

THE RELATIONSHIP BETWEEN  
FISCAL PERFORMANCE  
AND THE  
INTERNATIONAL RESERVES:- 1981 - 1991  
THE BELIZE EXPERIENCE

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## INTRODUCTION

This paper examines the impact of fiscal policy in Belize on key macroeconomic variables with specific emphasis on its impact on the international reserves from 1981 to 1991. Because the money supply is exogenously determined in small open economies like Belize fiscal policy assumes greater importance than monetary policy as a stabilization tool. Fiscal policy has the potential to stimulate economic activity and generate employment opportunities. However, the financing of a fiscal deficit from the banking system can, in the absence of foreign borrowing, impair foreign reserve levels. According to Khan and Knight (1985), if domestic financial markets are underdeveloped so that the government has to rely on bank credit for its financing needs, there will be close correspondence between the fiscal deficit and changes in the supply of domestic credit unless the authorities are prepared to allow the private sector to be crowded out of the credit markets.

In the case of Belize, fiscal policy coordination to achieve internal and external balance ~~was not~~ always successful between 1981 and 1991 ~~which~~ can be attributed possibly to the fact that governments are sometimes swayed by short run political considerations rather than the longer term economic perspective.

The paper is divided into three sections. The first reviews Belize's economic performance during 1981-1984, noting the internal and external developments which affected the economy with emphasis on the relationship between fiscal performance and the international reserves. Section two highlights Belize's experience with fiscal policy

implementation and management during the International Monetary Fund (IMF) Standby Program from 1984 to June 1986. Section three focuses on fiscal management since the successful completion of the IMF program.

#### 1. Economic Performance, 1981-84

Developing economies like Belize whose major exports are primary agricultural commodities and who rely heavily on imports for development and growth are extremely vulnerable to exogenous shocks. Such was the case with the Belizean economy during the first three years after independence in September 1981.

The major exogenous factors at the time were:

- [1] Declining world sugar prices which fell from 16.89 US cents per pound in 1981 to 5.20 US cents per pound in 1984 (sugar comprises some 60 percent of Belize's export earnings);
- [2] Depreciation of the pound sterling against the US dollar which adversely affected the earnings of sugar and bananas shipped to the EEC;
- [3] Heavy devaluations of the Mexican Peso;
- [4] A US recession during the period which impaired tourist earnings, foreign aid and remittances from Belizeans abroad;
- [5] Increase in oil prices contributing to the high import bill; and
- [6] Being a newly independent nation, Belize had to deal with these adverse economic conditions without the traditional subsidy from the United Kingdom to balance the fiscal budget.

Real GDP fluctuated during the period increasing by 2.2 percent in 1982 but declining by 1.9 percent in 1983 before rising again by 2.9 percent in 1984. Sugar export earnings declined by 23.7 percent during the review period from \$85.3 mn in 1981 to \$65.1 mn in 1984. This was in spite of a 3.9 percent increase in export volume over the period. This triggered off a 12.8 percent fall in export earnings between 1981 and 1983 from \$149.5 mn to \$130.3 mn. Increased receipts from the export of bananas, citrus and garments between 1983 and 1984 led to an increase in export earnings to \$145.7 mn. However, the devaluation of the Mexican peso hurt Belize's re-export trade with Mexico with earnings slipping from a record \$88.5 mn in 1981 to \$25.3 mn in 1983 before rebounding to \$40.7 mn in 1984. Inflation during the period was high (by Belizean standards) averaging 7.7 percent between 1982 and 1983 before being reduced to 1.9 percent by the end of 1984.

The overall fiscal deficit averaged 7.1 percent of GDP during the period of FY 1982/83 and FY 1984/85. Total revenue and grants rose marginally from FY 1981/82 to FY 1984/85 increasing by 1.3 percent to \$98.3 mn with trade taxes averaging nearly 55 percent of revenue and grants. Countries like Belize with underdeveloped tax structures earn a substantial portion of their revenue through taxes on income and international trade. Meanwhile total expenditures rose by 9.6 percent to \$121.4 mn largely reflecting a 22.3 percent increase in current expenditure as capital expenditure fell. The increase in current expenditure was brought about mainly by increases in wages and salaries, and subsidies and current transfers of \$9.4 mn and \$3.1 mn, respectively. The significant increase in current transfers coincided with increased expenditure following independence due to the setting up of embassies abroad and entry into

international organizations such as the IMF and the World Bank as well as subsidies to the Belize Electricity Board. The current account began incurring deficits in FY 1982/83 and grew to \$13.0 mn by FY 1983/84. The deficit subsequently fell during FY 1984/85 due to a \$13.7 mn increase in current revenue and a small rise in current expenditure. Increased receipts from income tax along with taxes on international trade and foreign currency transactions were primarily responsible for this increase. Current account deficits inhibit infrastructural development since the lack of savings after current operations constrains the government's ability to fund its investment program. In the absence of a current account surplus, a government is faced with the choice of delaying the locally funded portion of infrastructural expenditure and/or resorting to high levels of external borrowing which could create a serious debt problem. The overall deficit almost doubled during the period rising to 5.9 percent of GDP by 1984/85.

Money supply rose by 31.8 percent during the 1981-84 period to \$186.3 mn due mainly to a doubling of net domestic credit which more than offset the 1,695 percent decline in net foreign assets from \$2.0 mn to \$-31.9 mn.

The deficit was largely financed with domestic resources as net domestic credit to Central Government during the review period more than doubled from \$34.6 mn in 1981 to \$79.4 mn in 1984. Most of the increase in net credit to the government was facilitated by the Central Bank as the Central Bank's share of the increase in credit was 72.3 percent. Foreign borrowing rose marginally from \$4.6 mn in 1981 to \$7.2 mn in 1984. The increase in net domestic credit to the Government resulted in a drain on the country's foreign reserves from \$21.6 mn 1981 to negative \$0.7 mn in 1984. While in

1981 import coverage was low, by 1984 the reserve position had reached one of negativity signalling zero import coverage. At this point, Belize was facing a balance of payments crisis. Between 1981 and 1984 the balance of payment deficit increased from \$4.2 mn to \$13.9 mn which represented 3.7 percent of GDP. The current account deficit grew to \$10.4 mn or 2.8 percent of GDP in 1984 largely reflecting a deterioration in our terms of trade and an increase in imports.

## 2. The IMF Standby Program and its objectives, 1984-June 1986

As a result of the deterioration in its foreign reserve position, Belize had entered into a Stand-by program with the IMF. As a first step, Central Government obtained SDR3.6 mn from the Fund under the Compensatory Financing Facility (CFF) in 1983. Additional financing was secured from the Fund in December 1984 for SDR7.125 mn in December 1984 through a Standby Arrangement.

The objectives of the program were to:

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- [1] revive economic growth,
  - [2] reduce inflation,
  - [3] strengthen public finances and [4] restore some stability to the international reserves and the balance of payments.

The program utilized a package of fiscal and monetary policies. On the monetary side, measures were taken by the Central Bank to stimulate savings and reduce net domestic credit by raising interest rates and liquidity requirements. These measures were

largely successful as net domestic credit fell by 3.1 percent during the program period and deposits grew by 1.7 percent.

Fiscal policy measures were aimed at enhancing the rate of revenue growth within the economy and controlling expenditure. The fiscal deficit was to be reduced and along with the monetary measures, were aimed at reducing aggregate demand and ultimately imports leading to a reversal in the foreign reserve position. The reduction of the fiscal deficit would be achieved by increasing revenue and controlling expenditure. Government agreed to keep the deficit at 5 percent of GDP and in FY 1985/86 introduced the following revenue measures:

- [1] Stamp duty applied to goods cleared through the Customs department was increased from 8 percent to 10 percent.
- [2] Airport departure tax for non-residents was increased by \$10.00;
- [3] Airport landing fees were increased by 30 percent;
- [4] The administrative tax on intransit goods was increased from 2 percent to 3 percent; and
- [5] The hotel occupancy tax

These revenue measures had some effect on the fiscal accounts of FY 1985/86. The current account deficit was fell to \$0.4 mn from \$2.0 mn however, the overall deficit surged to \$39.1 mn or 10.1 percent of GDP with a \$12.0 mn increase in capital expenditure. Debt servicing rose \$5.5 mn to \$13.9 mn as arrears with external creditors were settled. With an increase in subsidies and current transfers current expenditure rose

by \$5.8 mn. In FY 1986/87 the pace of economic activity quickened as the positive effects of monetary restraint and an improvement in the country's terms of trade led to a 16.4 percent increase in retained imports and a 18.3 percent increase in taxes on international trade. Excise taxes and income taxes increased by 14.3 percent and 10.4 percent, respectively. At the same time, Government approved a salary adjustment package which awarded a 12.5 percent increase to senior employees and a 10 percent increase to junior officers. The increases in tax revenues resulted in a substantial 13.3 percent increase in current revenue which led to the first current account surplus (\$8.9 mn) since 1981/82. Current expenditure increased by 3.8 percent the result of the salary adjustment and this was partly offset by a reduction in subsidies and current transfers. With a 15.9 percent reduction in capital expenditures, the overall fiscal deficit was reduced to 4.8 percent of GDP. The fiscal deficit/GDP ratio achieved at the end of FY 1986/87 was in keeping with IMF requirements.

The monetization of the fiscal deficit continued during this period albeit at a slower pace as net domestic credit to Government rose by 16.9 percent to \$92.8 mn during 1985. During 1986, net domestic credit to Government rose by 3.3 percent to \$95.9 mn and this was accompanied by a substantial reduction in Central Bank credit largely due to a switch in the holder of Government paper to the commercial banks. Meanwhile, disbursements to Government on the IMF Standby loan and on the USAID \$15.0 mn loan resulted in official inflows of \$32.0 mn in 1985 and \$18.0 mn in 1986. Coupled with a sharp turnaround in the current account of the balance of payments from negative \$10.4 mn to \$25.6 mn, this led to a surplus on the balance of payments and substantial growth in the official reserves to \$9.1 mn in 1985 and \$32.6 mn in 1986.



During the Standby Program, real GDP grew by 0.3 percent in 1984 and 2.2 percent in 1986. With increased earnings from banana and citrus exports, more than offsetting the marginal decline in sugar export earnings led to a modest increase in exports from 1984-1986. The fiscal deficit was lowered to 4.8 percent of GDP by FY 1986/87. Current revenue (22.4 percent) grew at a faster pace than current expenditure (10.3 percent) and capital expenditure grew modestly during the review period. Fiscal discipline was restored during the period.

### 3. Fiscal Management, 1987 to 1991

For three consecutive years (1987-1989), the Belizean economy registered double digit real growth averaging 11.3 percent before decelerating to an average of 6.6 percent in 1990 and 1991. Inflation remained low averaging 2.8 percent between 1987 and 1990, before increasing to 6.7 percent in 1991 primarily as a result of the increase in oil prices due to the crisis in the Persian Gulf.

During FY 1987/88 additional revenue measures were introduced by the government;

- (1) revenue replacement duty for the importation of gasoline and kerosene was increased by \$0.25 and \$0.10, respectively; and
- (2) fee was imposed on motor vehicles crossing the borders of \$20.00 for buses, \$5.00 for motor vehicles and \$1.00 for individuals. The current account surplus grew from \$20.8 mn FY 1987/88 to 1989/90 reached a record high of \$51.0 mn in FY 1988/89 thereby enabling government to increase capital

expenditure significantly. The full effects of the revenue measures were now being realized, especially in the area of international trade and transactions given double digit economic growth and increasing imports. Current revenue increased by 66 percent during this period, while current expenditure rose by a 31.3 percent.

Capital revenues throughout the 1980's was at most \$3.7 mn in any FY until FY 1988/89. During this period, government commenced privatization of the telephone company, Belize Telecommunications Authority (BTA) and purchased the controlling rights of the international telephone services from Cable and Wireless Ltd.. Twenty-five percent of the BTA's ( the name of the company was subsequently changed to Belize Telecommunications Ltd.-BTL) shares were sold to British Telecom and 24 percent to the private sector while government retained its 51 percent share. This exercise earned \$34.5 mn in capital revenue. Additionally, a citizenship bonds program was implemented for the purchase of citizenship by foreign immigrants with intention to invest in Belize. This program, implemented in FY 1986/87, netted an estimated \$14.8 mn by FY 1989/90.

Government policy in the mid to late 1980's was to invest heavily in the development of the infrastructure. Foreign loans were secured for the construction of a new international airport, the rehabilitation of two major highways and the construction of roads and bridges in the least-developed South. External borrowing during 1987-1989 amounted to \$45.2 mn. Meanwhile, capital expenditure both for locally and externally funded projects more than doubled increasing to \$84.4 mn in FY 1989/90 from

\$33.8 mn in FY 1986/87. After overall surpluses of \$2.1 mn in FY 1987/88 and \$50.4 mn in FY 1989/90, a deficit was incurred in FY 1989/90 of \$14.3 mn.

During the last two years (1990, 1991), GDP growth decelerated to an average of 6.6 percent. Inflation rose during the period compared to the last half of the 1980's with rates of 3.4 percent and 6.7 percent, respectively. Meanwhile government fiscal policy followed the same objectives of improving the infrastructure, however it must be noted that several tax breaks were given like the elimination of the duties on stoves and refrigerators, and the passage of the International Business Companies Act which exempts international public investment companies from paying taxes. In spite of these new measures however, government accumulated huge surpluses of \$72.0 mn and \$63.1 mn, respectively on the current account in FY 1990/91 and FY 1991/92 largely because of increasing current revenues. Due to increased employment in the public service and improved collection by the Income Tax department, income tax revenue increased while increased imports led to increased revenues from international trade. Also increased revenue collection from other government departments along with good performance by the non-financial public sector (NFPE) led to increases in contributions to government accounting for the increase in non-tax revenue. Current expenditure continued to increase especially due to significant increases in public sector employment which led to a \$13.0 mn increase in wages and salaries over the last two FY's.

The process of the privatization of BTL was completed in FY 1991/92 as government sold the rest of its shares netting \$29.8 mn of the \$32.7 mn in total capital revenues. Infrastructural development continued at a brisk pace in the last two FYs with

development expenditure increasing by 55.6 percent to \$124.6 mn. An overall surplus of \$4.0 was recorded in FY 1989/90, however with the substantial increase in capital outlays in 1991/92, an overall deficit of \$30.0 mn was incurred representing 4.7 percent of GDP. The FY 1991/92 deficit was financed from domestic sources a reversal in net domestic credit from negative \$7.6 mn in 1990 to \$21.3 mn in 1991 largely reflecting Government's drawdown on its deposits in the banking system. Government's external borrowing during this period amounted to \$36.2 mn and were used to strengthen the economy's infrastructure. After growing to a record level of \$134.5 mn in 1990, the net official reserves declined by \$28.1 mn to \$96.6 mn in 1991. Despite the increase in external borrowing in 1991, reduced export volume due to a decline in citrus earnings (as a result of unfavourable weather conditions and low world prices) along with high import volume led to a steep decline in the official reserves. The large deficit incurred by government in FY 1991/92 played a major role in the decline in reserves because of the high import content of the capital expenditure.

## CONCLUSION

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The fact that the Belizean economy recovered after the IMF Standby Arrangement to achieve double digit growth in the late 1980's was indeed impressive. It is necessary to determine whether this growth is sustainable in light of the large deficits that the Government has been incurring and whether the reserves can be maintained at the acceptable 3 month coverage level.

The upswing in economic activity near the end of the IMF Standby Program was spurred by exogenous factors like increasing sugar prices, decreasing oil prices, and the

filming of a movie in Belize which brought in inflows of US\$5.0 mn. Factors accounting for fiscal discipline during the period included postponing some current expenditure, inadequate maintenance of government assets and a slowing down in the pace of implementation of capital projects. Shortly after the completion of the IMF program these expenditures started to increase and recently at a rapid rate. Meanwhile, the rate of increase in revenue has slowed as the revenue base shrinks.

Expenditures definitely need to be curtailed or the deficit will continue to grow. With a rapidly growing external debt, debt servicing will rise significantly in the mid to late 1990's. Reserve levels are not sustainable in the light of extensive external borrowing and heavy Central Bank credit to finance these consistently large deficits, even if the Central Bank credit is in the form of loss of Government deposits.

The relationships which have been discussed above suggest that indeed there is a relationship between deficit and the international reserves.

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**Table 2: GDP at Market Prices**

BZ\$mn

| End of Period | GDP   | % Growth |
|---------------|-------|----------|
| 1981          | 354.3 | n.a.     |
| 1982          | 334.7 | -5.53    |
| 1983          | 347.8 | 3.93     |
| 1984          | 371.1 | 12.05    |
| 1985          | 367.8 | -0.55    |
| 1986          | 422.2 | 8.94     |
| 1987          | 509.7 | 20.71    |
| 1988          | 577.1 | 13.23    |
| 1989          | 672.8 | 16.57    |
| 1990          | 733.2 | 8.98     |
| 1991          | 791.2 | 7.91     |

Source: Central Statistical Office

**Table 3: International Trade**

BZ\$mn

| End of Period | Domestic Exports | Retained Imports | Balance Of Trade | Re-Exports |
|---------------|------------------|------------------|------------------|------------|
| 1981          | 149.5            | 235.4            | -85.9            | 88.5       |
| 1982          | 121.4            | 193.6            | -72.2            | 62.4       |
| 1983          | 130.3            | 199.0            | -68.7            | 25.2       |
| 1984          | 145.7            | 225.5            | -79.8            | 40.7       |
| 1985          | 128.9            | 215.9            | -87.0            | 51.4       |
| 1986          | 148.9            | 220.4            | -71.5            | 36.3       |
| 1987          | 173.8            | 256.6            | -82.8            | 31.8       |
| 1988          | 190.3            | 318.4            | -128.1           | 42.2       |
| 1989          | 188.0            | 381.4            | -193.4           | 61.6       |
| 1990          | 209.1            | 388.0            | -178.9           | 49.0       |
| 1991          | 190.6            | 441.5            | -250.9           | 48.6       |

Source: Central Statistical Office

## STATISTICAL APPENDIX

Table 1: GDP at Real Prices

BZ\$mn

| End of Period | GDP   | % Change |
|---------------|-------|----------|
| 1981          | 333.2 | -2.2     |
| 1982          | 336.4 | 1.0      |
| 1983          | 329.9 | -1.9     |
| 1984          | 339.4 | 2.9      |
| 1985          | 340.5 | 0.3      |
| 1986          | 348.1 | 2.2      |
| 1987          | 391.6 | 2.5      |
| 1988          | 417.6 | 6.6      |
| 1989          | 478.8 | 14.7     |
| 1990          | 521.9 | 8.9      |
| 1991          | 543.6 | 4.2      |

Source: Central Statistical Office

**Table 4: Central Government Revenue and Expenditure**

|  | BZ\$mn  |         |         |         |         |         |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|  | 1981/82 | 1982/83 | 1983/84 | 1984/85 | 1985/86 | 1986/87 | 1987/88 | 1988/89 | 1989/90 | 1990/91 | 1991/92 |
| Total revenue and grants                 | 97.0    | 91.7    | 90.9    | 98.3    | 100.1   | 115.9   | 142.9   | 204.8   | 205.0   | 235.0   | 252.3   |
| Current Revenue                          | 83.4    | 78.6    | 77.5    | 91.2    | 98.6    | 111.7   | 132.8   | 162     | 185.9   | 211.5   | 218.3   |
| Tax revenue                              | 73.1    | 67.3    | 67.8    | 81.8    | 83.1    | 97.1    | 119.9   | 144.0   | 160.0   | 176.4   | 184.8   |
| International Trade Income               | 16.6    | 18.6    | 15.2    | 20.5    | 19.3    | 21.3    | 28.3    | 33.1    | 35.8    | 41.2    | 46.1    |
| Non-tax revenue                          | 10.3    | 11.3    | 9.7     | 9.4     | 15.5    | 14.6    | 12.9    | 18.0    | 25.9    | 35.1    | 33.5    |
| Capital revenue                          | 0.3     | 0.3     | 0.3     | 1.5     | 0.1     | 1.7     | 3.7     | 40.9    | 13.5    | 10.5    | 32.7    |
| Grants                                   | 13.3    | 12.8    | 13.1    | 5.6     | 1.4     | 2.5     | 6.4     | 1.9     | 5.6     | 13.0    | 1.3     |
| Total expenditure                        | 110.8   | 124     | 118.2   | 121.4   | 139.2   | 136.6   | 140.8   | 154.4   | 219.3   | 231     | 289.3   |
| Current Expenditure                      | 76.2    | 87.3    | 90.5    | 93.2    | 99.0    | 102.8   | 112.0   | 120.5   | 134.9   | 139.5   | 155.2   |
| Capital Expenditure                      | 34.6    | 36.7    | 27.7    | 28.2    | 40.2    | 33.8    | 28.8    | 33.9    | 84.4    | 91.5    | 134.1   |
| Current surplus/(deficit)                | 7.2     | -8.7    | -13.0   | -2.0    | -0.4    | 8.9     | 20.8    | 41.5    | 51.0    | 72.0    | 63.1    |
| Overall surplus/(deficit)                | -13.8   | -32.3   | -27.3   | -23.1   | -39.1   | -20.7   | 2.1     | 50.4    | -14.3   | 4.0     | -37.0   |
| Overall surplus/(deficit)<br>as % of GDP | 3.9     | 9.7     | 7.8     | 5.9     | 10.1    | 4.8     | 0.4     | 8.7     | 2.1     | 0.5     | 4.7     |

Source: Ministry of Finance



**Table 5: Changes in the Consumer Price Index**

1984 = 100

| End of Period | CPI    | Inflation Rate |
|---------------|--------|----------------|
| 1981          | 83.40  | NA             |
| 1982          | 89.40  | 7.2            |
| 1983          | 96.70  | 8.2            |
| 1984          | 100.00 | 1.9            |
| 1985          | 103.80 | 3.8            |
| 1986          | 104.60 | 0.8            |
| 1987          | 106.70 | 2.1            |
| 1988          | 110.10 | 3.4            |
| 1989          | 112.40 | 2.3            |
| 1990          | 115.80 | 3.4            |
| 1991          | 122.66 | 6.7            |

Source: Central Statistical Office

**Table 6: Government External Borrowing**

BZ\$mn

|      | Drawings | 0001 <sup>1)</sup> |
|------|----------|--------------------|
| 1981 | 4.6      | 19.2               |
| 1982 | 13.0     | 28.4               |
| 1983 | 5.8      | 45.2               |
| 1984 | 7.2      | 53.8               |
| 1985 | 32.0     | 99.0               |
| 1986 | 18.0     | 120.8              |
| 1987 | 9.2      | 135.8              |
| 1988 | 8.4      | 130.4              |
| 1989 | 27.6     | 140.6              |
| 1990 | 23.4     | 158.0              |
| 1991 | 36.2     | 177.4              |

Source: Central Bank of Belize  
1) Disbursed Outstanding Debt

**Table 7: Net Credit to Central Government  
From the Banking System**

BZ \$000

| End of Period | Central Bank | Commercial Banks | Total   |
|---------------|--------------|------------------|---------|
| 1981          | 28,099       | 6,474            | 34,573  |
| 1982          | 29,778       | 15,650           | 45,428  |
| 1983          | 36,748       | 31,511           | 68,259  |
| 1984          | 60,504       | 18,868           | 79,372  |
| 1985          | 60,182       | 32,637           | 92,819  |
| 1986          | 49,253       | 46,695           | 95,948  |
| 1987          | 36,801       | 45,922           | 82,723  |
| 1988          | (9,072)      | 37,888           | 28,816  |
| 1989          | (6,999)      | 17,032           | 10,033  |
| 1990          | (29,757)     | 22,113           | (7,644) |
| 1991          | 11,872       | 9,463            | 21,335  |

Source: Central Bank of Belize

**Table 8: Net Official Reserves**

BZ\$000

| End of Period | Central Bank Net Position | Central Gov't Net Position | Total             |
|---------------|---------------------------|----------------------------|-------------------|
| 1981          | 20,267                    | <del>1,374</del>           | <del>21,641</del> |
| 1982          | 19,326                    | 1,994                      | 21,320            |
| 1983          | 10,049                    | 3,142                      | 13,191            |
| 1984          | -5,008                    | 4,163                      | -745              |
| 1985          | 7,561                     | 1,511                      | 9,072             |
| 1986          | 29,049                    | 3,531                      | 32,580            |
| 1987          | 48,681                    | 4,242                      | 52,923            |
| 1988          | 86,269                    | 3,550                      | 89,909            |
| 1989          | 108,961                   | 4,180                      | 113,141           |
| 1990          | 130,006                   | 4,542                      | 134,548           |
| 1991          | 90,564                    | 6,088                      | 96,652            |

Source: Central Bank of Belize

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