

Personnel emoluments (PE) form the largest single expenditure item amounting to over 10% of GDP. In 2003/04, actual PE exceeded approved expenditures by some BZ$2 million or about 0.1% of GDP. In the recent past, PE estimates were not based on confirmed employment data of actual public officers and their pay scales. Thus there has been a consistent underestimation of expenditures under this head.

The PE should be based on listing of personnel by name and cost center. The Public Services Commission expected to complete the computerization of the establishment using HRMIS by September 2005. Once fully implemented and maintained, PE expenditures should be confirmed by the HRMIS before monthly PE payments are made. Thus, effectively a "two key" system should be maintained where payroll data is confirmed by the HRMIS data. This should provide the basis for more accurate forecasts of PE. The employment of an officer should be confirmed with Public Services Commission prior to payment of salaries every month. With the Public Services Commission computerizing its personnel records, this cross checking against payroll listings for each ministry can be effectively done. Employment lists should also be reviewed occasionally and randomly by ministries.

In recent years, estimates have included an account of the number of positions and personnel emoluments budgeted for each ministry and cost center. In addition, a summary of the total number of positions and personnel emoluments by pay scale and ministry should be provided.

Pension and Ex Gratia Payments

Pensions including ex gratia payments have been growing quickly in recent years, but has typically been underestimated. In 2003/04, approved estimates were nearly BZ$8 million below the actual expenditures of BZ$31.2 million, an underestimation of about 25%.

More accurate estimates of pensions and *ex gratia* payments needs to be made based on the attrition rate out of the public service to estimate new pensioners and recipients of gratuities, death rates of pensioners and any changes in the average annual pension amounts. The Accountant General is working to provide data on the number of pensioners paid in each of the years 1999-2004, but to date this information is not available. The Public Services Commission HRMIS should be used to identify expected retirees based on age.

Interest Payments

Interest payments have risen quickly in recent years and typically these payments have been significantly underestimated. This has been partly due to unexpected assumption of debts by the Central Government and underestimation through omission of interest on the new debts required to finance the deficit and/or the underestimation of deficits, and hence, added interest-bearing borrowing. In 2003/04, interest payments were underestimated by some BZ$20.6 million, and again in 2004/05, the underestimation was expected to be about BZ$16.7 million.

Interest payments should be estimated based on the full debt, including the borrowing requirement for rollovers and increases in debt that are expected during the forthcoming years. The Commonwealth Secretariat debt model used by the Central Bank of Belize can be used to estimate interests based on projections of rollover and new borrowings.

Public Utilities

Public utilities **-** water, electricity, telephone and street lighting- used by the ministries are budgeted under general administration account of the Ministry of Finance. These have generally been underestimated in recent years by amounts ranging from BZ$2

million to a high of nearly BZ$10 million in 2003/04. Much of the underestimation relates to telephone charges.

For public utilities, more realistic estimates are required based on actuals. Most of the underestimation relates to telephone charges. Since telephone use is subject to personal abuse, consideration should be given to shifting the responsibility for telephone charges to individual ministries to encourage greater economy. A process is being implemented to allocate budgets to ministries and split allocations in 2006/07.

Revenue Forecasting
Every year, the office of the Revenue Commissioner forecasts revenue prior to the budget-making exercise. In the past, their forecasts have generally come quite close to the actual collections. In 2004/05, however, the actual collections were 10% lower than the forecast. The reason is that a new land tax had been imposed on large land holdings, but collections were very poor. The prospects of collecting this tax are not very bright.

11.2 Presentation of Budget Estimates

To improve transparency, budget presentations should generally give actual budget performances for past years and provide clearer summary information on key budget expenditures that need greater control and reform, such as personnel emoluments and debt.

Summary table of aggregate revenues and expenditures should include summaries of preliminary outturns for last completed financial year and final outturns for the year prior to that. Presently, actual outturns are given for revenues and for detailed budgets by ministry, but they are not reported for the overall Government. Historical statistical reports for government accounts give only the approved or revised estimates, but not actual outturns. Approved estimates and the revised estimates for current year should include explicitly all budget supplementary approvals.

With the introduction of performance budgeting, programs should be organized around actual service delivery where appropriate and quantitative objectives should be reported, where feasible. Estimates for cost centers should be organized around program delivery arrangements. Estimates for general administration and policy units can remain as currently organized.

Capital budget categorization should separate physical capital formation from transfers and lending, investment in human capital, and institutional development. The different types of physical capital expenditures should be identified: construction of buildings and infrastructure and the acquisition of land, buildings, vehicles and equipment. Grants/transfers/subsidies should be in the current budget. Net lending should be a separate component of the capital budget.

Separate budget estimates should be made and identified for the payment of any overdue debts or pending bills in a ministry. This separates the allocation of funds for current year operations from the resources required to clear old debts.

Debt reports in Appendix B of the estimates should give stocks of debt as well as disbursements. The reports should give the original amount of a loan and Disbursed and Outstanding Debt (DOD) as of end of prior financial year and estimated DOD for end of current year and for the budget year. They should also include as memorandum items all loans guaranteed by the Government. Appendix B should also give a summary layout of interest *versus* principal payments. A summary table should give the breakdown of domestic and foreign interest and principal payments and stocks of outstanding debt by major types of loan.

11.3 Monitoring and Expenditure Control

As regards expenditure control, there is very little monitoring of departmental expenditures by the Ministry of Finance or line ministries. The recurrent budget is generally released in equal monthly installments, irrespective of the actual pattern of most efficient expenditures by a ministry. The financial operations of ministries are controlled by Finance Officers, a generally competent cadre, who report jointly to the Financial Secretary in the Treasury and to the Permanent Secretary of their respective ministries.

The entire focus of monitoring, however, is on the revenue performance of the Tax Department. A mid-year assessment of revenues and expenditures is made, and if revenue collections have fallen below the target, expenditures are curtailed. Monthly reports are prepared based on the statements from line ministries. When a department asks for the release of next installment of funds, they have to justify it by showing that the funds sanctioned earlier have been utilized. But there is no real monitoring of physical and financial progress of projects and programs. Even normal financial statements are not being published regularly and the Ministry of Finance is way behind in this.

Presently, the Ministry of Finance does not keep track of indicators developed for different activities or actual performance vis-à-vis such indicators. Ministry of National Development or Ministry of Human Development should be following it up but so far this type of monitoring is not being done by any agency.

In short, the Ministry of Finance does not do any monitoring but it simply exercises cuts and controls on expenditures when there is a shortfall in revenues.

11.4 Establishment of a Budget Analysis Unit

As noted above, the Ministry of Finance conducts little detailed budget analysis either independently or in conjunction with line ministries. This creates difficulties in directing resources to government priorities and/or making cuts or reallocations of funds in times of fiscal stress. It also makes the development and implementation of medium-term and performance budgeting difficult. To improve budgeting procedures within the current process and to pave the way towards medium-term and performance budgeting, the Ministry of Finance needs to establish a small budget analysis unit of two or three budget officers under the Financial Secretary.

The duties of this unit would include:

1. Oversee the budgets of a group of ministries.
2. Conduct budget analysis in conjunction with the finance officers and program directors in ministries such that they understand business of each ministry and are fully aware of the impact of short-term and medium-term changes in funding provided to a ministry. Where performance budgeting initiatives are being piloted or implemented, assistance would be provided in defining programs, output measures, unit costs and the mechanisms for preparing, presenting and managing budgets.
3. Consult/advise in preparation of budget and monitor releases and advise on reallocations within and between ministries.
4. Assist in developing analysis, forecasting and control mechanisms for personnel emoluments, pensions and interest charges in conjunction with Public Services Commission.
5. Assist in developing and implementing project appraisal standards for the analysis, approval and absorption of development projects and programs into the budget. This task would require co-ordination with the Ministry of National Development.

11.5 Some Recent Changes to the System

The Government of Belize has made changes in its top management in the Ministry of Finance (MoF) to try to reverse the deterioration in budget management. This has been accompanied by some changes in the budget system as well.

- The Ministry of Finance has begun to take a more direct role in managing many "capital expenditures" and also increased its communications and interactions with line ministries in planning and managing the budget.
- To reduce the growth rate in personnel emoluments, a moratorium has been imposed on new hires and many vacant positions have been eliminated. Work is ongoing to computerize the personnel and establishment records to assist in personnel control and planning. It is anticipated that the system will become operational and linked to payroll by the third quarter of 2005/06.
- The changes in MoF management have made noticeable improvements in a short time. They have restored more fiscal discipline in the use of the capital expenditure account, and the management of capital expenditure projects has been returned to the appropriate line ministries and the Ministry of National Development is playing a stronger role in planning and monitoring capital projects.
- Budget estimates for 2005/06 have used more recent actual budget information than in the past. In addition, improved communications have been re-established between line ministries and the MoF in the planning and budgeting process so that budgets reflect the ministries' needs and priorities more closely.
- Steps are also being taken to improve the quality of government financial statistics, particularly by the Central Bank of Belize. Notably Belize statistics have not been reported in the IMF Government Financial Statistics since 1997 and the 2003 Article IV consultations reported the need for capacity building in Belize national statistics.

12. Assessment of the Public Service[18]

In a Latin American and Caribbean context, Belize's civil, or "public," service places itself at an intermediate level of development. In particular, it benefits from a well-rooted and reasonably transparent meritocracy. Indeed, originating from a British style civil service, the challenges consist more in avoiding unwarranted bureaucratization of much formalized procedures, rather than dealing with excessive politicization of decisions. The deficiencies of the Belize public service are therefore efficiency-related in their nature.

12.1 Principal Challenges

Belize is facing a serious challenge when it comes to downsizing and streamlining its public service. A rapid increase in size has been accompanied by falling standards of efficiency and quality of public services. Functional control and accountability have also deteriorated. The public service is at present staffed with close to 12 000 public officers, including the uniformed services, teachers, and open vote personnel.[19]

It will be vital that necessary downsizing forms part of a more wide-ranging restructuring that also target other deficiencies within the public service. Gradual cut in staff costs (through attrition, severe limits on new hires, and wage restrictions) should be guided by an overall strategy aimed at increasing efficiency.

Increasing efficiency can only be achieved through strategic planning, an area that presents significant potentials for improvement. The centralized aspect of current planning practice causes efforts at lower levels to be poorly aligned with overall strategic objectives. Responsibility for executing reform rests in the Ministry of Public Service, without clear incentives for the rest of the ministries to join these efforts. A number of weaknesses within different subsystems of the public service originate from the fact that improvements are carried out as isolated efforts instead of reflecting an overall strategic plan.

Another crucial area with ample room for improvement is the area of performance management. The British colonial heritage has left Belize with a service characterized by rule following rather than being result oriented. It is central to develop performance management and incentive structures so that result-oriented behavior is rewarded.

A related problem is the excessive bureaucratization due to much formalized procedures. This differs from the challenges facing many of the Latin-American countries that experience a more politicized public service. Flexible and efficient procedures in work organization and employment management need to be introduced to tackle excessive bureaucratization.

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[18] The Belize public service has been scrutinized according to the analytical framework drawn up by Francisco Longo. The actual analysis in the case of Belize was conducted by Mercedes Iacoviello. This section provides an overview of some main findings from her study according to a division into seven subsystems.

[19] An estimate dated February 2004 indicates a total of 11,771 employees, out of which the permanent establishment comprises 7.586 employees, the open vote is estimated at 2,148, contract officers represent a total of 189, and Police and Defense forces represent 1848 employees (MAT, 2004).

The need to promote reform in the public service is clearly acknowledged and expressed through a common understanding of the social and economic benefits that reform will engender. Indeed, in year 2000 a Public Sector Reform was launched by the Government, which priorities comprised: a) transparency and accountability, b) rule by clear, rational, widely promulgated code of law, c) checks and balances to reinforce appropriate incentives; d) widest possible participation of the people of Belize in policies, programs and projects; e) the leaving of activities in the private and civil society sectors unless there is a compelling case for government intervention; and f) improved professionalism and competence within the public administration and to the people (Government of Belize, 2000). The Public Sector Reform Council was created in January 2000 with the mandate to advise on and coordinate the implementation of Public Sector Reform.

However, after a couple of years the initiative lost its initial strength. From the official document about the Public Sector Reform published in 2000, about 75% of the programmed strategies were at least attempted, although many discontinued, and about 50% effectively implemented. In June 2003, the Prime Minister reactivated the Public Sector Reform Council. The challenge is still to involve all ministries in these initiatives and to establish a detailed prioritization of the goals. Several sector reform initiatives exist, but there is no macro plan within which they can be coordinated.

12.2 Institutional Framework

The independent Public Services Commission oversees the public service. Its responsibilities consist of setting the code of conduct, fixing salaries and generally managing the public service. Also, it is in charge of exercising disciplinary control and recommending or removing staff from office. The commission's efforts are expressed through recommendations to the Governor General that carries them out. However, Belize is a constitutional monarchy and part of the Commonwealth in which the Governor General represents the British monarch Queen Elizabeth II. The Governor General inhibits a largely ceremonial role and is therefore expected to be neutral.

The Ministry of Public Service is in charge of personnel management and industrial relations practices in the national Government, including executing recruitment, transfers, promotions and disciplinary measures, and promoting and developing training programs. The Ministry also oversees the Secretariat to the Public Services Commission,[20] and the Secretariat to the Joint Staff Relations Council, which role is to watch over the conditions of service and welfare of Public Officers. The Ministry works in close partnership with the Ministry of Finance and the Ministry of Budget Management, advising on matters related to the creation and reclassification of posts, human resource requirements of ministries in terms of numbers and levels, rental of buildings, and other matters. Public service employees are to be insulated from overt political pressure, and their role is "to provide the services of the state and implement programs and projects of the Government in a fair, accountable and efficient manner" (PRC, 2000).

[20] The Ministry of Public Service has traditionally served as a secretariat to the Commission, but in June 2000 the Cabinet approved that the Public Services Commission function from its own office. To staff the Office, some members of the Ministry were transferred to occupy positions in the Office (MPS, 2000).

The Public Sector Reform Council meets on a monthly basis, functions as an advisory body to the Prime Minister and Minister of Public Service, and monitors the implementation of reform initiatives. Based on an extensive consultation process and on a review of previous diagnostic documents, the council has developed a "list of recurrent topics," and elaborated a work program for 2004–2005 that included Human Resource Management as one of seven main issues.

The legislation draws up different roles for the three institutions involved in the central administration of the human resources function (the Ministry of Public Service, the Public Services Commission, and the Public Sector Reform Council). There is nevertheless some degree of tension between them in terms of their responsibilities. The Public Sector Reform established the need to delegate powers from the Public Services Commission to the Ministry of Public Services, including the power to transfer, recruit and terminate employees. In the last years, part of these responsibilities were taken back by the Commission, but constitutionally these policies remains the responsability of the Ministry. These changes might reflect a political competition over the control of these functions and create some overlapping of functions.

12.3 Analysis of the Sub-systems

Human Resource Planning

The planning of human resources allows for the comparison of quantitative and qualitative human resource needs with expected internal resources in order to identify gaps and to find strategies to deal with shortcomings. Given the large size and high costs of the public sector in Belize it is clear that strategic planning is vital. However, the planning function represents maybe the weakest part of the public service. Moreover, the transversal feature of the planning function causes weaknesses at this level to be reflected in all subsystems of public service.

In Belize, a strategic management plan exists at the macro level. However, this is not layered down and hence each ministry establishes priorities and strategies without consulting the national plan. Rather than lacking information, it is the familiarity with how to engage in a constructive planning process that seems to be weak.

Strategic planning also needs to focus on the mix of staff in terms of skilled vs. unskilled personnel. In most ministries overstaffing is apparent; this is in particular the case on clerical levels. However, there is a shortage of specialized technical and managerial staff, which as a result is chronically overworked. A related problem is that the budget for recurrent expenditures on materials, supplies, and maintenance is currently assigned about 10% of recurrent expenditures and has not increased to the same extent as has staff; the public service is therefore seriously under equipped.

The information technology infrastructure has been weak when it comes to providing information about human resources. The Ministry of Public Service, with the funding by the Ministry of Finance, has been working on implementing a human resource component into the existing infrastructure. These efforts have benefited from the computerization of payroll already as of 1998. At successful implementation, the system

will provide inputs to planning, identification of training needs, and update of job description system.

Work Organization
The work organization function establishes and specifies the activities, functions, and responsibilities assigned to each position (job description) and the definition of the competencies, skills, and attitudes necessary for successful performance in each position (profile definition).

At present, job classification tends to represent rank rather than responsibilities. Also, functions are not satisfactorily defined and it is not clear to the employees what is expected from them. There is currently an initiative to streamline the complete job classification, which is done in parallel with implementing the human resource component into the information technology system. Profile definition gives weight to technical skills, but competencies such as leadership, initiative, decision-making, and problem solving are increasingly recognized as critical in managerial positions.

Although job descriptions are periodically reviewed, it is necessary that job descriptions be even more flexible and adaptable. Increased customer service challenges and rising expectations to access government services on behalf of a more diversified, multicultural society require continuous actualization of job descriptions and profiles. New legislation might also affect job classification.

A recent study concludes that there is a lack of information about organizational structures at all levels within ministries. Charts do not reflect real organization of the areas, and reporting lines are in some cases not clear (MAT, 2004). As pointed out in this report the Government should aim at restructuring in order to reduce the number of ministries and departments to a maximum of fifteen over the medium term. Also, earlier reform attempts called for flatter structures through the development of a reclassified service scheme but the strategy was never implemented.

Employment Management
Employment management refers to the policies and practices that manage how people enter, move around, and leave the organization. It involves all practices related to recruitment, selection, induction, mobility, and departure of staff. It is critical that equity, merit, and quality principles guide employment management.

Clear rules, but with built-in flexibility mechanisms, make the subsystem of employment management to one of the assets of the public service. The hierarchy of positions consists of thirty levels. The five highest ones (level 26 to level 30) are reserved for positions that follow a political appointment procedure according to section 107(1) of the Belize Constitution. The Governor General makes the appointment of these officers with the advice of the Prime Minister and consultation with the Public Services Commission. The rest of the public service (level 1 to level 25 in the pay scale) is subject to a merit-based selection procedure administered by the Public Services Commission. The procedure has been simplified and decentralized for the eight lowest levels (Level 1 to Level 8), which correspond to maintenance and basic administrative tasks. For these eight levels, the Public Services Commission Order delegated in year 2000 the authority

for recruitment and selection to the CEO in each ministry (Clarke, 2002). However, the Commission still checks that vacant positions are filled by following established procedures. It also controls the process for the promotions in middle rank positions.

The category of employees called “open vote” workers corresponds to temporary assignments, most of them in the lower classification levels, and they are hired completely at the discretion of the ministries. According to the Public Services Commission they are not used in excess. At present, evidence is not conclusive about abusive use of this type of assignments, yet there is definitely a possibility of undermining the merit system as a whole if an increasing number of employees are hired under this category.

Selection procedures are very detailed, and generally complied with. According to the regulations, the appointment and promotion of public officials is based on three factors in descending order of importance: performance/merit, integrity/professionalism, and experience/employment history (Services Commissions Regulations (SCR) art.16, PSR art. 11). The question that remains is if the procedures are efficient to establish who is the most competent candidate for a position, since the alignment between job description and individual profiles is far from perfect.

The Commission is in charge of approving tranfers between ministries (SCR, 43-49). The power to transfer public officers within the clerical, secretarial, administrative and accounting grades (called horizontal grades) was delegated to the Ministry of Public Service in 1994, and transfers within the Ministry were delegated to the CEOs in year 2000 (MPS, 2000). In recent years, there has been a curtailment of positions, and most movements are associated with promotions. Geographical transfers are very common, and in those cases relocation grants are assigned to the public officer.

There is a “cadet system,” which takes the form of recruitment of qualified, but inexperienced candidates from outside and within the service, into middle management positions. These officers are given "on the job" training with continuous supervision. The goal is that these officers provide improved support to senior management, and bring new insights, methodologies and professionalism to the organization (MPS, 2000).

The power to discipline public officers is vested in the Services Commission. The regulation opens up for the dismissal or removal of public officers as a consequence of discipline proceedings, abolition of offices, or the need to improve organization of the actual department.

Compulsory age for retirement is 55 years and re-employment is allowed if there is a chronic shortage of a technical or professional skill. Some concerns about increases in the frequency of rehiring have been raised in recent years.

Performance Management

The management of performance refers to the process of planning and evaluating the contribution of employees to the organization. It is vital that individual and group performances are aligned with the organization’s priorities. Also, to assure that performance is kept on its highest possible level and that sustained improvement is

enabled are crucial to the functioning of the organization. At present, performance management represents one of the weakest spots in the Belize public service.

Most institutions and organizations operate in the absence of clear mandates and performance targets. Thus, current procedures do not provide necessary performance framework within which to address the serious capacity and motivational issues. The public sector reform addressed these deficiencies but most of the initiatives could not be applied. The present performance evaluation system suffers from an excessive benevolent bias. A more complex form of high technical standard now exists but its use is far from generalized. Line managers find it difficult to assume their performance-managing role. Completion of the appraisal forms receives low priority and the forms are not seen as effective tools for expressing constructive criticism or comments. However, this is an ongoing reform and significant improvements to the evaluation system are on their way.

Compensation Management

Compensation management refers to the administration of compensation pay (salaries and bonuses) and non-financial benefits that the organization offers to its employees, to compensate them for their work towards the organization's objectives. It should be based on internal and external equity principles, with a salary structure based on the valuation and classification of positions, and some kind of variable payment scheme that link rewards to performance or results (either on the individual, group or institutional level).

The Public Service Regulations establish the rules for salary management (part VI, art. 105-128). Decisions about wage administration tend to follow the established procedures, and there is not abusive practice associated to them.

Given the excessive proportion of recurrent expenditures that are destined to personal emoluments, the salary strategy is dominated by a budgetary focus. However, it is necessary that this focus be strengthened even further. The Public Service Regulations establish an automatic increment system (PSR art. 106) in which the annual increment is tied to performance (PSR art. 108). In practice, it is assigned automatically to every officer, instead of being based on a well-conducted staff appraisal, despite the existence of such a system.

Wage equality among officers in similar positions is reasonable. However, problems arise when comparing terms and conditions of employment of established officers versus contract officers, since they are much more favorable for the last ones. This fact provides for a negative effect on staff moral. The wage compression is reasonable, reflecting a ratio of 9.8 between the higher and the lowest pay range for career positions.

Regarding external equity, the entry level salary is a bit higher in the public sector, but an employee can improve his/her situation much faster in the private sector based on good performance. As a consequence, at higher levels the public service loses people to the private sector, while at lower levels it still attracts competent candidates. Therefore, it is important to work on a strategy for retention of managers.

Several tools that aim at establishing incentives for good performance are in place. Among these are additional compensation for the job covered when an officer replaces another one, an award of one increment for passing clerical promotion examinations (PSR, art.12), and a merit award for outstanding service (PSR, art 111). However, there is a generalized perception that these tools are not being effectively used.

The Workers Compensation Act establish a retirement system based on the social security, and on the results of the respective collective agreement. The Pensions Act applies to the public service (SCR, art. 52), and establishes a "non-contributing" scheme. There is a proposal to extend the retirement age from 55 to 60 years old, and to review the Pensions Act so that new hires start contributing to the Social Security.

Development Management

Development management refers to the ability of stimulating professional development of the staff according to their potential, encouraging necessary learning, and defining career paths that match the organization's needs with different profile of employees. Promotion policies, career design and training management are the main processes included in this subsystem, and should be managed with a clear focus on the priorities and needs of the organization.

A need assessment for human resource development in Belize was conducted recently, which established that the main flaw in the public sector is related to leadership skills, more than technical skills (Waight, 2004). This confirm previous diagnosis indicating that many senior managers lack training to set direction, develop work plans and objectives, assign tasks to teams an supervise and monitor progress.

The Ministry of Public Services is in charge of coordinating the training function, both in-service training and scholarship programs. Efforts have been largely focused on formal administration rather than providing a strategic direction to training activities. This lack of planning has resulted in an ad-hoc training function generally ruled by the individual preferences of public officers. Thus, significant room for improvement exists and in particular it will be vital to strengthen planning of the human resource development and align needs to strategic objectives.

Human and Social Relations Management

Human and Social relations management refers to the management of the relations between the organization and its employees, and personnel policies and practices when these acquire a collective dimension. It involves labor relations management, which includes the collective negotiation of pay and working conditions; the management of the organizational climate in terms of communication policies and practices, and social benefits that are offered to employees in general or to aid particularly needy groups or individuals.

Belize benefits from strong and well-established relations in this area. There are several instances of interaction between management and Unions in the public sector, with Union representatives taking part in several joint bodies with responsibility in the design and implementation of human resource policies, like the Joint Staff Council, and the Human Resource Development Committee.

Since the ratification of International Labor Organization conventions (ILO Conventions Act, chapter 304:01), registered in June 1999, the Labour Relations Convention (ILOC 151) and the Collective Bargaining Convention (ILOC 154) have the force of law in Belize, providing a formal legal framework to the negotiations between management and Unions in the public sector.[21] In 2003 the first Collective Agreement was achieved, after a negotiation on salary increases, benefits improvement and modification of the tax structure. More recently, there was a collective agreement for the Central Bank (December 2004), which included a variety of issues (testimonial).

The Joint Staff Relations Council represents a more informal but still important instance for discussion of issues between management and Union, as a complement to other instances of collective bargaining. The chair of this Council is the CEO of the Public Service Ministry, and the co-chair is the president of the Public Service Union. It was created as a "gentlemen's agreement" as a negotiation area and there is no formal legislation supporting it. It is not an instance of conflict resolution, but its advisory role to the Cabinet provides an instance to discuss sensitive issues before they escalate into a conflict. From the government perspective it provides a good model for balanced labor relations. From the Union's perspective there is a valuable instance but it has a weak impact on the conditions of employment, since the final decision is with the Ministry of Public Service and the Cabinet if to pass proposed changes to the legislation.

The critical fiscal position has made it more difficult to negotiate compensation, increments and grants, a fact that has deteriorated labor relations in recent years. For example, the Union has been on grievance for four years on increments and salaries for public officers being moved to statutory bodies (paraestatal organizations – electricity, social security, large hospital). The agreeement was that movement would not affect their income and conditions of employment, but it resulted in a conflict that lasted four years and it was just recently that the problem could be solved. The Union sees as a negative change the politizied turn implied by replacing Permanent Secretaries with CEO's appointed by the ministers. The division of responsibilities between the Ministry of Public Service and the Services Commission is also seen as a problem as the system has become more complex and power is seen to have "broken into pieces" among different institutions.

12.4 Recommendations

The role of the Ministry of Public Service and the Public Sector Reform Council should be reinforced, so that their initiatives are accompanied by the necessary actions in other government areas. There should be a real pressure for change, and power should be vested on these institutions so that they are able to put pressure on those areas required for implementation of reform. The reform efforts should be owned by the public service at large, and not only by the Ministry of Public Service. At the same time, the role of the Services Commission should be revised to guarantee that it provides the overseeing of central decisions regarding human resources throughout the Government, without adding unnecessary bureaucratization of the decision process, and avoiding overlapping with the Ministry.

[21] Even before that ratification, the right to negotiate was recognized to the Unions in Belize.

Another central issue that has already been addressed in previous diagnostic reports (Universalia, 2000; PSRC, 2003; MAT, 2004) is that proposed actions to improve the Human Resource Management system should be prioritized, and clearly assigned to an agency that must be set accountable for results. Another point to take into account is to maximize positive interactions with other reform initiatives suggested in this report. These initiatives should be used as a platform to introduce improvements in the public service.

From the analysis of each specific subsystem, several recommendations can be drawn. First, that the focus on strategic planning should be emphasized even more. Most of the weaknesses in several subsystems come from the fact that efforts to improve specific processes are not framed within a strategic plan. Second, it is central to develop performance management and incentive structures so that result-driven behavior is rewarded. This is the only way to make sure that the process-oriented culture is gradually replaced by a focus on results. Third, Human Resource Development needs to be aligned to strategic objectives. In that sense, the ongoing process to develop a Human Resource Development plan is a central step to start working in that direction. Fourth, even though the Work Organization and Employment Management subsystems are reasonably developed, more flexible and efficient procedures should be introduced in order to avoid bureaucratization.

13. Conclusions and Recommendations

Revenue and Expenditure Measures

The Government is faced with the challenge of raising its primary surplus from the current estimate of 1.6% of GDP to a sustained level of at least 5.5%. The quicker it can raise the primary surplus rate, the longer it can defer having to go back into the external commercial debt markets and avoid possible default situations,[22] with extremely unattractive prospects in the short term. However, restructuring expenditures also requires adjustments to be undertaken over the medium term, particularly given that wages, pensions and interest charges are the dominant expenditures. Accordingly, it is recommended that additional tax measures collecting an added 2% of GDP be implemented over the initial few years and that these be replaced gradually by expenditure cuts which save 0.6% initially and increase to 3.9% of GDP over time as illustrated in Table 4.1. This would give a total primary surplus of 4.2% in 2005/06 rising to 5.5% over the medium term.

The primary source of added revenues would be a broad-based 5% import surcharge that would not only raise about 2% of GDP in revenues, but also help restrain imports and close the current account deficit. The import surcharge can be gradually reduced with the reinstating of a broad-based VAT taking effect.

On the expenditure side, personnel emoluments would be gradually cut through attrition and severe limits on new hires to positions on a priority list that would maintain and

[22] The original version of this report included a further discussion of some of the issues that would need to be considered in the event of a debt default and devaluation. Please contact Vibeke Oi RE2/RE2 vibekeo@iadb.org to obtain a copy of this version of the report.

improve key social and security services and government management, including budget management. For example, any new teacher hired should be appropriately qualified. Wages would be frozen and bracket increases phased in again to a limited share of officers subject to performance based criteria. The wage bill as a share of GDP should be brought below 8% of GDP over the medium term to control the deficit and improve the mix of government inputs required for proper service delivery.

Utility spending requires controls and the public pension system needs to be thoroughly reviewed and rationalized in co-ordination with the social security system. Capital expenditures need to be contained and cleaned up (removing current expenditures and transfers) and subjected to proper financial and economic appraisals and checks for availability of future current funding where they are not self-sustaining. In addition, the orderly wind-up of the DFC is required along with consideration of limiting off-budget expenditures that are not subject to proper oversight and accountability. Similarly, explicit budgeting for government guarantees is required. In general, the recommendations for improved budget systems in this report should also serve to control and improve the quality of government expenditures.

Reform of Public Spending and the Budget Process

The Government has a relatively large budget with total expenditures (excluding social security and other off-budget public entities) of around 30% of GDP. The budget, however, follows a simple one-year cycle with few, if any elements, of medium-term or performance budgeting and weak budget analysis and project appraisal. The current budget is largely allocated on incremental growth following the pattern of spending approved in the previous year such that expenditure patterns have remained remarkably constant from year to year, with expenditures on current government operations of around 15% of GDP and a further 4% of GDP on training, pensions and interest.

Over the recent years, however, particularly since 2002/03, current expenditures have risen because of the marked increases in wage, pension and interest expenditures. Current expenditures rose from around 19% of GDP in the years up to 2002/03, with wages, pensions and interest forming 70% of these expenditures, to 26% in 2004/05 and estimated at 25% in 2005/06, with wages, pensions and interest rising to about 77% of current expenditures or over 19% of GDP. Rising wage and pension spending caused about 30% of this increase, and the remainder was due to escalations in the interest charges, largely coming from a lack of budget discipline in capital and off-budget expenditures. About one-third of current expenditures are on social programs with the education sector receiving two-thirds of this spending. Teachers, health professionals and related support staff absorb about 70% of social spending.

Some of the major problem areas needing attention are highlighted first.

Lack of Medium-term Planning and Performance Budgeting

With the dominance of personnel, pension and interest expenditures, the current budget leaves little room for year-to-year reallocations between line items or "cost centers." The lack of medium-term planning and budgeting exacerbates the difficulty of reprioritizing expenditure allocations. With a few exceptions, ministries conduct little or no budget analysis or have no information on unit costs of the services they provide to guide budget

allocations. In some cases, expenditure allocations are even based on prior year approved budgets rather than actual expenditures or the underlying information about service usage such that actual expenditures and budget approvals are significantly out of line. Current expenditures are relatively tightly controlled (except for utilities and pensions, and until recently, personnel) and releases are handled in a largely mechanical fashion. By contrast, with a few exceptions, no monitoring of program performance is undertaken.

Problems with Capital Budgeting

The capital budget has been operated in sharp contrast to the current budget. It has been volatile and undisciplined. Capital expenditures have contained more than expenditures on physical capital formation or even institutional and human capital development projects. Miscellaneous and irregular current expenditures and transfers have also been included. The capital budget has been used to multiple purposes – fiscal stabilization, new ventures, transferring resources to off-budget expenditures (as occurred with the DFC), – as well as financing development projects. Weak, if any, economic or financial appraisal has been applied to domestically financed development projects. Donor agencies conduct appraisal according to their requirements for donor-financed projects. Recently, project implementation monitoring has been re-established.

Reforming the System

Given this budgeting context, there is significant scope to improve the budget process that should help avoid the financial crises situations and improve the costs-effectiveness of service delivery and the responsiveness of services to changing public demand. A selection of the recommended reforms are highlighted here.

Establishing a Budget Analysis Unit and Enhancing the Information Base

The weak budget analysis capability needs to be strengthened in two ways. One is to establish a budget analysis unit within the Ministry of Finance that will not only conduct budget analysis but also provide leadership to the line ministries in reforming their budget practices. Another is to upgrade the information bases on which budget estimates are made. Wages, pensions and interest are three growth areas in current spending, but there have been underlying weaknesses in building or using the available computerized data to analyze, control and forecast these key expenditures. The computer-based capacity exists for debt and interest, is being built for personnel and emoluments, but is missing for pensions.

Strengthening the Capital Budgeting Process

The capital budget is weak in all respects: preparation, use and presentation. Strong capital budgeting requires medium-term participatory planning that identifies the current and future service gaps, whether in the social, infrastructure or energy sectors, develops and appraises projects and programs to meet these gaps, and plans how these projects can be financed and supported, where necessary, by the current budget. The lack of a capital budgeting process, and to some extent the capacity to implement it, has led to *ad hoc* project selection and abuse and misuse of the capital budget.

Improving the Budget Preparation

Improved budget preparation and estimates will also allow improved budget presentations. The budget documents are missing information on aggregate actual

outturns and revisions to approved estimates brought in through supplementary budgets. Improved presentations are also required for key items, including personnel and emoluments, debt and interest charges and provision for contingent liabilities. The budget presentation would need to change more radically as medium-term and performance budgeting procedures are adopted that would identify forward resources and program commitments as well as put more emphasis on the actual service delivery outputs and outcomes.

Major Steps in Adopting a Medium-term Framework

The budget system in Belize lacks most elements of medium-term and performance budgeting. This undermines its capacity to deal with fiscal crises and avoid getting into such situations. It also limits the capacity of the Government to deliver services efficiently. Achieving major reforms of a budget process is an ongoing multi-year task. At this point, therefore, it is important to identify some of the early steps that could be taken.

Stating a Strategic Budget Policy

A fundamental building block of any medium-term budget framework, and a clear priority in Belize given the financial crisis, is the preparation of a medium-term macroeconomic and fiscal framework that would lay out the resource envelopes available to the Government over the medium term as it restructures its debts. Linked to this is the need for a Statement of Strategic Budget Policy to be provided in mid-fiscal year that would not only lay out the fiscal framework for the budget but would lay out the priorities and feasible new programs that the Government was planning so that the detailed budget preparation is conducted by all parties knowing both the resources available and the priorities of the Government. The preparation of a Budget Strategy requires a lengthy consultation phase inside the Government and with stakeholder groups. The budget preparation cycle would need to be amended to accommodate a medium-term budgeting process.

Resolving Some Social Program Issues

Outside of the benefits that medium-term budgeting should bring to the capital project planning and budgeting process, it should also serve as a framework for resolving major social program issues facing Belize. The structure of the public pension system needs to be rationalized in conjunction with the role played by the Social Security Fund (SSF) in providing long-term benefits. In addition, the structure and financing arrangements need to be resolved for the roll out of a National Health Insurance program providing primary health benefits. The SSF is facing a depletion of its reserves as it is being used to fund a NHI pilot project without offsetting contributions from beneficiaries or any residual gap being made up from government revenues.

Introducing Performance Budgeting and Management

The introduction of performance budgeting and management, or at least elements of it, is critical to achieving improved cost-effectiveness in service delivery. This should be undertaken in selected programs and institutions where its application is feasible and likely to be effective. Already steps are underway in establishing the Belize City Hospital as a separate body and putting it under a performance contract. Other areas for consideration would be universities, technical colleges and high schools with appropriate

management capacity, road maintenance and related administrative services, and water and sewage services. In all other service delivery areas, managers should be required to identify their major service delivery programs, the outputs of the programs, the activities and inputs required to achieve these outputs, and the accrued unit capital and current costs of the outputs. This basic information should form the basis of setting appropriate output targets for programs consistent with the budget allocations to the programs. The "cost centers" in the budget would need to be re-organized to reflect the underlying programs and managements responsible for meeting explicit performance targets.

Improving the Social Sector Service Delivery

Performance budgeting and management can clearly benefit social sector service delivery by making them more cost-effective and allocating resources more efficiently. In addition, in the context of the fiscal restraint program that the Government will need to implement over the medium-term, which will require strict controls on and clear prioritization of any new hiring, improvements can be achieved in the quality of staffing of schools, hospitals and health centers.

Capacity Building

Clearly, to achieve a major and sustainable budget reform requires development of capacity to implement all its components. However, more critical at this stage is that the Government need to develop and train a team of managers who can design and lead the implementation of a budget reform from within the Government. The donor community could be most useful in supporting the growth of such a budget reform management team.

Appendix A Analysis of Debt Sustainability

A.1 Debt Stock Adjustments

To start this analysis of the debt adjustment dynamics, it is useful to state the standard relationship for a change in government debt-to-GDP ratio (δ_t) at the end of year t:

$$\delta_t = \delta_{t-1} (1+ i_{nom})/ (1+ g_{nom}) - (PS_t) /Y_t \qquad (A.1)$$

or $$\delta_t - \delta_{t-1} = \delta_{t-1} (i_{nom} - g_{nom}) / (1+ g_{nom}) - (PS_t) /Y_t \qquad (A.2)$$

where i_{nom} is the nominal effective interest paid on the government debt, g_{nom} is the growth rate of nominal GDP, PS_t is the primary surplus and Y_t is the nominal GDP in year t.

To apply this relationship to check the primary surplus rates required for stabilizing and reducing the debt-to-GDP ratio, the effective interest rate needs to be known. Given Belize has a complex portfolio of commercial domestic and external borrowing as well as donor provided loans, this interest rate is not obvious. From Table 3.1 section 3, it is evident that donor agencies are providing about 31% of loans to Belize; about 60% come from external commercial sources; and the remainder from domestic sources. Noticeably donor financing is significantly cheaper at about 4% compared to about 10% for commercial debt because of lower interest rates, concessional loans and grace periods in payment.

A simple analysis of the debt situation, using relationship A.2, given the current debt-to-GDP ratio of about 104% and effective interest rate on the total debt stock of 8%, and assuming a nominal GDP growth rate of 5% would suggest that a primary surplus of about 3% of GDP should stabilize the debt stock i.e. have no change in the debt-to-GDP ratio over the coming years. A higher primary surplus would start to reduce the debt-to-GDP ratio over the coming years. In fact, budget estimates for 2005/06 show a primary surplus estimated at 1.6% in the base case plus some expenditure reductions. This is clearly insufficient to contain the growth in the debt-to-GDP ratio. In the short-run, however, the situation is eased by expected privatization receipts of 3.2% of GDP from sale of BTL shares. In addition, the special loans arranged as a private placement through Belize Sovereign Debt (Cayman) Limited by Bear Stearns and disbursed in March 2005 have left the Government with significant foreign exchange reserves to pay off debts during 2005/06, support the foreign exchange reserves and cover the current account deficit. This has been taken into consideration in the simulations below.

The deteriorating sovereign risk situation of Belize during 2004 made it necessary for the Government to switch from open-market bond issues to specially designed privately-placed notes. The essential features of the 5 and 10-year notes issued by the Government are given in Table A.1.

Table A.1 Summary of Notes arranged through Belize Sovereign Debt (Cayman) Limited

		5-Year Note	10-Year Note	Total
			US$ millions	
Gross Loan Amount	*A*	**71.47**	**65.21**	**136.68**
Total Reserves	*B*	12.91	17.46	30.38
Loan net of reserves	*C = A-B*	58.56	47.75	106.31
Fees and charges	*D*	2.31	2.31	4.62
Prepaid Insurance Premiums	*E*	3.56	4.50	8.07
Initial insurance premium	*F*	1.10	1.16	2.26
Net Usable Loan	*G=C-(D+E+F)*	**51.59**	**39.78**	**91.37**
Effective annual interest rate		**15.0%**	**15.4%**	
Interest rate paid to note holders		4.85%	5.69%	
Interest rate paid on reserves		3.55%	3.94%	
Insurance premium rate		3.40%	3.60%	

Source: Government of Belize, Ministry of Finance

These notes were for US$136.68 million, but the special features were required to protect the note holders that resulted in the Government receiving only net usable funds of US$ 91.37 million. The notes were insured for sovereign default requiring the payment of insurance premiums. In addition, reserve funds have to be maintained to protect the payments of principal, interest and insurance premiums. These reserve funds earn interest for the Government. As a result, fairly complex repayments have to be made for the life of the loans with effective annual costs rising and then falling at the end as the reserves are recaptured.

Overall the effective annual interest rate paid on the two loans is 15% to raise the US$51.59 million over 5 years, and 15.4% to raise the US$39.78 million over 10 years. This compares unfavorably with the bond issues made in 2002 and 2003 that had interest rates in the range of 9.5% to 9.75%. Clearly, the external borrowing options facing the Government are limited and expensive. While this loan buys relief in the short-term, it is at a high price and at the risk of the loan being exhausted before the Government risk rating improves.

Hence, looking at the short-term situation will be important. The higher the receipts that can be earned from privatization and other asset sales and the higher the primary surplus, the longer the reserves accumulated from these special notes and the longer the delay in the need for going to the external commercial markets again. On the other hand, any shortfalls in revenues or any unexpected need to assume further guaranteed debts from public agencies will worsen the situation.

To determine the prospects of the Government having to borrow again from the external markets, the repayments of the existing debt and prospects of alternative disbursements have to be projected over future years. It is also clear that the costs of new borrowing are rising in the market place as the national debt burden rises. These costs are expected to rise both because the low-priced domestic debt and donor debt sources are limited and

because new long-term commercial debt is likely to cost more than any old debts repaid as country risk rises. Foreign aid has gradually been declining over the years since independence. Belize as a middle-income country cannot expect any growth in concessional debt. With worsening economic conditions, some donors may also become reluctant to maintain their lending levels to Belize.

A.2 Impact of Varying Interest Rates and Primary Surpluses on Debt Stock

To forecast the debt dynamics with varying interest rates on new debt compared to the old ones, a more disaggregated debt model than given by (A.1) and (A.2) is required. The latter assumes that interest rates on all debt remain the same. Specifically, it needs to recognize that interest rates on new debt, at least external commercial debts, may be charged at higher rates. Therefore, for debt type k (donor, domestic, external commercial) in period t, D_t^k is given by:

$$D_t^k = (D_{t-1}^k - R_t^k)(1 + i^k) + R_t^k (1 + i_m^k) + ND_t^k (1 + \nu\, i_m^k) \qquad \text{(A.3)}$$

where D_t^k = stock of debt of type k at the end of year t
R_t^k = roll over or repayment of principal of debt type k in year t
ND_t^k = net new disbursements of debt of type k in year t
i^k = average interest rate on outstanding debt of type k
i_m^k = marginal interest rate on debt type k
ν = share of new debt paying interest expense in the year

For domestic and commercial debt it can be reasonably postulated that the marginal interest rate will rise with an increase in the central government debt-to-GDP ratio and eventually will grow exponentially as the debt situation worsens. In addition, assumptions are needed about the pattern of debt in the future. As a base case, it is assumed that donor debts remain constant in real terms, or that the US dollar value of debts will grow at the rate of inflation. This implies that donor debts will be rolled over and additional loans equal to the outstanding debt times the inflation rate are disbursed. This may be somewhat optimistic given that donor funded capital III expenditure projects have been declining as a share of GDP in recent years. In practice, over the medium term the Government needs to receive gross disbursements of new loans to the order of US$ 30 to 40 million each year. Failure to maintain the confidence and goodwill of donor organizations will put Belize financing at further risk.

Also, while domestic borrowing has been a declining share of GDP over recent years, largely because of privatization receipts, given the current financial stress, it is unlikely that the Government will not need to go to the domestic market. It is assumed that domestic debt will grow in line with economic growth. This will mean that the Government will raise some BZ$8 to 10 million in net new borrowing from the domestic markets each year over the medium term.

The residual new borrowing required to cover the deficit and to sustain the international reserves would be met through external commercial borrowing. While ideally Belize foreign reserves should be about two months of imports or approximately 10% of GDP given imports of about 60% of GDP, it is assumed that they will only be maintained at

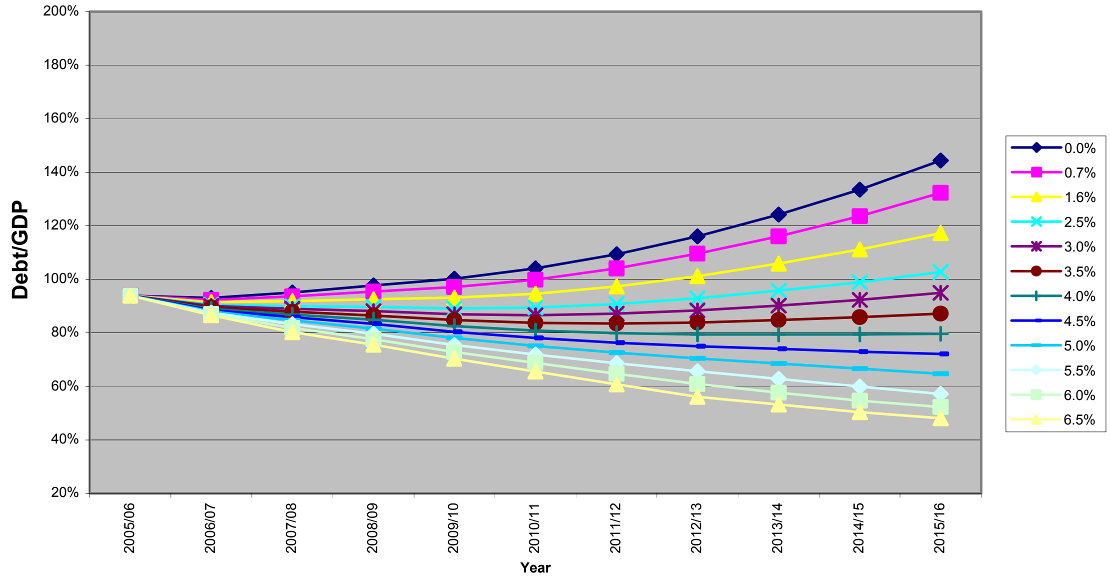
5% of GDP or about one month of imports until the external debt burden eases. This will require some US$13.5 million to be added to reserves over 2005/06 and then an additional amount of approximately US$3 million in each subsequent year. With fiscal constraint reducing domestic demand, and hence imports, the months of import coverage achieved by reserves of 5% of GDP is expected to rise.

As a starting point, in order to avoid any new external commercial borrowing, a primary surplus of at least 1.8% will be required assuming 3.2% of GDP is received from the re-privatization of BTL. This is slightly higher than the 1.6% in the projected base case plus the already planned expenditure cuts. If a primary surplus of 1.8% is achieved and sustained for one year, this avoids foreign borrowing problems for a year, but in 2006/07 some US$68 million in gross external borrowing would be required with the Government ratio of debt to GDP still at about 94%. It is likely that another expensive special loan arrangement would again be required.

The importance of raising the primary surplus rate above 1.8% to reduce and defer the amount of external borrowing is clear. For example, if the primary surplus could be raised to 4.8% in 2005/06 and subsequent years, then external commercial borrowing could be deferred till 2007/08 when the debt-to-GDP ratio would be down to about 88% and falling. Alternatively, a similar effect might be achieved if the primary rate could be raised only to 3.6% in 2005/06, but increased to about 6% in 2006/07 and subsequent years. Clearly there are benefits to raising the primary surplus quickly and front-loading the debt reduction gains, but achieving sustainable revenue increases or expenditure cuts takes time.

To illustrate the sensitivity of the debt recovery to the primary surplus, the base case simulations of the debt-to-GDP ratio are made assuming a nominal economic growth rate of 5% and inflation of 2.5%. Interest rates on new external commercial loans are expected to rise with the increasing ratio of external debt to GDP. The interest on new longer-term domestic debt is also expected to rise as external borrowing becomes more costly. In all the cases, the sales of BTL and the maintenance of foreign reserves are already included, as discussed above. Figure A.1 illustrates the trends in the ratio of debt to GDP over the coming years at various primary surplus rates. If the primary surplus can be raised to at least 3%, the debt-to-GDP ratio is initially stabilized, but because of the higher interest rates on new debt and the declining share of donor debt, the effective interest rate increases and eventually the debt-to-GDP ratio starts rising again. To ensure a continuous downward trend the primary surplus has to rise and remain at 4.5% or higher, but even at 4.5% the debt would only be reduced to about 75% of GDP after 8 years. If a primary surplus of 6% can be sustained for ten years, then the debt-to-GDP ratio would be brought down to about 60% in the same time. This would be a more sustainable external debt burden.

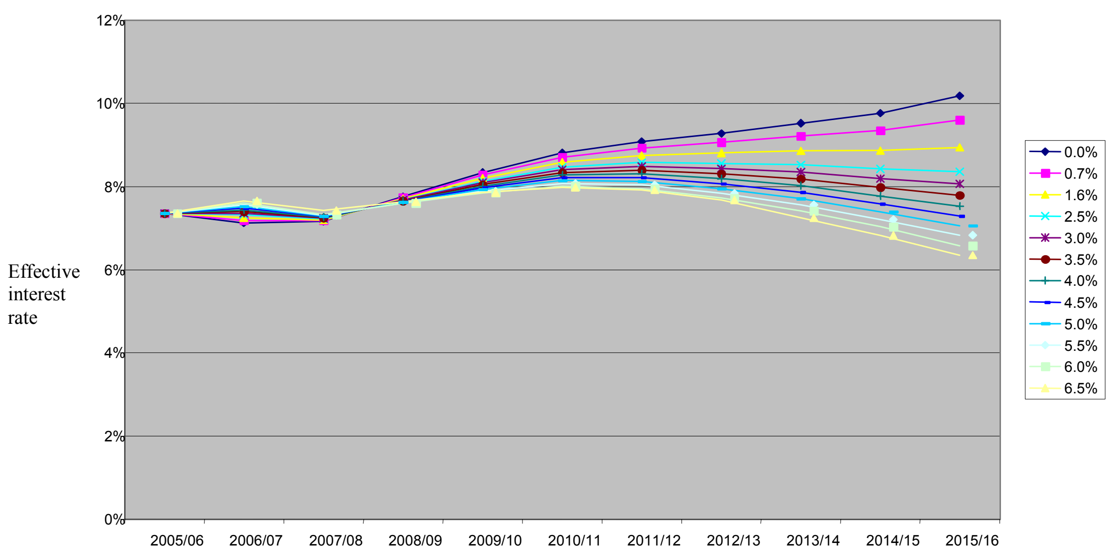
Figure A.1 Projections of Debt to GDP for Various Primary Surpluses



Source: Debt data from Government of Belize, simulations by authors

Figure A.2 illustrates the pattern of effective interest rates at different primary surplus rates. It shows that as old debts are rolled over, the effective interest rate is expected to rise over the medium term before the effects of the falling ratio of debts to GDP at the higher primary surplus rates cause the effective rates to decline.

Figure A.2 Effective interest rate on debt at different primary surplus rates, 2005-2015

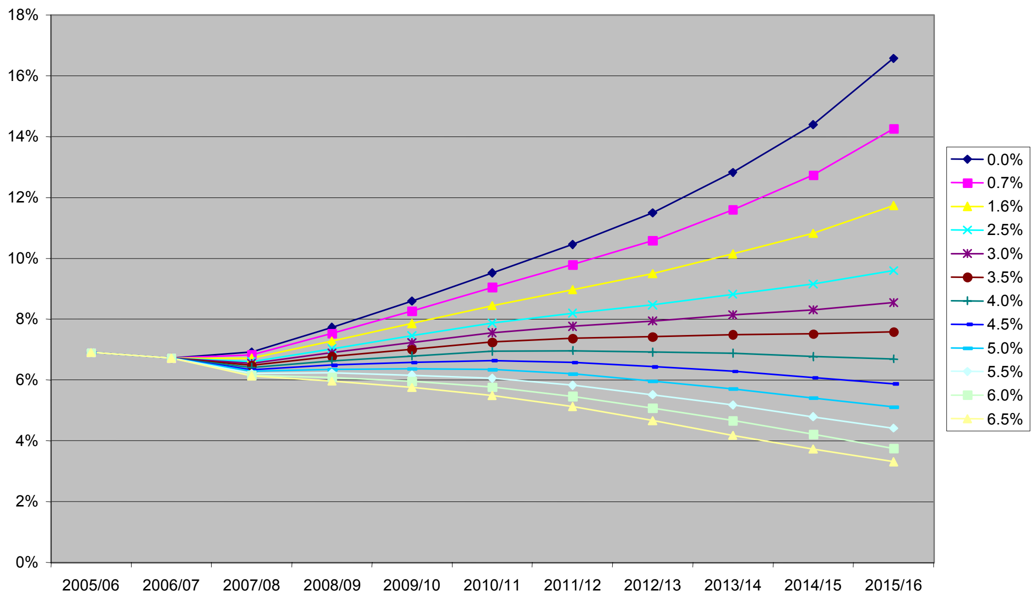


Source: Debt data from Government of Belize, simulations by authors

The impact of higher effective interest rates also serves to keep the cost of interest expenses as a share of GDP high for a sustained period. Figure A.3 shows that except in the cases of sustained primary surplus rates above 5%, interest expenses remain above 6% of GDP in the medium to long term. With a growing dependence on commercial borrowing, both external and domestic, the Government can expect to have higher costs of borrowing in the future during the earlier years. Only in the cases of sustained primary surpluses of over 5% do the interest expenses as a share of GDP start eventually falling to more modest levels below 6% of GDP in the medium term.

The trend in the debt-to-GDP ratio is naturally dependent on various factors which are briefly outlined in the following paragraphs.

Figure A.3 Interest Expenses to GDP for Various Primary Balances, 2005-2015



Source: Debt data from Government of Belize, simulations by authors

A.3 Nominal Economic Growth Rate[23]

The trend in the debt-to-GDP ratio is sensitive to the nominal economic growth rate. Compared to the debt responses in Figure A.1 where a sustained nominal growth rate of 5% is assumed and the primary surplus long-run "break-even rate" is about 4.5%, if the economic growth rate drops to 4%, then the primary surplus rate needs to be maintained at over 5% to contain the debt-to-GDP ratio over the long run. If the growth rate is higher at 6%, then the long run breakeven primary surplus rate drops to about 4%. With the contractionary fiscal policy, slower growth is more likely than faster growth.

[23] In the original version of this report, an appendix that provided background data on external and government debts in Belize and simulations of expected debt-to-GDP ratio under various economic and policy scenarios were included. Please contact Vibeke Oi RE2/RE2 vibekeo@iadb.org to obtain a copy of this version of the report.

A.4 Other Factors Affecting the Debt Situation

Level of Donor Financing

The long-run required primary surplus is also sensitive to the rate of growth of donor financing. If donor agencies cut back their lending such that the stock of donor debt declines by 5% a year, the long-run breakeven primary surplus rises to 5.5%. If donor debt grew by 10% a year, then the long-run breakeven primary surplus drops to 3.5%.

Guaranteed Debt

A possible risk to containing the Government debt arise from any added guaranteed debt that the Government may be required to assume, if for example, the DFC cannot service its remaining debts. In 2005/06, the Government has been transferring a significant amount of resources to the DFC to service DFC debts. The Government could still have to assume some US$20 to 30 million of DFC debts. For example, if the Government has to service an added $10 million in each of 2005/06 and 2006/07, then to avoid any new external borrowing in these two years, the primary surplus would need to rise to 5.7% in each of these years – a difficult task. The long-run breakeven primary surplus rate, however, would remain at about 4.5%.

Privatization Receipts

By contrast, any further privatization receipts that can be achieved in the short-run would be particularly helpful in avoiding any need to borrow in the external commercial markets.

Country Risk Premium

Any policy measures that lower the country risk premium paid by Belize would lower the long-run breakeven primary surplus rate. For example, if the external borrowing premium could be lowered by one percentage point, then the primary surplus could be lowered by about 0.5%. An IMF program, for example, could provide standby credits from the IMF and IDB that could amount to about 4% of GDP and would raise the import coverage to close to 2 months of imports.

Implications of a Possible Devaluation for the Adjustment Measures

All the adjustment measures considered above hold within the framework of a fixed exchange rate peg. It is clear that this is the Government's desired policy as far as feasible. While an overvalued exchange rate can clearly dampen investment and employment growth in the key export and tourism sectors, the high stock of foreign debt clearly provides a short-term discouragement to any devaluation. If the Government were to default on external debts, however, in a planned or unplanned fashion, then serious consideration can be given to a simultaneous devaluation.[24]

[24] The original version of this report included a further discussion of some of the issues that would need to be considered in the event of a debt default and devaluation. Please contact Vibeke Oi RE2/RE2 vibekeo@iadb.org to obtain a copy of that version of the report.

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