FISCAL STRATEGY STATEMENT

FISCAL YEAR 2018/2019

Contents

Charts

1. PURPOSE

The *Fiscal Transparency and Responsibility Regulations,* ***Statutory Instrument No. 95*** **of 2010** requires the Minister of Finance to present to the National Assembly and to release to the public a Fiscal Strategy Statement, which explains the fiscal strategy of the Government.

The purpose of the Fiscal Strategy Statement is to *enhance fiscal discipline by increasing public awareness of the government's fiscal strategy and to establish benchmarks for evaluating the government's conduct of fiscal policy*. The statement must disclose sufficient information to enable the public to scrutinize the conduct of fiscal policy.

The overall objective of the fiscal strategy is to ensure fiscal sustainability over the medium term while delivering essential services. Sustainability is a core requirement of fiscal policy since Belize's public debt levels are high. A sustainable fiscal position provides greater certainty for business, and encourages foreign investment. It helps the Government to focus the budget on policies that strengthen long-run economic growth.

2. SUMMARY

The economy of Belize is currently challenged by low growth and high levels of public debt. The Government of Belize intends to confront these challenges with a Fiscal Strategy that, over the coming five years, tries to contain public spending and promote private sector growth. The Fiscal Strategy contains the following quantitative key elements:

1. *Increase the ratio of revenue to GDP by 2 percentage points of GDP* over the next two years. This shall be achieved without further increases in tax rates. Tax compliance shall improve through a more effective tax collection. The Government will make the tax system fairer by simplifying and broadening tax bases and eliminating exemptions.
2. *Reduce current, non-interest expenditure by 2 percentage points of GDP* over the coming five years. The Government shall contain the public wage bill and other personnel at their current level, while giving more emphasis to crime prevention. Subsidies will be shifted from industries that have matured to conditional social programs that reduce poverty.
3. *Improve debt management and keep interest payments constant as a percentage of GDP.* Continued aggressive debt management with the objective of moving towards less expensive forms of financing, such as Treasury Bills and Notes and concessional multilateral debt. This will over time alleviate the burden of debt service to the Budget, and prevent interest payments from rising significantly.
4. *Maintain the level of capital spending at 5 percent of GDP.* The Government shall evaluate the efficiency of capital projects but will ensure that their level does not

fall below 5 percent of GDP. Capital spending, especially in infrastructure, is essential for achieving higher growth rates in Belize.

5. *Contain the fiscal deficit to 1.5 percent of GDP.* This is a level that could be financed by domestic sources and keep the debt level from rising.
6. *Increase the primary surplus beyond 2 percent of GDP.* A primary surplus of 2 percent of GDP is the minimum required for stabilizing the debt level. Over the medium term, the primary balance shall improve substantially.
7. *Reduce the level of public debt by 13 percentage points of GDP by 2022.* A decline in the debt ratio from 93.8 percent to 80.2 percent will send a strong signal of commitment by the government to sound policies.
8. *Structural reforms* to make the economy more productive and competitive by removing trade barriers, monopolies and infrastructure bottlenecks. This includes creating a simpler and fairer tax system, and encouraging private credit.

3. BACKGROUND

Belize's fiscal policy is preparing for important challenges ahead. Recent years saw a slowing down in real economic output, flat tax revenues and a growing deficit. At the same time, financial conditions for debt service have become relatively benign following the third debt exchange in March 2017. This was a debt restructuring which immediately reduced interest rates and shifted repayment obligations into the far future. Notwithstanding the substantial cash flow relief over the near and medium terms, long term debt sustainability concerns remain. Policy action thus becomes necessary because public and publicly guaranteed debt stood at 93.8% for fiscal year 2017/2018.

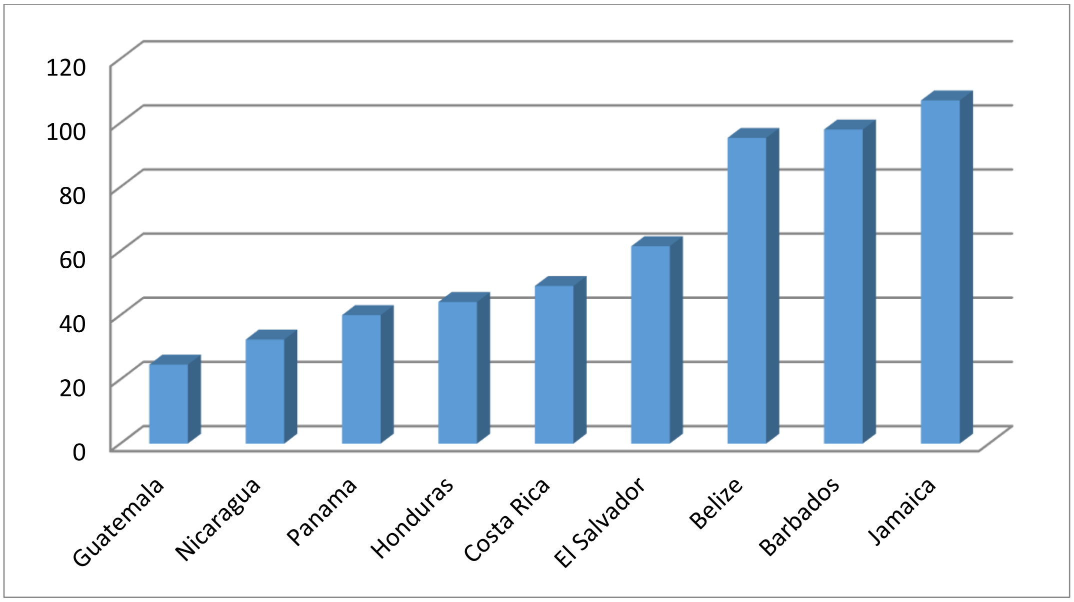
The agreement with the private external bondholders is anchored by fiscal adjustment. The Government has committed to bondholders to tighten the fiscal stance by 3 percentage points in Fiscal Year 2017/18 and to maintain a primary surplus of 2 percent of GDP for the subsequent 3 years. In addition, Belize would be required to submit a Report to the National Assembly if it fails to meet the primary surplus targets. We have also agreed to request technical assistance (TA) from the International Monetary Fund (IMF) to: i) identify the reasons for the missed primary surplus targets; and ii) recommend remedial measures. Belize has committed to publish the findings of any such IMF TA as well as the Annual Article IV Consultation Reports. Additionally, if the primary surplus target is missed, interest payments on the restructured bond will become due quarterly rather than semi-annually (for the subsequent 12 months that the target is missed).

Further rising debt service could swell future deficits again and make the fiscal position unsustainable. To confront this challenge, the Government has developed a *Medium-Term Fiscal Strategy*. It describes the particular situation facing Belize and outlines the policy responses from Government.

3.1 Debt and Debt Service

Belize is the third most indebted country in the Caribbean after Jamaica and Barbados (chart 1). At 93.8 percent of 2017 GDP, Belize's public debt level exceeds thresholds considered safe by international standards (60 percent of GDP).

Chart 1: Public Debt in Percent of 2017 GDP

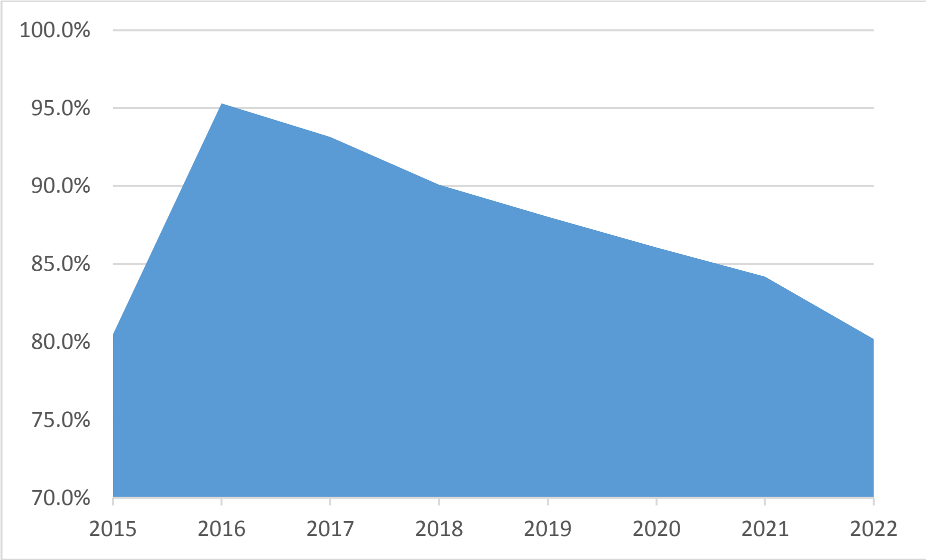


Source: IMF, Regional Economic Outlook, September 2017

Belize's debt challenge is only recent. Before 2000, Belize followed a conservative fiscal policy and kept debt levels low. A series of expensive policy decisions at the beginning of the last decade trebled the debt ratio within five years. The Government is fully aware that the current debt level is unsustainable despite the recent restructuring in March 2017, and that prudent fiscal policy is critical to placing public debt on a downward trajectory.

The agreement with private external creditors in March 2017 reduces the debt service cost of a relatively more expensive portion of the external debt, and the NPV gain is significant. However, for these gains to be lasting, however, the debt restructuring needs to be underpinned by a credible and sustained program of fiscal consolidation, combined with structural reforms to boost growth.

Chart 2: Public Debt in Percent of GDP



Sources: Ministry of Finance and Central Bank of Belize.

3.2 Recent Fiscal Policy

The budget for Fiscal Year 2017/18 targeted fiscal consolidation equivalent to 4 percentage points of GDP. While the current projections suggest that the fiscal performance will more than likely not meet the budgeted targets, a significant turnaround of 3.6 percent of GDP is expected. Accordingly, a primary surplus is expected at 1.8 percent of GDP instead of the budgeted 3.1 percent, and the overall deficit is projected at 1.0 percent of GDP in place of an overall surplus of 0.2 percent. This lower than expected out-turn is due to revenue shortfalls arising from weak economic activity and some slowdown in government investment.

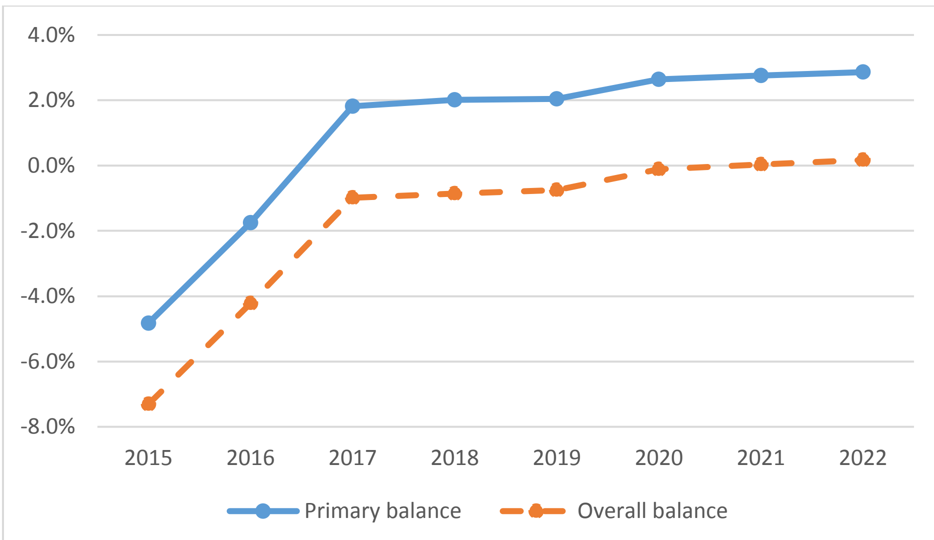
Revenues are expected to underperform with capital spending reductions comprising the bulk of the fiscal adjustment. While the new revenue measures which were introduced in the Fiscal Year 2017/18 budget are generating additional revenues; the revenue yield in several cases has been lower than expected. Taxes on international trade and transactions, in particular, will fall short of budget projections largely reflecting the slow pace of economic recovery and enforcement challenges.

Furthermore, court rulings against the Government have reduced international reserves and increased government debt. In early November, the Caribbean Court of Justice (CCJ) ruled against the Government in a Belize Telemedia Limited case. The Government was, therefore, required to pay US $78 million to the former owners of the nationalized utility company. The Official International reserves briefly fell to 2.8 months of the imports of goods and services but recovered to 3.8 months by yearend.

The Government recognizes that the structure of public spending is rigid, and the space for fiscal policy is constantly shrinking. About 60 percent of revenues are absorbed by salaries, pensions and subsidies to pay school teachers. These items are effectively indexed on public wages and tend to move in lockstep. About 20 percent of revenues are consumed by supplies, materials and utilities, which are expensive in Belize. However, the functioning of public services depends on these expenses. Finally, interest payments on debt absorb another 10 percent of revenues.

A balanced budget leaves only about 5 to 10 percent for expenditures that promote growth and development, in particular capital spending. With increasing needs to fight crime and poverty, the space for capital expenditure is narrowing further. Without corrective actions, the ability of the Government to effectively influence the economy in a positive way becomes more challenging.

Chart 3: Fiscal Balance as Percent of GDP



Sources: Ministry of Finance and Statistical Institute of Belize

The current fiscal situation can be described as fragile, as the road ahead is fraught with risks. Effective interest rates will continue to exceed GDP growth substantially. This means that expenditures will tend to rise faster than revenues, unless the Government runs a primary surplus. Anything less may throw Belize off the path to sustainable debt levels.

All present indicators suggest that Belize needs to run an annual primary surplus of around 2 percent of GDP in order to reduce the debt to GDP ratio to 80 percent of GDP in 5 years. This will be a challenge, as primary surpluses have been under 2 percent since

2012. With continuing expenditure pressures and the reality of natural disasters, and without corrective action, the debt ratio would over time increase, not decrease.

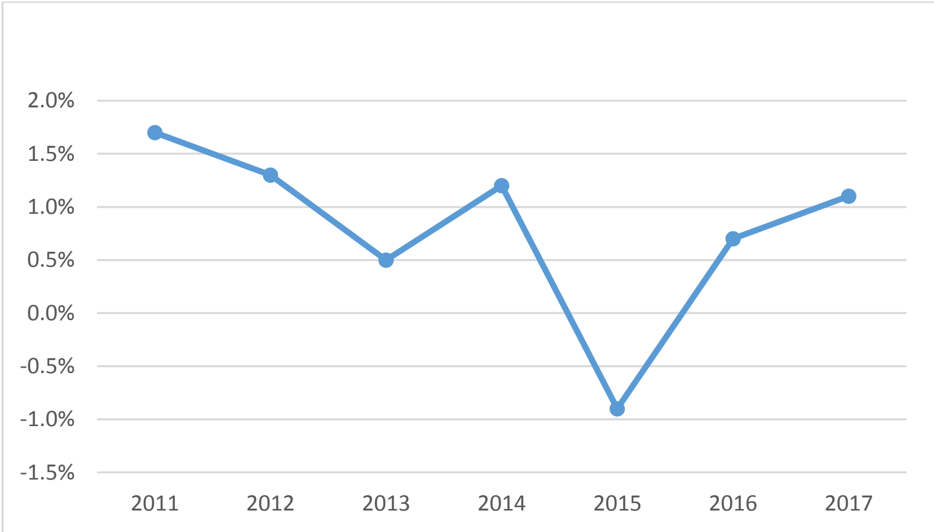
It is thus important to hold the line on expenditures to keep the debt under control. The future should envisage primary surpluses substantially above 2 percent of GDP in order to bring the debt ratio down over time.

3.3 Economic Growth

At the same time as debt has increased in Belize, GDP growth has slowed. Averaging more than 7 percent in the first half of the last decade, economic growth slowed to less than 2 percent per year since 2005. This rate was below the natural expansion of the population, and if continued, would erode living standards. Slower growth also complicates the path out of the debt problem.

The recovery has been slower than expected in 2017. Preliminary estimates suggest that the economy grew by 0.5 percent (y/y) on average in the first three quarters of 2017, compared with the budget's projection of 2.5 percent. Agriculture and fisheries remain particularly weak, following 2016 setbacks (hurricanes and shrimp and citrus fruit diseases), while crude oil production continues to decline. Tourist arrivals are up by about 11 percent (y/y) as of December with corresponding growth in restaurant and hotel activity. Belize's unemployment rate was 9.7 percent in September 2017, down from the peak of 11.1 percent in September 2016.

Chart 4: Annual Percent Change in Real GDP



Source: Statistical Institute of Belize

Underlying trends in labor, capital and factor productivity limit potential GDP growth in Belize. But higher growth is as essential to overcome the debt problem. Structural reforms are therefore necessary to remove obstacles to productivity growth. Small improvements in competitiveness can set off a virtuous cycle. A more productive economy with a lower debt burden becomes more attractive to foreign investment. This will increase capital accumulation and stimulate further growth. Structural reforms are thus a key part of the Medium-Term Fiscal Strategy.

4. Fiscal Objectives

Government Revenues: The Government will aim to improve the efficiency of revenue collection rather than increase tax rates in the future. After carrying out a comprehensive review of the existing tax framework, the Government will:

- *Make revenue collection more effective and forceful.* Tax compliance should improve, which could increase tax revenues by 2 percentage points of GDP over the coming two years.

- *Make taxes simpler, broader and more equitable*. Eliminate certain tax privileges and exemptions, with the aim of reducing overall tax rates on the general public. A more equitable and efficient tax system is expected to be supportive of economic growth, and over time increase Government revenue.

Government Expenditures: The Government will aim to contain and reduce current expenditures, while at the same time protecting capital expenditures that promote economic growth. More specifically:

- *The bill for public wages and consultants shall increase by no more than the expected rate of inflation* over the medium term (about 2 percent per year). This implies managing carefully the levels of public sector employment, and limiting the increase in salaries. Included under this objective is employment in Government-owned agencies and subsidized employment in the private sector. Priorities within the public sector shall be reviewed, and special emphasis shall be given to security, education and health.

- *Reduce transfers and subsidies by BZ$20 million by 2020.* Government owned agencies will be restructured to be more efficient and rely less on Government subsidies. Subsidies to privileged private industries will slowly be reduced and phased out to free resources for the poor.

- *Transfers shall be reoriented from industries towards reducing poverty*. The volume of targeted social programs shall increase, with specific conditions attached for the beneficiaries, such as undertaking efforts in education, health care, and job search.

- *Debt management shall become more aggressive so as to reduce debt service*, which now amounts to 15 percent of revenue. An example is the shift from bank overdraft to Treasury Bills and Notes, which cut domestic interest payments. Equally, external debt financing shall prioritize concessional loans from multilateral and bilateral sources. This debt shall over time replace the expensive commercial bank debt. If possible, commercial bank debt shall be retired early.

- *Capital expenditures will not fall below 5% of GDP.* While reducing capital expenditures may be easier than reducing current expenditures, it is detrimental to growth. Besides fiscal adjustment, the second pillar of Belize's Fiscal Strategy is promoting medium-term growth. The Government has also introduced new policies and procedures to ensure that capital expenditures are prioritized and productive via the Growth and Sustainable Development Strategy (GSDS).

Administrative and Public Financial Management Reforms: To contain expenditure, enhance expenditure management and achieve the fiscal targets, a number of administrative and public financial management reforms will be introduced:

- Implementation of a central treasury management system and the establishment of a single treasury account to improve the central Government's ability to manage scarce financial resources.
- Implementation of a strategy to enhance the internal audit functions of the Government.
- A commitment control system established in the budget process.
- Standardization of bidding documents for public procurement to increase competition and savings in public procurement.
- Establish a single beneficiary system to streamline and better target subsidies and transfers to households.
- No new contracts or hiring of public servants including in statutory bodies and state-owned enterprises, with few exceptions (i.e. education, health and security to respond to population growth).
- Comprehensive civil service census and design of a civil service rationalization plan.
- Parametric pension reform to increase the average retirement age of civil servants and address the issue of contributions to the scheme.

Deficit and Primary Balance: The overall balance shall not exceed a deficit of 2 percent of GDP on average in the coming years. The primary balance (the deficit before interest payments) shall record a surplus of at least 2 percent of GDP. More specifically:

- *The overall deficit shall not exceed 2 percent of GDP.* This is an amount that may be financed safely from domestic sources in Belize. External concessional financing will primarily retire and replace expensive commercial bank debt, and finance capital spending.

- *The primary balance shall target a surplus of at least 2 percent of GDP.* The primary balance is the overall balance excluding interest payments. The target of 2 percent of GDP results from debt sustainability calculations and indicates the minimum surplus necessary to keep the debt ratio on a downward path. Over time, the primary balance shall increase substantially beyond 2 percent of GDP in order to reduce the public debt burden.

Structural Reforms: The second pillar of the Fiscal Strategy of Belize is promoting the conditions for sustained, medium-term growth. The Government aims at improving the competitiveness of the economy and reducing the overall level of cost. In particular, it will:

- *Promote external trade and domestic competition.* The Government will give priority to the free flow of goods and services across borders, reduce trade barriers, promote domestic competition in all sectors, and eliminate tax exemptions, subsidies and other privileges to certain industries. Structural reforms will aim at creating a level playing field in the private sector, and reducing the cost of doing business.

- *Improve infrastructure.* By prioritizing capital expenditures in the budget, the Government will make a direct contribution to better business conditions in Belize. It shall improve the domestic infrastructure in transport and communications.

- *Simplify, broaden and lower taxes.* A simple, fair and efficient tax system is an important contribution to a good business environment, and will support productivity and economic growth.

- *Limit domestic government debt and promote private credit.* Domestic financing of the deficit shall be limited to 2 percent of GDP. This prevents the Government from absorbing domestic savings and crowding out private investment. It helps lower interest rates on private credit and improves financing conditions for small and medium companies. Over time, this will promote private capital formation and economic growth.

- Simplify procedures to reduce time and costs of opening a business.

Public Debt: The Government aims at first stabilizing, then reducing the high level of public debt over the medium term. In particular, the ratio of public debt to GDP shall decline from currently 93.8 percent to 80.2 percent by 2022.

5. MEDIUM-TERM FISCAL FRAMEWORK

The Fiscal Responsibility legislation requires the Government to set measurable targets and indicators that can be monitored. The Medium Term Fiscal Framework (MTFF), which is featured at Table 1 of this document, presents an “Adjustment” scenario. The “Adjustment” scenario shows a projection that is consistent with the Fiscal Strategy outlined in the main text. The table also contains the main economic assumptions underlying the projections.

The MTFF will need to be updated periodically. Fiscal targets and policies depend crucially on the economic environment, in particular on economic activity in the rest of the world, changes in commodity prices, and an absence of natural disasters. External and internal developments that were not foreseen in the original MTFF and assumptions that will change the projections, as a matter of course can materialize. Hence, future Fiscal Strategy statements shall be modified by updated MTFF projections.

6. FISCAL RISKS

The Medium-Term framework assumes a convergence of the economy towards long-term trends. Short-term risk factors remain present, however, and could complicate the road ahead considerably. These risks include in particular:

- A relapse of the world economy into recession. Many of the imbalances that caused the financial crisis of 2008 and the global recession of 2009 remain unresolved. While the private sector in many countries is reducing its indebtedness, the public sector is on an unsustainable debt path in the industrialized world. At some point, the public sector will not only withdraw stimulus money but embark on a painful and long adjustment process. If this combines with ongoing adjustment in the private sector, industrialized economies could slide back into recession, dragging Belize down in the process.

- Spiking commodity prices. Many commodity prices have not only recovered from the recession but surpassed pre-recession peaks. Continued supply shortages coupled with strong demand from Asian economies could lead to global spike in commodity prices, with negative consequences on growth and inflation. Belize could be forced into a stagflation scenario.

- Natural disasters. Hurricanes and flooding have not been factored into the medium-term projections explicitly. Implicitly, the high frequency of hurricanes in Belize may be one of the reasons for its relatively low rate of potential growth.

TABLE 1: MEDIUM TERM FISCAL FRAMEWORK

Fiscal Year beginning in April of	2015	2016	Est. 2017	Proj. 2018	Proj. 2019	Proj. 2020	Proj. 2021	Proj. 2022
				in millions of Bz dollars				
Revenue & grants	1,015.5	1,051.6	1,106.6	1,183.3	1,206.0	1,231.3	1,255.9	1,281.0
Expenditure	1,277.0	1,206.1	1,143.7	1,208.7	1,236.8	1,231.1	1,249.6	1,268.3
o.w. Interest payments	88.8	90.6	105.6	111.9	112.6	115.2	117.8	120.6
Primary balance	(172.7)	(63.9)	68.5	86.5	81.8	115.4	124.2	133.3
Overall balance	(261.5)	(154.5)	(37.1)	(25.4)	(30.8)	0.2	6.4	12.7
Public Debt	2,879	3,493	3,535	3,515	3,556	3,599	3,645	3,594
o.w. Central Government	494	748	1,027	1,068	1,116	1,158	1,189	1,221
Gross domestic product	3,578	3,665	3,769	3,902	4,039	4,182	4,329	4,482
				in percent of GDP				
Revenue & grants	28.4%	28.7%	29.4%	30.3%	29.9%	29.4%	29.0%	28.6%
Expenditure	35.7%	32.9%	30.3%	31.0%	30.6%	29.4%	28.9%	28.3%
Primary balance	-4.8%	-1.7%	1.8%	2.2%	2.0%	2.8%	2.9%	3.0%
Overall balance	-7.3%	-4.2%	-1.0%	-0.7%	-0.8%	0.0%	0.1%	0.3%
Public Debt	80.5%	95.3%	93.8%	90.1%	88.0%	86.1%	84.2%	80.2%
o.w. Central Government	13.8%	20.4%	27.2%	27.4%	27.6%	27.7%	27.5%	27.2%
Memorandum Items:								
GDP growth (2000 prices)	2.7%	0.0%	1.6%	2.0%	2.0%	2.0%	2.0%	2.0%
CPI inflation	1.1%	2.4%	1.2%	1.5%	1.5%	1.5%	1.5%	1.5%