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June 12, 2014

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Approved By
Western Hemisphere Department

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CONTENTS

GLOSSARY

ACAS	-	Advisory, Conciliation and Arbitration Service
ACH	-	Automated Clearing House
AGE	-	Agency for Government Employees
AML/CFT	-	Anti-Money Laundering and Combating the Financing of Terrorism
AQRs	-	Asset Quality Reviews
ATM	-	Automated Teller Machine
ATS	-	Automated Transfer System
AusAID	-	Australian Agency for International Development
BBB	-	Belize Business Bureau
BCBS	-	Basel Committee on Banking Supervision
BCCI	-	Belize Chamber of Commerce and Industry
BEL	-	Belize Electricity Limited
BISL	-	Belize International Services Limited
BNTU	-	Belize National Teachers Union
BTL	-	Belize Telemedia Limited
BWG	-	Budget Working Group
CAMELS	-	Capital Adequacy, Assets, Management Capability, Earnings, Liquidity,
	-	Sensitivity
CAR	-	Capital Adequacy Ratio
CBA	-	Central Bank Act
CBB	-	Central Bank of Belize
CCL	-	Caribbean Congress of Labor
CRS	-	Credit Reporting System
CSD	-	Central Securities Depository
CFATF	-	Caribbean Financial Action Task Force
CGBS	-	Caribbean Group of Banking Supervisors
CIDA	-	Canadian International Development Agency
CPSS	-	Committee on Payment and Settlement Systems
CRR	-	Cash Reserve Ratio
CUA	-	Credit Union Act
DBFIA	-	Domestic Banks and Financial Institutions Act
DFC	-	Development Finance Corporation
DSG	-	Domestic Standing Group
DNFBs	-	Designated Non-Financial Businesses and Professions
DvP	-	Delivery versus Payment
ELA	-	Emergency Liquidity Assistance
FIRST	-	Financial Sector Reform and Strengthening Initiative
FSAP	-	Financial Sector Assessment Program
FATF	-	Financial Action Task Force
FSCA	-	Fiscal Sustainability and Compensation Authority
FIs	-	Financial Institutions
FIU	-	Financial Intelligence Unit

FSCTCI	-	Financial Services Commission of Turks and Caicos Islands
FSSD	-	Financial Sector Supervision Department
FSU	-	Financial Stability Unit
GEA	-	Government Employer's Authority
GOB	-	Government of Belize
GUFs	-	Global Union Federations
HRMIS	-	Human Resource Management Information System
IBA	-	International Banking Act
IBC	-	International Business Company
ICRG	-	International Cooperation Review Group
IDB	-	Inter-American Development Bank
IFC	-	International Finance Corporation
IFSC	-	International Financial Services Commission
IMMARBE	-	International Merchant Marine Registry of Belize
LAC	-	Latin America and Caribbean
MDAs	-	Ministries, Departments, and Agencies
MOF	-	Ministry of Finance
MOU	-	Memorandum of Understanding
MPS	-	Ministry of Public Service
NBBL	-	National Bank of Belize Limited
NPC	-	National Payments Council
NPLs	-	Non-Performing Loans
NPS	-	National Payments System
NPOs	-	Not-for-Profit Organizations
NTUCB	-	National Trade Union Congress of Belize
OAG	-	Office of the Auditor General
PEFA	-	Public Expenditure and Financial Accountability Assessment
PFM	-	Public Financial Management
POS	-	Point of Sale
PSU	-	Public Service Union
PSRB	-	Permanent Salaries Review Board
RSPs	-	Remittance Service Providers
ROAs	-	Returns on Assets
RTGS	-	Real Time Gross Settlement
SIFIs	-	Systemically Important Financial Institutions
SOI	-	Supervisor of Insurance
SSS	-	Securities Settlement System
SSB	-	Social Security Board
TCI	-	Turks and Caicos Islands

WHERE DO WE STAND ON EFFORTS TO STRENGTHEN BELIZE'S FINANCIAL SECTOR?[1]

Summary

1. **Belize's banking system has been strengthening since the 2011 Financial Sector Assessment Program (FSAP)**. Non-performing loans (NPLs) have been declining and their provisioning has been increasing. Capital adequacy ratios have been improving as well. After two years of losses, partly caused by higher expenses on provisioning and loan write-offs, returns on assets have turned positive in 2013. The system has been highly liquid, partly reflecting lack of investment opportunities.

2. **The improvement in financial stability indicators was boosted by implementation of key FSAP recommendations**. The Central Bank strengthened provisioning and loan classification standards. The new rules force banks to focus more on the borrower's capacity to repay the loan rather than on the value of collaterals. A revised Domestic Banks and Financial Institutions Act (DBFIA) addressed a number of gaps identified by the FSAP including related party transactions, consolidated supervision and bank resolution. It also strengthened Central Bank powers including by raising penalties for violating Central Bank regulations and guidelines. Recent revisions to the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework should bring Belize in significant compliance with Financial Action Task Force (FATF) recommendations.

3. **Nonetheless, banks' balance sheets remain weak and vulnerable.** NPLs remain high and capital buffers may be overestimated because provisioning is still insufficient. Stress tests reveal that compared with the 2011 FSAP findings, more banks now appear weak, partly because their capital buffers were eroded by higher expenses on provisioning and loan write-offs. Banks that were identified as weak during the 2011 FSAP remain in that category. Under adverse but plausible scenarios, banks' capital shortfalls could reach several percentage points of GDP.

4. **The regulatory, supervisory, and crisis management frameworks as well as the financial infrastructure could be further strengthened**. The supervision department of the Central Bank could be strengthened with examiners specializing in information technologies (IT) with the view of ensuring the integrity of banks' IT systems. Asset quality reviews and forward-looking stress tests could complement current supervisory practices and improve Central Bank's assessments of banks' balance sheets. The possibility of exemptions to limits on large exposures should be removed from the banking law and banks willing to extend large loans must raise

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[1] The main authors of this note are Jacques Bouhga-Hagbe, Joel Okwuokei, and Kristine Vitola (all WHD), with very valuable inputs from the Central Bank of Belize and David Parker (MCM).

capital for that purpose. The Central Bank should be able to enforce remedial action on banks without prior consultation with or approval of the Minister of Finance. Bank resolution and liquidation could become truly administrative actions and court approvals should be removed from the banking law. The latter should supersede company insolvency laws. A registry of moveable property would help deepen financial markets.

5. **The authorities agreed with the thrust of staff's recommendations but shared some dissenting views.** On regulation and supervision, the authorities do not agree with removing the possibility to grant exemptions to the limit on large exposures. In their view, the small size of the Belizean market would require extremely large and disproportionate capital injections to support large credit to the productive sector. This would put upward pressure on already high interest rates as highly capitalized banks seek to maintain their ROAs. On Central Bank autonomy, the authorities agreed with the idea of allowing the Central Bank to enforce remedial action on banks without prior consultation with or approval of the Minister of Finance in the case of increases in capital requirements. However, in the case of liquidation or cancellation of license of a systemic domestic bank, they are of the view that at the minimum there should be some degree of consultation with the Minister of Finance given that the systemic risk and fiscal contingency falls on the government.

Introduction

6. **The main purpose of this note is to assess the current strength of the balance sheets of large banks in Belize and take stock of progress made on the regulatory, supervisory, and crisis management frameworks since the 2011 FSAP**. This is part of a Fund-wide effort to strengthen financial sector surveillance in the context of Article IV Consultations. The note analyzes the banking system's soundness, and assesses the effectiveness of the regulatory, supervisory and crisis management architecture in light of the FSAP recommendations.

7. **Belize's financial sector is sizeable and continues to strengthen.** Its size has not changed much since the 2011 FSAP, with total assets amounting to about 163 percent of GDP at end-March 2014. Progress in strengthening banks' balance sheets is visible as banks' non-performing loans (NPLs) have been on a declining trend, including because of loan write-offs. Capital buffers have also been improving, though they may be overestimated because of still low provisioning. Since the FSAP, loan classification strengthened in line with FSAP recommendations and banks have been addressing the resulting shortfalls in provisioning.

8. **Nonetheless, Belize's financial sector continues to pose non-negligible financial stability and fiscal risks, which warrant very close monitoring**. Weaknesses identified during the FSAP mission remain. NPLs remain high. In addition to being overestimated, capital buffers may not be sufficient to absorb large but plausible losses. Significant progress has been made on the regulatory, supervisory, and crisis management frameworks. However, remaining weaknesses, including in the supervisory function of the Central Bank, which may not be intrusive enough

given the risks posed by some banks, point to the possibility that many financial institutions' balance sheets could be much weaker than reported.

9. **The note is organized as follows**. Section A describes the structure of the financial system. Section B presents developments in banks balance sheets since the 2011 FSAP as well as the main sources of systemic risk to the financial system. Section C discusses the updated stress tests for the banking system, including a new model of banks' profitability that was not used in the 2011 FSAP. Section D presents the crisis management framework. Section E describes the next steps toward an even stronger financial system. Concluding remarks are in section F.

A. Overview of the Financial System

The composition of the financial system has not changed much since the 2011 FSAP. Domestic banks are still dominant, followed by international (offshore) banks. The domestic insurance sector is very small and credit unions are heavily involved in financial intermediation. The offshore non-bank financial sector includes many international insurance and business companies. Reforms implemented since the FSAP address a number of gaps identified by the FSAP, including on provisioning and loan classification. Progress on regional cross-border supervision is still hampered by disputes on parallel banking issues between Belize and the Turk and Caicos Island (TCI). Outstanding deficiencies in AML/CFT are being addressed. The payment system is being modernized. A Credit Bureau is being established and a draft Credit Reporting legislation has reached an advanced stage. As during the 2011 FSAP, capital markets are still shallow, dominated by government paper and a few major participants.

Composition of the Financial System

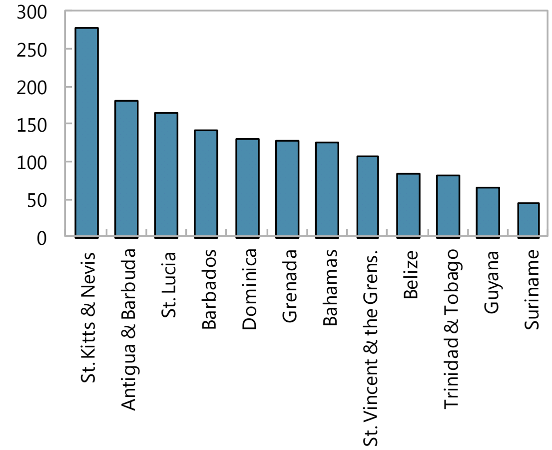
10. **Belize's financial system is large relative to the size of the economy (Text Table 1).** The assets of the financial system are estimated at BZ$5.4billion equivalent to 163 percent of GDP at end-March 2014. In 2010, financial system assets stood at BZ$4.3billion, implying an increase of 24 percent[2]. The financial system comprises 6 domestic banks, 6 international (offshore) banks, 14 domestic insurance companies, 12 credit unions, a private finance company, the state-owned Development Finance Corporation (DFC), and the Social Security Board (SSB).[3] In addition, there is a substantial number of international insurance companies and other international businesses in the Belize offshore financial sector.

[2] Since 2010, two private entities have voluntarily wound-up their operations– a mutual trust company in 2011 and an international bank in 2013.

[3] The assets of the SSB are not included in the financial system's totals because the authorities do not consider the entity as part of the financial system for regulation purposes.

11. **The domestic banking system remains dominant in the financial system but appears relatively small by regional standards (Text Chart).** At end- March 2014, domestic banks' assets amounted to BZ$2.9 billion, 89 percent of GDP, or over half the financial systems' total assets. Despite increasing in absolute terms, the size of the domestic banking system relative to the financial system actually declined by about 3 percentage points since 2010, as banks have been repairing their balance sheets following the tightening of prudential requirements (Table 1). In the banking system, domestic banks account for 68 percent of the total assets, 67 percent of total deposits and 81 percent of total loans (Text Table 2). Between December 2010 and March 2014, deposit liabilities of the domestic banks increased by 23 percent, while their loan portfolio expanded only by 5 percent on account of loan-write-offs and weak economic activity. Of note, the biggest bank in terms of assets has about one-third of the assets (28 percent of GDP) of the domestic banking system, and an equivalent share of the banking system's deposits and loans. The second biggest bank in terms of assets holds slightly more than half of the total capital of the domestic banking system.

Caribbean: Total Assets of Domestic Banks
(2012 or latest available, percent of GDP)



Sources: National authorities; Eastern Caribbean Central Bank (ECCB); and IMF staff calculations.

Text Table 1. Belize: Financial System

	No. of Institutions			Asset Size (BZ$ million)			% of Total			% of GDP		
	Dec-10	Dec-13	Mar-14	Dec-10	Dec-13	Mar-14	Dec-10	Dec-13	Mar-14	Dec-10	Dec-13	Mar-14
Depository Institutions												
Domestic Banks	5	6	6	2,498	2,830	2,955	57.3	54.4	54.5	89.3	87.6	88.7
International Banks	8	6	6	975	1,339	1,415	22.4	25.7	26.1	34.9	41.4	42.5
Credit Unions	13	12	12	535	717	722	12.3	13.8	13.3	19.1	22.2	21.7
Non-depository Fis												
Development Financing	1	1	1	149	92	94	3.4	1.8	1.7	5.3	2.8	2.8
Microlending	1	1	1	1	2	2	0.0	0.0	0.0	0.0	0.1	0.1
Unit Trust	1	0	0	8	0	0	0.2	0.0	0.0	0.3	0.0	0.0
Insurance Companies												
Life (Long Term)	5	6	7	117	147	147	2.7	2.8	2.7	4.2	4.6	4.4
Nonlife (General)	6	6	5	53	51	59	1.2	1.0	1.1	1.9	1.6	1.8
Composite	2	2	2	23	26	27	0.5	0.5	0.5	0.8	0.8	0.8

Source: Central Bank of Belize.

Text Table 2. Belize: Deposits and Loans for Domestic Banks and Credit Unions (December 2010 - March 2014)

	Domestic Banks		Credit Unions	
	Loans (BZ$'000)	Deposits (BZ$'000)	Loans (BZ$'000)	Deposits (BZ$'000)
Dec-10	1,762	1,962	367	429
Dec-11	1,756	2,065	389	477
Dec-12	1,803	2,290	427	529
Dec-13	1,854	2,305	488	579
Mar-14	1,850	2,415	487	588

Source: Central Bank of Belize.

12. **A new public bank, the National Bank of Belize, was established in late 2013 (Box 1).** The bank, which started operations in November last year, has the primary purpose of providing mortgage lending to public officers, teachers and other needy low-middle-income Belizeans at more affordable rates than currently available in the market. The plan, however, is to offer full-scale banking services to the public, commencing in July 2014. The government committed BZ$20 million[4] from Petrocaribe resources as the start-up fund.

13. **International (Offshore) banks are the second largest component of the financial system.** They account for one-quarter of financial system assets (BZ$1.4 billion or 43 percent of GDP), up by 45 percent in 2010. Similar to domestic banks, three international banks own about three-quarters of the sector' assets. The biggest among them accounts for 43 percent of total loans, 28 percent of total assets, 23 percent of total deposit and 45 percent of capital. There are two types of international banking license–class A and B. The differences between the two relates to the capital requirement and nature of business.[5] A Type 'A' license holder is eligible to conduct business of accepting deposits and lending in foreign currency involving non–residents and any person who engages in trade in the export processing or commercial free zone, without restrictions. On the other hand, a type 'B' license holder is not permitted to accept deposits from or lend to the general public. The Central Bank in 2013 wound up the operations of Handels International Bank and Trust Company Limited, which had the appearance of a shell bank due to the absence of meaningful decision–making and management.

14. **There is significant foreign presence in the Belize financial system.** Several of the large financial institutions in the country are part of international financial conglomerates:

[4] The sum of BZ$10 million has been released to the bank.

[5] For a Type 'A' License, the capital requirement is minimum US$3 million in the case of an indigenous company, or minimum US$25 million in the case of a foreign bank. For a type B license, the minimum is US$1 million for an indigenous company, and US$15 million for a foreign bank. A type 'B' license can be converted to type 'A' subject to approval by the Central Bank.

- One domestic bank is a subsidiary of the Canadian Bank of Nova Scotia. Another domestic bank is a branch of First Caribbean International Bank of Barbados, a Canadian bank ultimately owned by the Canadian Imperial Bank of Commerce (CIBC);

- Another domestic bank is majority–owned by a Honduran holding company (55 percent), Sociededad Nacional de Inversiones, S.A. (SONISA). This bank is in the same group with a domestic insurance company;

- A large bank, which is ultimately owned by a holding company controlled by a prominent investor, also owns an international bank in Belize and is indirectly linked to a bank in Turks and Caicos through a parallel banking structure without the containment of consolidated supervision;

- A small domestic bank is majority-owned by an international bank (84 percent). Both banks maintain integrated functions and share the same board, management and staff. Meanwhile, the international bank is majority-owned by a private locally incorporated holding company (52 percent), and partly by an international bank in Antigua (38 percent), Antigua Overseas Bank Limited – which itself is ultimately owned by another holding company, ABI Financial Group.

15. **The domestic insurance sector is very small.** Its assets to GDP ratio remained around 7 percent on average since 2006, and just 4.4 percent of the financial system's assets. There are seven life insurers, of which one is locally incorporated, and another one shares common ownership with a bank. There are also four general insurers of which two are locally incorporated, with one being a branch of a foreign company and another being an agency of a foreign company. There are two composites insurers, which are locally incorporated, and one of them shares common ownership with a bank. Finally, there is one association of underwriters that is both insurer and reinsurer. General insurance appears dominant with property, motor, accident and sickness being the main lines of business. Also, the market relies heavily on the external reinsurance market for the transference of risk, and yet there are no registered reinsurers besides the above-mentioned association of underwriters.

16. **Credit unions are heavily involved in financial intermediation.** They operate on a smaller scale than commercial banks; accept savings/share deposits; and offer loans to their members. As of March 2014, personal loans accounted for 36 percent of credit union lending, followed by lending for building & construction (28 percent) and real estate lending (19 percent). Seven credit unions account for 13 percent of the financial system assets, some 22 percent of GDP, as at March 2014. The seven unions boast of around 145,000 memberships (around 46 percent of Belize's population). Between December 2010 and March 2014, credit unions registered increases in loans and deposits of 37 percent and 33 percent, respectively. Meanwhile, the assets of the largest credit union, the Holy Redeemer amounted to BZ$472 million, 14 percent of GDP, and represents 65 percent of the credit unions' total assets. The deposits of the same credit union accounts for 65 percent of the credit unions' total deposits at end-March 2014.

17. **There is a small private finance company, which offers loans to finance insurance premiums.** This finance company, with assets of BZ$2.2 million at end-March 2014, has been in existence since 2008. By financing insurance premiums, the company aims to improve cash flow for businesses and individuals, and make insurance more affordable, especially for small and medium enterprises.

18. **The non-bank offshore sector offers a vast array of services[6].** These include: international business, trust, international insurance, collective investment scheme (mutual fund), asset protection, securities trading, money lending, safe custody, foreign exchange trading, money transmission, consultancy, money brokering, money lending, money exchange, payment processing, etc. Available information suggests that there are probably more than 260 registered companies that offer various offshore services in Belize. The International Business Companies (IBC) appears dominant in the sector, and is modeled after that of the British Virgin Island, which is regarded as the benchmark model of offshore corporations. As at January 2014, there were 98 IBC registered providers, 58 trust providers, and at least 61 companies that trade in securities. In addition, there are 20 registered international insurers, which offer services covering long-term insurance, general insurance, reinsurance, and captive business services[7]. Offshore financial services are generally tax exempt.

19. **The government took over the IBC Registry in mid 2013.[8]** The IBC Registry was a privatized concession based on an agreement between the government and a private sector company, the Belize International Services Limited (BISL). The Registry contains information on all registered IBCs–name of owners, official registered agents, capital structure, types of shares, number of directors, business objectives, powers of owners and directors. Registration makes an IBC legal, while a registered agent keeps custody of the companies' documents of incorporation. The registry is an additional source of government revenue.

20. **Two public institutions make up the rest of the financial system.** These are the Development Finance Company (DFC) and the Social Security Board (SSB). The DFC is a non-deposit taking, government owned institution, which restarted operations in 2009 after becoming insolvent and closed in 2005. The new DFC now offers credit to the private sector for several economic activities, including agriculture, tourism, housing, and transportation, etc. The assets of the DFC was BZ$94 million (2.8 percent of GDP) in end-March 2014, accounting for just 2 percent of the financial system. The SSB is the administrator of Belize's national insurance scheme and a major player in Belize's financial system (Box 2). It had BLZ$444 million in assets

[6] Under the Belizean law, separate licenses are required for each kind of service.

[7] Captive insurance companies offer services only to a parent company, an affiliate or any person as authorized by the Insurance Supervisor.

[8] The government also assumed control of the International Merchant Marine Registry of Belize (IMMARBE) at the same time. Both registries were being managed by BISL.

(14 percent of GDP) at end-2012. Its investment and lending portfolio is diversified, including both financial and real assets across a relatively large clientele base.

21. **The authorities consider five domestic banks as systemic.** This reflects not only the size of each bank relative to the financial sector and the economy but also the Central Bank's belief that failure of one bank can trigger a run on the others. Besides the domestic banks, one credit union, the Holy Redeemer Credit Union, and the Social Security Board, are also seen as systemic.

Regulatory and Supervisory Architecture

22. **The financial system is regulated by various legislations passed over the last decade.** Belize has enacted a number of important legislations over the past decade covering every sector of the financial system–domestic banking, international banking, domestic insurance, international insurance, international business, credit unions, anti-money laundering, etc. A revised Domestic Banks and Financial Institutions Act became effective in January 2013 (Box 3). Legislation on anti-money laundering was revised in February 2014 (Box 4). Most of the other legislations are due for revision to bring them up to international standard and enhance supervisory practices.

23. **Financial sector supervision is divided among three institutions.** The Central Bank of Belize supervises all the banks, the credit unions, a finance company, and the DFC. The Supervisor of Insurance (SOI), under the Ministry of Finance, supervises domestic insurance. The International Financial Services Commission (IFSC) supervises the offshore sector, including international insurance companies. The SSB is governed by its own Board and externally audited on an annual basis.

24. **Regulatory reforms since the 2011 FSAP have strengthened the banking system significantly.** Following the recommendations of the 2011 FSAP, the authorities accelerated financial sector reforms to address vulnerabilities (Annex I). Key reforms included:

- **New provisioning and loan classification standards (Box 5).** The new standards introduced in December 2011 require that banks that are already excessively exposed to credit risks carry levels of provisions consistent with their capacity to absorb future losses. More importantly, they encourage banks to focus more on borrower's repayment capacity rather than the value of collaterals as it was mostly the case in the past. The Central Bank has also issued regulations prescribing the methodology and procedures for evaluating and classifying loans and specified the appropriate treatment of interest and other interest bearing assets. A directive was also issued in 2011 prohibiting banks from acquiring assets for sale from borrowers in exchange for settlement of debts and to correct such transactions that had already taken place.

- **Revisions to the Domestic Banks and Financial Institutions Act (Box 3).** The new Act addresses a number of gaps identified by the FSAP, including related party transactions, consolidated supervision, corporate governance, and bank resolution. It now addresses the Basel Core Principles to which Belize were partially non–compliant. In addition, the Act is expected to enhance compliance and efficiency by raising administrative penalties for violation of central bank's regulations.

25. **Further regulatory changes are underway**. Plans are underway to revise the international banking legislation. The authorities have made progress in revising the domestic insurance and credit union legislations.

26. **As per consolidated and cross-border supervision, progress is being hampered by disputes between Belize and the Turk and Caicos Islands.** The Central Bank carries out consolidated supervision to the extent that it receives reports at the group-level from entities under its jurisdiction. With respect to cross-border supervision, progress is being hampered by disputes between Belize and the Turks and Caicos Islands, which continue to contravene international best practice by approving the establishment and maintenance of a parallel banking structure that poses a risk to Belize's financial system (Annex I).

27. **The complex ownership structure of some financial institutions is a challenge for financial sector supervision.** This is partly due to lack of information about the ultimate beneficiaries. For domestic financial institutions with foreign affiliations, monitoring related party lending and loan concentrations has been extremely difficult. In performing consolidated supervision, there is a limit to which the regulators can investigate the activities of holding companies which are outside their jurisdiction. Also, little is known about the activities of the offshore companies beyond minimal information required by law upon registration[9]. However, for the banking system, the revised DBFIA attempts to address some of these difficulties, at least by giving the Central Bank the authority to request ultimate beneficiary information from banks.

28. **Outstanding deficiencies in Belize's national AML/CFT architecture are being addressed.** In May 2011, the Caribbean Financial Action Task Force (CFATF)[10] identified Belize as one of the jurisdictions that have weaknesses in their AML/CFT regime. Following minimal progress in addressing the weaknesses, the CTAFT in May 2013 established an action plan with agreed deadlines, which was designed to strengthen the AML/CFT regime in Belize. In this plan, the Belizean authorities were required to: (a) address deficiencies with the obligations on conducting customer due diligence; (b) fully implement the CFT framework, (c) extend the

[9] The International Business Companies Act requires the disclosure of the directors and shareholders, but not beneficial owners of corporate shareholders.

[10] The CFATF is an organization of 29 jurisdictions of the Caribbean Basin that have agreed to implement the international standards on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), as recommended by the Financial Action Task Force (FATF). The CFATF identifies the jurisdictions that have strategic deficiencies in their AML/CFT system and works with them to address those deficiencies that pose risks to the international financial system.

AML/CFT framework to designated non–financial businesses and professions (DNFBs), (d) address deficiencies with operational independence of the Financial Intelligence Unit (FIU); and (e) prohibit dealings with shell banks. Belize has made efforts to address these deficiencies (Box 4). However, because of insufficient steps to improve the compliance regime, the CFAFT in its November 2013 meeting decided to call on its members to consider implementing counter measures to protect their financial systems from ongoing money laundering and terrorist financing risks emanating from Belize. After this statement, additional legislation was enacted in February 2014, which would bring Belize into significant compliance with FATF recommendations.

Financial Market Infrastructure, Products, Instruments, Market Participants and Weaknesses

29. **The current payment system in Belize is predominantly paper-based**. Cash remains a vital payment medium for the general public although the use of non-cash payment instruments is growing. Check is the primary non-cash payment instrument. Indeed, check clearing is the only centralized interbank payment system and is owned and operated by the Central Bank. The clearing and settlement processes are manual and paper-based, which increases processing cost and settlement time. Notwithstanding, the authorities see the payment system as critical in ensuring financial system soundness, and facilitating monetary policy implementation and capital market development.

30. **Commercial banks are the main providers of payment services in Belize.** They offer retail payment services using checks for both small and large value transactions, online bill payment, debit cards for Point of Sale (POS) transactions and cash withdrawal through Automated Teller Machines (ATMs). However, these forms of payment are limited to intra-bank transactions due to the absence of an automated interbank payment system. Banks also provide direct credit facilities, and issue internationally accepted credit cards, which are used for both local and foreign transactions.

31. **Belize's payment system is being modernized.** Since 2010, the World Bank has provided technical assistance at the initiation and planning stages for a National Payments System (NPS) development and legal and regulatory reform, with funding from the Financial Sector Reform and Strengthening Initiative (FIRST). Project execution, which started in 2012, is partly funded by the Australian Agency for International Development (AusAID). In leading the reform, the Central Bank has adopted a collaborative approach with stakeholders through the formation of various working groups. The Central Bank also established a dedicated Payment System Project Office. The NPS reform is being implemented in two phases under nine different pillars (Annex 2). In the short term (1-2 years), the plan is to have the backbone of the NPS, that is, the Automated Transfer System (ATS) replace the existing manual clearing and settlement by the end-March 2015. Over the medium term (4–5) years, the reform process is expected to be completed, and will see the development of the Securities Settlement System (SSS), to provide a platform for capital market, and interbank market development. The legal and regulatory

framework has advanced. An NPS bill is expected to be finalized in June this year, while other related legislations are being drafted.

32. **Similarly, a Credit Bureau is being established and a draft Credit Reporting legislation has reached an advanced stage.**[11] In 2010, the Central Bank engaged the IFC to assist in developing a Credit Reporting System (CRS)[12] in Belize. The system will help to reduce risks for financial institutions and is expected to lead to lower interest rates, making loans more affordable and more widely available, thus broadening and deepening individuals' and small businesses' participation in the formal financial system. The credit reporting draft legislation is undergoing final revisions and is scheduled for enactment in 2014 after which a Public Awareness Campaign will be launched, followed by Licensing of a Credit Bureau. The legislation will provide for establishment of a credit reporting system in Belize, data protection and confidentiality, consumer rights and remedies, and the Central Bank's power to oversee the system. This project is being supported through technical assistance from the IFC and CIDA and in collaboration with the financial system and other relevant stakeholders.

33. **The securities market is shallow reflecting a narrow range of financial instruments.**[13] There are only a handful of equity and debt instruments, which are issued by the government and quasi-government agencies, such as BTL and BEL. There are no active secondary and private markets, except for treasury bills, which are open to competitive bidding by the public. Government securities appear more attractive than private instruments. Treasury bills, which are mostly held by banks, have maturity of up to one year, though the government only issues them for three months. Treasury notes, on the other hand, have a maturity of one to ten years.

34. **Financial institutions provide a captive market for government securities.** This partly reflects limited investment opportunities. Treasury bills and notes that are three months to maturity are among the central bank approved liquid assets. Thus, banks hold these assets primarily for prudential purposes, despite their relatively low returns, especially on treasury bills. Similarly, certain government debt instruments are held by insurance companies for regulatory reasons.

35. **There are a few major participants in the domestic financial market.** They include the domestic commercial banks and the Central Bank. Private sectors participation as both supplier and buyers of securities in the financial market is generally not significant. This could reflect the

[11] After passage of the bill, it could take 1-2 years before the bureau becomes operational.

[12] The CRS will comprise data providers, data subjects, legislation, rules, procedures, standards and technology that would facilitate the collection and sharing of information for use in making credit and loan decisions. The plan is to have a CRS that covers both personal and commercial credit information.

[13] Commercial banks' deposits are the commonly held savings instrument in the country.

lack of understanding of capital market benefits. The Central Bank occasionally plays the role of buyer of last resort for these instruments.

36. **There is an interest rate floor on savings deposit.** The floor, which currently stands at 2.5 percent, is intended to protect small savings, including for pensioners. The Central Bank's recent attempts at reforming the monetary system, including by gradually phasing out the interest rate floor[14] with a view of lowering lending rates, was partly successful as interest rates have declined. Nonetheless spreads remain wide and banks have used the additional profit margin to strengthen their balance sheets.

B. Balance Sheets Developments and Risks

Banks' balance sheets have strengthened since the 2011 FSAP. NPLs are declining but remain high. Improving capital buffers may be overestimated mainly because of increasing but still insufficient provisioning. Remaining weaknesses in the supervisory framework suggest that banks' balance sheets could be weaker than reported. Main threats to the banking system broadly remain as identified during the 2011 FSAP, though the government refinancing risks are emerging as a new threat.

Balance Sheets Developments since the 2011 FSAP

37. **The banking system's NPLs remain elevated but have improved modestly since 2011 (Text Table 3)**. NPLs for the system have gradually declined to 16.7 percent of total loans in March 2014 (14.2 percent for domestic banks and 26.9 percent for international banks) from 21.4 percent in December 2011. The decline in NPLs is partly attributed to loan write-offs, which amounted for the last three years to 3.4 percent of total assets of the banking system at end-2013.

[14] The rate was reduced from 4.5percent to 3.5 percent in November 2010, and further to 2.5 percent in October 2011.

Text Table 3. Belize: Financial Soundness Indicators 1/
(Domestic and international banks; in percent)

	2007	2008	2009	2010	2011	2012	2013	Mar-14
Capital/risk-weighted assets 2/	22.7	20.4	22.2	23.9	24.2	20.5	22.3	23.4
Capital/total assets	16.9	15.6	16.5	16.5	14.7	11.9	12.4	12.0
Excess statutory liquidity 3/	49.2	30.1	33.5	43.8	64.3	83.5	79.1	104.3
NPLs/total loans	6.9	11.7	14.0	18.7	21.4	20.3	17.6	16.7
Provisions/NPLs	31.2	24.1	18.1	15.5	24.4	38.3	46.7	49.7
Provisions/total loans	2.1	2.8	2.5	2.9	5.2	7.8	8.2	8.3
NPLs net of provisions/capital	19.2	40.0	48.2	61.9	66.1	58.5	42.0	36.6
Memorandum items:								
Capital/risk-weighted assets 4/	...	...	...	...	...	...	20.4	21.5
NPLs net of provisions/capital 4/	...	...	...	...	...	...	45.7	39.8

Sources: Central Bank of Belize; and Fund staff estimates.

1/ Includes BZ$43 million award to Belize Bank Ltd. by the London Court of International Arbitration (LCIA). The amount is being disputed by the government.
2/ The required capital adequacy ratios for domestic and international banks are 9 percent and 10 percent, respectively.
3/ In percent of statutory liquidity requirement.
4/ Excludes BZ$43 million award by the LCIA.

38. **The NPLs are unevenly distributed across banks, and the sizable portfolio of NPLs in one domestic bank and most international banks remains a source of concern.** Close to 70 percent of the banking systems' NPLs are in the domestic banking system. About half of domestic banks' NPLs are in one bank. Three–quarters of the NPLs in international banks are in the two largest ones. However, for all international banks, NPLs exceeded 25 percent of total loans at end-March 2014, except for one bank where NPLs represented 16 percent of total loans.[15] Two domestic banks remain relatively close to the 5-percent ceiling recommended for NPLs.

39. **Provisioning for NPLs notably improved since the 2011 FSAP**. Provisions as a percentage of total NPLs improved from 24.4 in December 2011 to 49.7 at end-March 2014. The ratio of NPLs net of specific provisions to total loans fell from 16.9 percent at end- December 2010 to 9.4 percent at end-March 2014 due to a reduction in the level of non-performing loans and an increase in specific provisioning. These improvements largely reflect new provisioning and loan classification standards implemented by the Central Bank at end–2011. Accordingly, banks have been required to fully provision or write off bad loans within 3–5 years.[16]

40. **Banks' ability to absorb losses also improved since the 2011 FSAP, and with the exception of a few banks, reported capital buffers seem adequate, though they may be**

[15] The Central Bank reported data cover 5 international banks.

[16] In order to comply with the revised standards, the Central Bank mandated commercial banks to evaluate specific loan loss provisions at least on a quarterly basis concurrent with the quarterly loan classification review. Two domestic and two international banks were permitted to adjust their balance sheet over a five–year period because of the size of the required adjustment relative to other banks.

overestimated because provisioning is still insufficient (Text Table 4). The ratio of NPLs net of provisions to capital amounted to 37 percent at end-March 2014, compared with 66 percent at end-2011. The CAR for the banking system was 23.4 percent at end-March 2014, compared with 24.2 percent at end-2011. Overall, the CARs for both domestic and international banks are well above the regulatory minimum although with differences across banks.[17] In particular, one Canadian bank appears overcapitalized with the CAR of 58.7 percent at end-March 2014, reflecting reinvestment of earnings.

Text Table 4. Belize: Largest Banks Capital Shortfalls Under Various Capital Adequacy Measures (December 31, 2013) 1/

(In thousands of U.S. dollars, unless otherwise indicated)

Name of the bank	Share of banking system's assets (percent)	CAR=9% 2/	CAR=12% 2/	CAR_g=9% 3/	CAR_g=12% 3/	Cap/TA=5% 4/
Largest banks	89	699	6,134	761	7,262	2,009
in percent of GDP	...	*0.0*	*0.4*	*0.0*	*0.4*	*0.1*
Systemic banks	22	0	2,874	0	3,505	0
in percent of GDP	...	*0.0*	*0.2*	*0.0*	*0.2*	*0.0*
Memorandum item:						
Nominal GDP (US$ millions)	1,615					

Sources: Belize authorities; and IMF staff estimates.

1/ Shortfalls in provisions are deducted from qualifying capital.
2/ Capital adequacy ratios (CARs) are computed with risk-weighted assets (RWA) that use weights prescribed by the Basel I agree
3/ Capital adequacy ratios (CARs) are computed with risk-weighted assets (RWA) that use weights prescribed by the Basel I agree with the exception of the weight on government securities, which has a weight of 10 percent instead of zero percent.
4/ Cap/TA is the ratio of capital to total assets.

41. **The banking system is very liquid but not very profitable (Table 2).** Excess reserves over statutory requirement have been persistently high but are unevenly distributed across banks. One domestic bank accounts for about 60 percent of the total. Loan write-offs, high NPLs and increased provisioning are eroding net earnings. The banking sector's returns on assets have become positive in 2013 for the first time since 2010. Overall, international banks appear more profitable than domestic banks perhaps helped by exemptions from payment of taxes.

42. **Collateral valuation and supply is still problematic, but the tightened prudential requirements partly ameliorate credit risks.** Collateral is still mostly in the form of real estate and the supply of other form is still limited by the small stock of marketable securities and the lack of registry for movable property. The real estate sector is still weak and the liquidation process is still long, unchanged since the 2011 FSAP. Belize does not have a collateral registry and weaknesses persist in the land registry system. Yet, most banks' lending is secured by land and real estate properties. The CBB plans to issue guidance on valuation of collateral in the future. In the meantime, the tightened prudential requirements on provisioning partly address credit risks stemming from weaknesses in collateral valuation (Box 5).

[17] The regulatory minimum for domestic and international banks is 9 percent and 10 percent, respectfully.

Main Sources of Systemic Risks

43. **Main threats to the banking system broadly remain as identified during the 2011 FSAP, though the government refinancing risks are emerging a new threat (Text Table 5).** After compensation for the nationalized companies starts, gross financing needs will jump sharply raising the possibility of a debt distress. Since government paper represents a significant share of banks' portfolios, losses on government paper would wipe out the capital buffers of many banks. This risk could be nonetheless mitigated by the fact that the Central Bank is the buyer of last resort of government paper as noted above. Other threats are as described during the 2011 FSAP. Distress in the weakest banks is likely and would have significant impact on financial stability and the budget. With banks' non negligible exposures to agriculture, tourism, and export sectors, negative shocks in these sectors would have some moderate to severe impact on financial stability. Any shock that would lead to the need to defend the exchange rate would likely trigger and interest rate hike, which in turn would undermine repayment capacity and increase NPLs. Effective capital controls could mitigate this risk. Finally, connected lending and large exposures could be higher than reported and would indicate even higher NPLs and probably the insolvency of some banks.

Text Table 5. Financial Sector Risk Assessment Matrix

Nature/Source of Main Threats	Likelihood of Severe Realization of Threat in the Next 5 Years	Expected impact on Financial Stability if Threat is Realized
1. Distress in the largest weak bank or the weakest banks.	**Medium to High** NPLs have been declining but remain high in many banks. Provisioning has been improving but remains insufficient in some banks, including the largest one.	**Severe** The CAR of the system will fall below 9 percent and most banks' CAR will be below this regulatory minimum. One of the banks is the largest in the system and probably too big to fail. Its capital shortfalls would exceed 5 percentage points of GDP in many adverse scenarios. The financial cost of resolving failing banks would entail sizeable fiscal costs, adding to pressure on debt.
2. Fiscal policy implementation.	**Medium to High** The adoption of a lower fiscal primary balance will leave the country in a highly vulnerable position, with a sharp jump in gross financing needs in 2017 after compensation for nationalized companies is assumed to start. Refinancing risks could lead to a debt crisis.	**Severe** Government paper represents a significant portion of banks' portfolio, reaching about 8 percent of total assets for some banks. Losses on this paper would wipe out the capital of many banks.
3. Negative shocks to agriculture, tourism or exports of goods.	**Medium** A significant share (10 percent) of the banking system lending has been extended to borrowers from these sectors.	**Moderate to Severe** A 25 percent increase in NPLs in these sectors will leave the banking system adequately capitalized but the CARs of one bank would fall below the regulatory minimum.
4. External or internal shocks leading to the need to defend the fixed exchange rate.	**Low to Medium** If the exchange rate has to be defended, domestic interest rates may have to be raised significantly.	**Moderate** An increase in interest rates would undermine capacity and drive up NPLs further.
5. Connected lending and large exposures.	**Medium** The true extent of connected lending large exposures is not known as the supervisors still cannot ascertain the identity of ultimate owners.	**Moderate to Severe** If borrowers are connected to the bank or to each other, the level of NPLs could actually much higher and some banks may actually be insolvent. If the top ten borrowers of each bank defaults, then the CAR of each will turn negative, except for one bank.

C. Assessing the Strength of Banks' Balance Sheets

When compared with the 2011 FSAP, the updated banking system stress tests show that more banks now appear weak. This is partly due to the strengthening of loan classification and the accompanying increase in provisions and loan write-offs, which affect the growth of banks' capital buffers. The extension of the projection horizon in the updated stress tests from three to five years allowed for a better assessment of the impact of shocks over a longer period of time and highlighted new weaknesses. Projected weak export performances are raising projected NPLs. In baseline projections, more banks will see their CARs fall below the regulatory minimum by 2019. Weak banks identified in the 2011 FSAP remain in that category.

44. **The banking sector stress tests were carried out by IMF staff in 2014 as part of the assessment of the risks and vulnerabilities of the financial sector.** Stress tests of the banking system were conducted in cooperation with the Central Bank of Belize (CBB). In order to analyze the impact of plausible shocks to the financial system, static and forward-looking stress tests were used. All stress tests were conducted using the end-2013 data and incorporated the impact of the change in the provisioning requirements introduced by the CBB in 2011. The summary results are reported in Table 3.

45. **The static single-factor stress tests looked at the impact of liquidity shocks, credit risk, and credit concentration risk.** Other risks, such as interbank market risk and operational risk, were not analyzed due to a lack of sufficiently detailed data. Direct and indirect interest rate risk was not analyzed because existing models to assess such risks were not deemed to be relevant in the case of Belize.

- *Liquidity shock*. The liquidity stress test simulated the impact of a run on banks by its different classes of depositors. The stress test results confirmed that liquidity risk is particularly low. It would take 35 days for the banking system to completely exhaust its liquidity and 15 days for the liquidity ratio to fall below the 23 percent mandatory requirement. However, under these assumptions, one bank would see its liquidity ratio fall below the prudential requirement after only four days, and another bank after five days.

- *Credit risk*. First, a "migration" stress test was applied by shifting 10 percent of current performing loans to "substandard" status, in addition 20 percent of "substandard unsecured" loans to "doubtful" status, and 20 percent of "doubtful" loans to the "loss" category. This "migration" shock lowered the system-wide CAR by 1.1 percentage points. Two banks would face capital shortage of about 0.1 percent of GDP to meet the minimum CAR. Second, the impact of a "generic" stress test was analyzed by shifting 10 percent of current performing loans to the "substandard" category. In this case, the banking system's CAR declined by 1 percentage point. The same two banks would have capital shortage of about 0.1 percent of GDP.

- *Sectoral credit stress tests*. These tests looked at the impact of a 25 percent increase in NPLs (i) across all sectors, (ii) in the sugar sector, (iii) in the citrus sector, (iv)in the banana sector, (v) in the citrus, sugar, and banana sectors combined, and (vi) in tourism and related sectors. These results showed only a marginal impact on CARs, with the CAR of the five domestic commercial banks falling by only 1.1 percentage points in the case of a 25 percent NPL shock across all sectors.

- *Large loan exposure.* A range of stress tests were carried out to assess the banking system's exposure to large borrowers – defined as those with a loan in excess of 10 percent of the bank's capital. In a scenario where each individual bank's top ten large exposures that are performing migrate into loss status, all banks except for two would face negative CARs. The CAR of the banking system as a whole would also become negative and require capital injection of about 16.4 percent of GDP to meet the 9.0 percent minimum requirement. In the case where the performing loans of the top five and top ten borrowers from the banking system migrate into loss status, three banks will require recapitalization to meet the minimum capital adequacy requirement, with the shortfall most pronounced in one bank – 2.5 percent and 3 percent of GDP, respectively.

46. **Three forward-looking models were also developed to measure the impact of a continued and persistent decline in economic activity on banks' loan quality and capital buffers.**

- Staff used the credit model estimated during the 2011 FSAP, which models changes in NPLs as depending on their lagged value, the lagged change (over four quarters) of the required cash reserve ratio, and the contemporaneous change in total export values over the previous year. Projected NPLs are derived using staff projections for the growth of exports and total bank loans, assuming no change in the required cash reserve ratio.
- Once NPLs are projected for each bank, staff assumes that various categories of NPLs (i.e. standard, doubtful, loss) and their subcategories (i.e. secured, unsecured) are projected assuming that their share in the banks' total NPLs remains unchanged during the projection period. Required provisions are then projected using the latest provisioning guidelines. Actual provisions are assumed to represent a constant fraction of required provisions.
- The first stress test model (Model 1) assumes that banks' capital buffers remain at their end-2013 level in nominal terms and adjust them for shortfalls in provisions. The results show that the banking system's CAR would slide under the 9 percent threshold in the high-stress scenario in 2019. Under the baseline scenario, one international bank would require additional capital to meet the regulatory minimum CAR in all projection years. Under the stress scenarios, three banks would fall short of capital in all projection years.
- In the second model (Model 2), bank capital is projected using the key elements of bank income statements. Projections of various lines of the income statements are done as during the 2011 FSAP. The resulting projections of retained earnings are added to (or, in

the case of losses, reduced from) capital buffers of the previous year. In all scenarios, the banking system's CAR would gradually decline but remain above the minimum requirement. Two banks would require significant amounts of recapitalization even under the baseline scenario, with their CARs turning negative in 2015 and 2017, respectively. Under thigh-stress, two banks would need capital injection over the whole projection period.

- The third model (Model 3) projects bank capital by using Returns on Assets (ROAs) after taxes. It multiplies them by the stock of assets to derive profits after taxes. Capital is estimated by adding profits after taxes and subtracting shortfalls in provisions from the previous period's capital. The results imply that while the banking system's CAR under the baseline would increase over the projection period as ROAs improve for some banks, one bank would face capital shortfall as of 2015. In the low-stress case, capital buffers of three banks would offset CAR shortfalls in other banks. In the high-stress scenario, the banking system would become undercapitalized in 2016 and face negative CAR in 2019. Only two banks would remain adequately capitalized throughout projection years.

D. Crisis Management and Financial Safety Net

Can Belize foresee a very unfavorable systemic development in its financial system and/or cope with it? While Belize has never experienced a financial crisis, a framework for handling potential crisis is being prepared. Ability to respond to emergencies is constrained by the high public debt level, the fixed exchange rate, contingent liabilities, and under-developed financial infrastructure.

Macro-Prudential Surveillance

47. **The Central Bank of Belize Act does not give the Bank the explicit mandate to promote financial system stability**. Despite this, the Central Bank recognizes that focusing on micro-prudential supervision alone is inadequate to minimize the likelihood of a financial crisis. It sees as very critical the need to control systemic risk in the financial system, which can emanate from weaknesses within and between each component of the financial system. Consequently, the following are some of the measures and steps being taken:

- **Financial stability analysis and financial reporting.** In efforts to operationalize a framework for a regular financial stability analysis, the Central Bank established a Financial Stability Unit (FSU) in August 2012. The work of the unit is supervised by a Financial Stability Committee, which comprises the Deputy Governor (Research) and the Directors of the Research and Financial Sector Supervision departments. The mandate of FSU is to put in place a framework for macro–prudential surveillance in order to identify financial sector vulnerabilities and suggest risk mitigation strategies. In connection with this, the Central Bank is developing a framework and capacity to carry out macro-prudential surveillance and financial stability reporting. In June 2013, the CBB drafted its financial stability report, which addressed issues related to domestic banks, international banks, credit unions and domestic insurance. These sectors represent 95 percent of the financial system. Financial soundness indicators are published every quarter for individual banks and the largest credit unions. Going forward, the Central Bank may need to consider using forwarding looking risk indicators.

- **The new domestic banking legislation gave the Central Bank the primary objective of maintaining confidence in and promoting the safety and soundness of the financial system.** The legislation greatly enhanced the micro-prudential powers of the Central Bank and provides for the use of specific tools, including requirements for capital buffers, provisioning, liquidity, as well as restrictions on payments of dividend, lending, investment and leverage.

- **The Central Bank has a credible single factor 'top down' stress testing program.** Stress testing exercises are conducted on a quarterly basis and cover the resilience of banks' capital to hypothetical shocks on interest rates, credit and liquidity. The Central Bank also conducts a liquidity stress test which examines the number of days that a bank would have convertible assets needed to pay depositors and at the same time meet the legal requirement in the event of a run on deposits. The stress tests being conducted have some shortcomings. They neither consider extreme shocks nor the impact of changes in correlation across risk factors. These stress tests have been integrated as part of the periodic financial stability reports provided to senior management and the Board. A significant shortcoming is the limited availability of prudential data for financial institutions that operate outside of the purview of the CBB, including the non-bank offshore sector. In order to overcome this issue, a MOU to facilitate information sharing with the Supervisor of Insurance is currently being finalized and periodic meetings are held between the SOI and the CBB.

Crisis Preparedness

48. **A Financial Management Plan for Banks and Financial Institutions has been prepared and the various elements of this plan are currently under review**. The scope of the framework extends to all financial institutions (FIs) licensed by the Central Bank. The framework includes a Domestic Standing Group (DSG), which is responsible for crisis prevention and management. It consists of the Central Bank of Belize, as National Coordinator, the MOF and the Supervisor of Insurance. If a crisis develops, the Central Bank would take the lead in identifying and brokering solutions. The plan has been developed in accordance with the following regulatory mandates envisaged in the Domestic Banks and Financial Institutions Act, the Central Bank Act, and the Basle Core Principles.

49. **The authorities are fully cognizant of the fact that normal times monitoring is a key element in crisis preparedness**. This monitoring includes periodic reviews of financial stability indicators and stress testing of the banking system. Early warning indicators may signal the need for supervisory intervention as may be necessary. Ability to respond to emergencies will likely be

constrained by the high public debt level, the fixed exchange rate, contingent liabilities, and an under-developed financial infrastructure.

50. **The proposed financial management plan makes provisions to facilitate the confidential exchange of information with other regulators**. MOUs are the preferred mechanism to support this exchange. Under the plan, institutions that meet specific criteria would be placed under intensified monitoring. Where institutions are deemed to be systemic, the DBFIA enables the Central Bank to issue appropriate Practice Directions that are suited to the risk profile of such institutions.

Liquidity Management

51. **In times of financial crisis, Central Bank can use its lender of last resort function to provide Emergency Liquidity Assistance (ELA) to financial institutions that are still solvent**. While such institutions may be illiquid, they must still prove that they are viable to qualify for assistance under the ELA. In order to discourage imprudent liquidity management, lending terms of the ELA contain a punitive element and the borrowing institution must provide suitable collateral. The terms and conditions of the ELA, including repayment would be determined on a case by case basis and would be clearly defined in an agreement.

The Banking Restructuring and Resolution Framework

52. **The revised DBFIA addresses issues related to the statutory administration and winding-up of licensees**. The primary tools for resolution include private sector purchase, establishment of a bridge bank, the partial transfer of deposits and assets to a good bank and temporary public ownership. In the case of systemically important financial institutions (SIFIs) whose failure may negatively impact the real economy, the central government can provide solvency support. The conditions, scope and limits would be determined on a case by case basis. Procedural manuals will be developed to facilitate this process. The level of private sector involvement and burden sharing will be determined by the particular circumstances affecting the financial institution. Given the small size of the financial sector, each bank is treated as systemically important since a run on one bank increases the likelihood that a run on other institutions may be triggered.

Regional Crisis Management

53. **The Central Bank has signaled its agreement to the regional crisis management plan developed by the Caribbean Group of Banking Supervisors (CGBS) but has not yet signed the related regional MOU**. This is due to the CGBS's reticence on a widely supported resolution, which holds TCI accountable for the creation and continued support of a parallel banking structure. The FSCTCI continues to contravene international best practice by approving

the establishment and maintenance of a parallel banking structure which poses a risk to Belize's financial system.[18] Hence, Belize is doubtful of the practical benefits of participating in the MOU and the ability or willingness of the CGBS to hold regional participants accountable for violating its terms and conditions.

Deposit Insurance

54. **The proposed financial management plan includes the implementation of a deposit insurance scheme**. An information paper on a deposit insurance scheme was submitted to the Cabinet. There is no definite timeframe for the establishment of a deposit insurance scheme.

E. Next Steps Toward a Stronger Financial System

55. **Staff sees the following measures as key to a stronger financial system in Belize**:

Banking Regulation and Supervision

- *Assess the true strength of banks balance sheets through asset quality reviews (AQRs)*. Priority for this measure is high and it should be implemented immediately to assess the extent of banks' problems. Central Bank examiners only review a small share of banks' assets and a reputable international auditor would complements reports from banks internal and external auditors.

- *Order weak banks to raise capital*. Priority for this measure is high and it should be implemented immediately to contain vulnerabilities in banks' balance sheets. Delaying such orders would magnify these vulnerabilities going forward and undermine the authority of the Central Bank.

- *Complement current static stress tests of banks with forward-looking ones*. Priority for this measure is high and it should be done immediately. The current central bank stress tests do not take into account the evolving outlook of the economy and bank profitability. The Central Bank could refine models of bank profitability that are used in this note.

[18] The CGBS was tasked by regional central bank governors to investigate and recommend measures to resolve the parallel banking dispute on 27 May 2011. On 22 November 2013, the CGBS finally presented its findings to the governors which confirmed that a parallel structure was deliberately created by FSCTCI, in violation of a bilateral MOU they previously signed with Belize. The CGBS was tasked to revise the existing MOU, by including two new articles: one on dispute resolution and the other on suspension of non-compliant members.

- *Strengthen the supervision and legal departments of the Central Bank.* Priority for this measure is high and it should be implemented immediately. Examiners specializing in Information Technologies (IT) must be hired by the Central Bank to review banks' IT systems and help ensure their integrity. In-house legal experts must also be hired by the Central Bank.

- *Establish criteria for defining systemic banks.* No criteria are given as to why five of the six domestic banks are considered systemic. The authorities are referred to: BCBS's "A framework for dealing with domestically systemically important banks" (www.bis.org/publ/bcbs224.pdf).

- *Remove the possibility to grant exemptions to the limit on large exposures.* This recommendation of the 2011 FSAP should be implemented as soon as possible. Banks must increase capital if they want to extend large loans. Stress tests indicate that banks are extremely vulnerable to default from their large borrowers. They should gradually reduce such large exposures and a transition period can be introduced on a case by case basis.

Central Bank Autonomy

- *Enable the Central Bank to enforce remedial action on banks without prior consultation with or approval of the Minister of Finance.* This recommendation of the 2011 FSAP should be implemented as soon as possible. The Minister of Finance approval is still needed for the revocation of licenses of domestic banks. This undermines the Central Bank's authority and creates moral hazard.

Crisis Management and Bank Resolution Framework

- *Make bank resolution and liquidation truly administrative actions.* This is a medium priority measure, which could be implemented in the near-to-medium term. In particular, court approvals should be out of the banking law and the latter should supersede company insolvency laws.

- *Set up a financial safety net.* Priority for this measure is high and it should be implemented immediately. It could be done through the deposit insurance scheme envisaged in the Financial Management Plan or through a Recovery and Resolution Fund.

- *Establish standard safeguards to the use of the Emergency Liquidity Assistance Facility and set conditions applicable to all.* Priority for this measure is high and it should be implemented immediately. Treatment of banks should not be on a case-by-case basis.

- *As part of the crisis management plan, sign and implement an MOU to facilitate coordination and information sharing among the regulators–the central bank, MOF, SOI, and the IFSC*. Priority for this measure is high and it should be implemented immediately.

Financial Infrastructure

- *Set up a movable property registry*. This recommendation of the 2011 FSAP should be implemented as soon as possible to support financial markets deepening.

- *Review the opportunity to remove the interest rate floor on savings*. This measure should be implemented as soon as possible. The current floor may be raising the cost of financial intermediation, thus contributing to hampering the deepening of financial markets.

56. **The authorities agreed with the thrust of staff's recommendations but made some dissenting observations:**

- On **regulation and supervision**, the authorities do not agree with removing the possibility to grant exemptions to the limit on large exposures. In their view, the small size of the market would require extremely large and disproportionate capital injections to support large credit to the productive sector. This would put upwards pressure on already high interest rates as highly capitalized banks seek to maintain their ROAs.

- On **Central Bank autonomy**, the authorities agreed with the idea of allowing the Central Bank to enforce remedial action on banks without prior consultation with or approval of the Minister of Finance in the case of increases in capital requirements. However, in the case of liquidation or cancellation of license of a systemic domestic bank, they are of the view that at the minimum there has to be some degree of consultation with the Minister of Finance given that the systemic risk and fiscal contingency falls on the government.

- On the **interest rate floor**, the authorities do not agree that the floor on interest rates on savings is raising the cost of financial intermediation. They noted that evidence has shown that the interest rate spreads have widened after the reduction in the interest rate floor on savings. Moreover, they are of the view that in a fixed exchange rate system, a differential is required between international and domestic interest rates to discourage capital flight.

F. Concluding Remarks

57. **Belize's financial system has been strengthening since the 2011 FSAP following implementation of key reforms**. NPLs have been declining, and provisioning and capital adequacy ratios have been improving. This progress is essentially due to ambitious reforms by the Belizean authorities, including implementation of more prudent loan classification and provisioning requirements. Revisions to the banking law strengthened the powers of the Central

Bank, including by raising penalties for contravening Central Bank regulations and guidelines. The Central Bank also has powers to ask institutions under its supervision to raise capital beyond requirements if necessary. The AML/CFT legislation has also been revised and should allow Belize to comply with FATF recommendations**.**

58. **Nonetheless, significant weaknesses remain in the financial system and must be addressed more forcefully**. NPLs remain high and capital buffers are overestimated because provisioning is still insufficient. Remaining weaknesses in the supervisory framework suggest that banks' balance sheets could be even weaker than reported. The Central Bank should immediately conduct an asset quality review of all banks to assess their true strength. It should also hire personnel to monitor banks IT systems and ensure their integrity. Weak banks should be ordered to raise more capital. Limits on large exposures must be enforced. Banks that plan to extend large loans must raise enough capital to ensure that their large exposures remain within prudential limits. Efforts to modernize the financial infrastructure should be accelerated. Strengthening the land and moveable property registries would greatly support these efforts.

Box 1. The National Bank of Belize Limited (NBBL)

The NBBL is a limited liability company incorporated under the Companies Act, Chapter 250 of the laws of Belize. The Government of Belize (GOB), which is the sole shareholder, provided initial startup capital of BLZ$10.0 million, with a commitment to invest additional funding as the need arises. While the institution is currently focused on mortgage lending, NBBL plans to provide full banking services to the Belizean public with a particular focus on public service officers, teachers and other low-to-middle income Belizeans, at lower interest rates than those currently being offered by the other domestic banks in Belize.

The NBBL's main objective is to lower the total cost of home-ownership for its target customers. The bank intends to operate as a commercial entity that is financially viable but without yielding completely to profit maximization, which could lead to price marginalization of portions of its targeted market. It is expected that the NBBL will focus on providing financing for the housing needs of public service employees, teachers and other low-to-middle-income Belizeans who have not been able to access financial services due to pricing and more stringent requirements from other commercial banks.

The NBBL in its business plans stated that it intends to apply sound banking principles in its risk management process as required by the DBFIA to ensure that significant risks are properly identified and managed while other risks resulting from its ordinary operations are mitigated to the extent possible. The NBBL intends to utilize the CAMELS approach, which is a widely used methodology for assessing the different components of a financial institution's risk profile and management.

As required by the DBFIA, the NBBL will be establishing an internal control framework that includes a fully operational Internal Audit Division, which will be charged with the following:

- Protecting the resources of the Bank against theft, waste, fraud and inefficiency;
- Ensuring accuracy and reliability in accounting and operating data;
- Securing compliance with internal policies and external regulations;
- Evaluating the level of performance in all divisions of the organization; and
- Proposing changes and improvements to the systems and procedures of the Bank.

As at April this year, the bank has recruited about 21 staff, and approved loans valued at BLZ$12 million of which BLZ$5 million has been disbursed, mostly for mortgages. Average mortgage lending was BLZ$100,000 per customer, at a fixed rate of 5.5 percent, over a 20 year period. The bank proposes to open a branch in Belize City, in addition to the main office in Belmopan, the Capital City of Belize. It will start accepting deposits in July this year, and has begun to offer diverse banking products to all customers.

Box 2. The Social Security Board (SSB)

Established in 1981, the SSB is a statutory entity with responsibility to administer Belize social security fund. The Board consists of nine members: five government representatives, including the Chairman, two representatives of labor, and two representatives of the private sector. The Chief Executive Office (the Manager), who is appointed by the Minister of Finance, has responsibility to collect contributions, pay benefits, invest funds, among others functions. Contributors to the scheme are employed person over the age of 14 years.

With a government loan of BLZ$$50,000 as initial start of fund, the Social security fund has grown to BLZ$ 444.4 million in 2012. The SSB has a diversified investment and lending portfolio all in the domestic economy. Thus, it does not hold assets or liabilities denominated in foreign currencies as yet. It has equity in and lends to its two associates–Belize Telemedia Limited and Belize Electricity Limited in which it has shareholding of 20.2 and 26.9 percent respectively. Further, it has small shareholding in a domestic bank and significant shares in Belize Water Services Limited.

Long-term investments totaled BZ$102.7 million in 2012, and are in equities, term deposit, private sector loans (over half including to credit unions, DFC, farmers associations, etc.), mortgages, real estate, lending to government, Municipal bonds, and debentures (BEL). Short term investments (BZ$121.6 million) are mostly in term deposits, with small amount on GOB treasury notes (BZ$10.5 million). Non-performing investments amounted to 2.5 percent of total investments as at December 2012.

59. The Board's activities are exposed to a variety of financial risk, and thus its overall risk management program seeks to minimize their potential adverse effects. It uses different methods to measure and manage the various types of risk to which it is exposed, and sets specific limits on various financial instruments to manage overall potential exposure. In particular, legislation limits a single investment to not more than 20 percent of total reserves. The board's policy requires weekly monitoring of overall market positions by the Investment Manager, to be reviewed by the Investment Committee and the Board on quarterly basis. Compliance with investment policies are reported to the Investment Committee on monthly basis. The SSB is governed by its own Board and externally audited on an annual basis.

SSB Investments by Asset Class, 2012

	In percent of total investments
Term Deposits	30.83
Investment in Associates	39.05
Private Sector Loans	14.63
Mortgage and Housing	2.49
Real Estate	3.39
Treasury Notes	2.85
Equity	1.69
Debentures	1.55
Others	3.52

Source: SSB Financial Statement for 2011 and 2012.

In order to mitigate credit exposure, the SSB holds different types of collaterals, including cash; residential, commercial and industrial property; fixed assets such as land, plant, and machinery; and marketable securities; third party guarantees, and letters of credit. The board determines the appropriate collateral for each lending facility based on product type and risk profile of the counterparty. For example, for lending to corporate or small and medium-size enterprises, fixed assets are generally accepted as collaterals for long term loans and current assets for working capital finance. The valuation of properties is done by an empanelled appraiser before loan approval. Unsecured lending facilities are extended for certain products, such as derivatives, credit cards and personal loans subject to the Board's approved limits. Collateral values are monitored periodically. Meanwhile, the Board sees the ability to pay as the primary consideration for any lending decision, and collaterals are by no means substitutes.

Box 3. Some Key Elements of the New Domestic Banks and Financial Institutions Act (DBFIA)

The new law introduced a resolution mechanism that allows for a statutory administrator with sufficient legal powers to undertake restructuring transactions and implement a mechanism for orderly liquidation. The statutory administrator may be appointed by the central bank under certain circumstances, including when a bank's capital fall below half of the minimum requirement. Available options for restructuring a failing bank are capital injection by the shareholders, recapitalization by new investors, mergers, sales and other restructuring. A bridge bank may be created by the government or the central bank for a temporary period for the purpose of resolving the failing bank. The Central Bank has the power to approve mergers, sale of assets and restructuring of liabilities. Two-tiered depositor preference is established in the law, with the first tier of BLZ$5,000 Belize specified to protect small depositors.

The law also expanded the definition of a "borrower group" and set new borrower limits for banks. Unsecured loans to a borrower or a group shall not exceed 15 percent of paid up capital and reserves. Unless approved by the Central Bank, the aggregate amount of all loans to a borrower, or a group shall not exceed 25 percent of capital and reserves. Further, the aggregate amount to all borrowers shall not exceed 6 times the capital and reserves. Where the limits are exceeded, the Central Bank has powers to ask banks to reduce their loans, increase capital, or make 100 percent provisions for the amount in excess of requirements. These limits, however, do not apply to lending to the government.

The new law raised administrative penalties for contraventions of Central Bank's regulations and guidelines, and introduced even stiffer ones in areas where none existed in the old law. This allows for better supervision instead of always having to resolve issues with banks in courts. For example, if banks fail to meet the additional capital requirements as prescribed by the CBB, they will pay a fine of $100,000 and $10,000 for each additional day until they are in full compliance.

The law also regulates related- party transactions requiring for full disclosures of all such dealings. It broadened the definition a related party, and permits any such transactions on market terms and conditions (with some exceptions) after approval of the bank's board. Secured loan to a related party shall not exceed 15 percent of capital and reserves, while total loans (secured and unsecured) to all related parties shall not exceed half of capital and reserves. Concessionary loan to an employee and officer shall not exceed the equivalent of 100 percent of the annual emolument of such individual, and aggregate disbursement to all persons shall not exceed 10 percent of capital and reserves.

The fully-paid-up capital requirement for a local bank is minimum BLZ$10 million, a foreign bank BLZ$100 million (worldwide fully paid-up capital), a local financial institution BLZ$2 million. The central bank, however, has powers to ask any bank or institution for additional capital beyond the specified requirements if in its opinion it is necessary and prudent given the nature of institution' business, conditions of assets, deposits and liabilities.

Another important aspect of the new law is the provision for consolidated supervision, which entitles the Central Bank to uncover natural persons who are behind bank's ownership. There are also provisions related to bank managers, corporate governance, internal controls, risk management, conflicts of interest, related parted transactions, monitoring of credit exposures, etc.

Finally, a bank is restricted from declaring, paying dividends and repatriating profits until: all prior losses have been written off, all impaired loans and other assets are adequately provisioned, the bank complies with all directives of the central bank, including on single borrower limits, and capital and reserves. There are also restrictions on ownership interests by a local bank in another entity, including another local bank.

Box 4. Belize: The Authorities' Reforms on AML/CFT Regime

In response to the 2011 Caribbean Financial Action Task Force (CFATF) Mutual Evaluation report, high priority was placed on addressing Belize's anti-money laundering (AML) shortcomings. An AML Unit was established within the Financial Sector Supervision Department (FSSD) of the Central Bank in 2011, staffed by three examiners, one of whom is a Certified Anti-Money Laundering Specialist. On-site AML compliance examinations of one credit union and two international banks were completed in 2011. Thereafter, examinations of five credit unions, two domestic banks and three international banks were completed in 2012 and in 2013. AML compliance was assessed during on-site examinations of one credit union, one domestic bank, one international bank and one financial institution.

The IMF provided a technical assistance program on AML matters, which led to the implementation of a Financial Risk Assessment module to gather data from domestic and international banks, as well as credit unions, on customer base, products and services. A risk assessment tool to analyze the risks posed to each institution was also created to identify money laundering vulnerabilities in the financial system. The IMF team continues to assist the Central Bank by providing guidance on the drafting of on-site and off-site AML manuals and fine tuning the Central Bank's AML/CFT off-site monitoring processes.

Moreover, between January and October 2013, the authorities made several legislative amendments. Notwithstanding this, it was the opinion of the November 2013 CFATF Plenary that the country was not adequately compliant. Hence, a second public statement was issued, calling on member countries to consider taking counter measures against Belize, to protect their financial systems from the money laundering and terrorist financing risks posed.

In February this year, new important amendments to existing legislation and new regulations were passed. In particular, the amendments (i) strengthen compliance in the legal framework to ensure compliance with international standards and obligations relevant to money laundering and terrorist financing; (ii) prohibit dealings with shell banks, strengthen customer due diligence, compliance and record keeping requirements and reporting obligations for financial institutions and Designated Non-Financial Businesses and Profession (DNFBs); (iii) enhance compliance with CFT obligations, particularly freezing and confiscating terrorist assets, expedited implementation of targeted financial sanctions by the UN Security Council, clarifying listing and de-listing procedures and including NPOs in the AML/CFT supervisory regime; and (iv) strengthen and clarify the sanctions regime, including implementation of a comprehensive administrative penalty regime.

Other improvements to the legislative framework include: (i) amendments to the FIU Act to allow for operational independence; (ii) amendments to the Companies Act to require mandatory registration of beneficial owners of registered companies; (iii) the enactment of DNFBs Regulations to allow for extension of the AML/CFT framework to DNFBs; (iv) the enactment of the Money Laundering and the Terrorism (Prevention) National Anti-Money Laundering Committee Regulations to establish a statutory body to advise the Minister of Finance and co-ordinate national AML/CFT efforts; (v) amendments to the Domestic Banks and Financial Institutions Act to make prohibition against licensing of shell banks.

In addition, the authorities have drafted three other pieces of legislation to amend the Trusts, and Gaming Control Acts, which would further enhance the regulatory framework. The AML/CFT reform process implementing the FATF 49 recommendations must be completed by November 2014. Having reviewed the recent legislations, the CFATF in a public statement issued in May 2014 noted that Belize has made significant progress in addressing the AML/CFT deficiencies. Belize was encouraged to continue working with the CFATF to ensure the reform process is completed by addressing its remaining deficiencies and continue implementing its Action Plan.

Box 5. New Provisioning and Loan Classification Standards

Under the old provisioning rules, specific provisioning started to apply once payments were more than three months in arrears, which gave banks time to restructure overdue loans before provisions are required. Secured loans were never subject to specific provisions and were always classified as substandard irrespective of the length of the overdue payment period.

Under the new provisioning rules, loans that are 3-6 months past due are classified as substandard, and loans that are 6–12 months overdue are classified as doubtful. Loans that are one year past due are classified as loss. This classification, which was applied to unsecured loans only in the old provisioning rules, now applies to all loans whether secured or not.

Moreover, under the new provisioning rules, commercial banks were initially required to set aside provisions of 70 percent of the outstanding balance of a collateralized loan classified as a loss. Subsequently, the level of provision was reduced to 50 percent for domestic banks only, effective April 1, 2013, because of earlier than anticipated improvements in banks' balance sheets. All loans classified as substandard and doubtful require 20 percent and 50 percent provisioning, respectively.

New Provisioning Requirements for the Banking System
(In percent)

	Domestic Banks	International Banks
Substandard	20	20
Doubtful	50	50
Loss		
Unsecured	100	100
Mortgage	50	70

Source: Central Bank of Belize.

The provisioning requirements for unsecured loans remain unchanged in that specific loan loss provisions of 100 percent must be set aside for loans that are classified as non-performing for more than one year. All banks are now required to make minimum provisions on a monthly basis in order to become fully compliant by the end of their respective phase-in periods which range from three to five years. A three-year transition period was initially mandated and two banks have been granted conditional approval for five-year phase-in periods.

Table 1. Belize: Structure of the Financial System 1/

	2006	2007	2008	2009	2010	2011	2012	2013	Mar-14
Number of institutions									
Domestic commercial banks	5	5	5	5	5	5	5	6	6
International commercial banks	8	8	7	7	8	7	7	6	6
Credit unions	14	13	14	14	13	12	12	12	12
Nonbank financial institutions (incl. the DFC)	1	1	1	3	3	2	2	2	2
Domestic insurance companies	15	14	14	13	14	12	12	14	14
Of which: Inactive	2	1	...	...	...	...	...	...	...
International insurance companies (incl. reinsurance)	5	6	7	8	12	...	...	...	...
Financial system assets (BZ$ millions)	**3,059**	**3,424**	**3,747**	**4,108**	**4,360**	**4,674**	**5,031**	**5,204**	**5,421**
Domestic commercial banks	1,883	2,121	2,419	2,512	2,498	2,552	2,760	2,830	2,955
International commercial banks	618	716	684	783	975	1,178	1,308	1,339	1,415
Credit unions 2/	351	391	443	483	535	589	651	717	722
Nonbank financial institutions (incl. the DFC)	31	31	33	151	159	144	97	92	96
Domestic insurance companies	176	166	168	179	193	211	216	226	233
Assets as percent of total financial system									
Domestic commercial banks	61.6	61.9	64.6	61.2	57.3	54.6	54.9	54.4	54.5
International commercial banks	20.2	20.9	18.2	19.1	22.4	25.2	26.0	25.7	26.1
Credit unions 2/	11.5	11.4	11.8	11.7	12.3	12.6	12.9	13.8	13.3
Nonbank financial institutions (incl. the DFC)	1.0	0.9	0.9	3.7	3.6	3.1	1.9	1.8	1.8
Domestic insurance companies	5.8	4.8	4.5	4.4	4.4	4.5	4.3	4.3	4.3
Assets as percent of GDP	**125.6**	**132.7**	**136.8**	**153.4**	**155.9**	**157.0**	**160.0**	**161.1**	**162.7**
Domestic commercial banks	77.3	82.2	88.3	93.8	89.3	85.7	87.7	87.6	88.7
International commercial banks	25.4	27.7	25.0	29.2	34.9	39.6	41.6	41.4	42.5
Credit unions 3/	14.4	15.1	16.2	18.0	19.1	19.8	20.7	22.2	21.7
Nonbank financial institutions (incl. the DFC)	1.3	1.2	1.2	5.6	5.7	4.8	3.1	2.8	2.9
Domestic insurance companies	7.2	6.4	6.1	6.7	6.9	7.1	6.9	7.0	7.0
Memorandum item:									
Nominal GDP (BZ$ million)	2,435	2,581	2,739	2,677	2,797	2,978	3,145	3,231	3,332

Source: Central Bank of Belize.

1/ Except for the number of institutions, no data exists for the international insurance companies and other international companies.

2/ Data from the seven largest credit unions.

Table 2. Belize: Financial Soundness Indicators of the Banking System (Commercial Banks)

(In percent, unless indicated otherwise)

	2006	2007	2008	2009	2010	2011	2012	2013	Mar-14
Capital adequacy									
Regulatory capital to risk-weighted assets	21.2	23.1	19.5	20.7	22.4	23.7	22.3	24.4	24.3
Regulatory capital to total assets	16.4	17.2	14.4	15.2	15.3	14.1	13.1	13.7	13.3
Banking sector asset composition									
Sectoral distribution of loans to total loans									
Households	36.6	35.4	36.1	36.5	38.9	34.6	36.4	37.3	37.3
Of which: Proportion secured as mortgage loans	10.4	8.8	10.2	10.9	11.2	11.5	12.8	13.6	14.0
Agriculture	7.7	7.5	7.8	7.4	7.5	7.6	6.9	8.2	8.7
Building and construction	13.0	13.5	11.8	13.3	10.9	25.3	26.5	27.3	27.4
Manufacturing	1.8	2.0	2.4	2.7	2.7	2.0	1.8	1.3	1.2
Tourism	5.7	8.9	7.6	7.2	7.8	6.2	5.3	5.0	4.8
Real estate	7.9	7.0	8.1	8.3	8.3	12.1	13.3	14.3	14.4
Retail and wholesale	12.5	11.6	13.1	12.3	12.4	12.1	11.2	9.8	9.9
Transport	3.3	3.5	4.4	4.2	3.3	2.9	2.8	2.1	2.2
Non-residents	0.7	0.7	0.6	0.7	0.7	0.2	0.2	1.0	1.0
Geographic distribution of loans to total loans									
Domestic	94.6	93.4	91.8	90.4	90.2	...	...	...	...
Foreign	5.4	6.6	8.2	9.6	9.8	...	...	...	...
Banking sector asset quality									
Nonperforming loans to gross loans	6.2	6.6	12.7	12.2	18.4	19.0	17.2	14.8	14.2
Provisions to nonperforming loans	34.5	34.2	23.1	19.5	18.2	28.0	40.8	46.0	49.6
NPLs net of specific provisions to capital	22.3	23.3	53.4	50.9	74.2	70.7	55.2	42.3	38.6
Specific provisions to gross lending	1.3	1.2	2.0	1.4	2.3	4.5	6.2	5.9	6.0
Banking sector earnings and profitability									
Return on average equity	21.8	20.8	17.3	11.4	3.0	0.2	-3.6	2.7	2.0
Return on average assets	3.5	3.5	3.3	2.6	0.7	-5.3	-9.0	2.4	1.2
Return on average assets (after taxes)	3.5	3.5	2.6	1.7	0.4	-5.6	-9.3	2.2	0.3
Interest margin to gross income	45.9	47.1	36.1	40.4	45.6	49.3	54.5	57.6	55.1
Non-interest expenses to gross income	38.5	37.6	42.8	35.4	38.9	43.2	46.5	51.4	48.9
Spread between average lending and deposit rates	8.5	8.3	7.8	7.9	8.2	9.4	9.4	9.0	9.0
Banking sector liquidity									
Liquid assets to total assets	19.9	19.7	20.3	21.9	24.3	27.2	29.6	28.8	31.1
Liquid assets to total short-term liabilities	25.4	25.6	25.7	27.4	30.5	33.4	37.0	35.5	38.3
Total deposits to total loans	99.8	100.1	104.5	108.3	111.4	117.5	127.0	124.3	130.5
Foreign currency liabilities to total liabilities	8.0	3.8	6.8	3.5	2.1	0.9	0.3	1.1	2.1
Banking sector sensitivity to market risk									
Net open positions in FX to capital	19.3	27.7	11.5	16.3	30.2	...	...	68.7	56.4

Sources: Central Bank of Belize; and Fund staff calculations.

Table 3. Belize: Stress Tests - Projected Banking System Capital Adequacy Ratios and Capital Shortfalls

Type of Stress Test	Dec. 2013 Actual	Dec. 2014 Proj.	Dec. 2015 Proj.	Dec. 2016 Proj.	Dec. 2017 Proj.	Dec. 2018 Proj.	Dec. 2019 Proj.
Current CAR 1/	22.0%						
CAR taking into account shortfall in provisions 1/	19.2%						
CAR Under Selected Shocks 1/							
Migration shock	18.1%						
Credit Concentration Risk 2/							
Impairment of loans of top ten borrowers of each bank	-7.4%						
Impairment of loans of top five borrowers from the banking system	13.2%						
Impairment of loans of top ten borrowers from the banking system	11.7%						
Liquidity Shock - Days to Illiquidity							
Days till illiquid	35						
Days till breach of Legal Requirement	15						
CARs in Forward-Looking Stress Test Models 3/							
Model 1							
Baseline scenario	20.7%	19.6%	18.9%	17.8%	16.1%	14.6%	13.6%
Low-stress scenario	20.7%	17.2%	16.5%	15.4%	13.8%	12.3%	11.3%
High-stress scenario	20.7%	15.1%	14.3%	13.2%	11.5%	10.0%	8.7%
Model 2							
Baseline scenario	20.7%	20.6%	20.7%	20.3%	19.2%	18.1%	17.5%
Low-stress scenario	20.7%	18.2%	18.4%	18.0%	16.9%	15.7%	14.9%
High-stress scenario	20.7%	16.1%	16.3%	15.8%	14.5%	13.1%	11.9%
Model 3							
Baseline scenario	20.7%	21.7%	23.0%	23.8%	24.1%	24.4%	25.3%
Low-stress scenario	20.7%	16.4%	15.0%	13.2%	11.4%	9.7%	8.3%
High-stress scenario	20.7%	12.9%	9.9%	6.6%	3.5%	0.5%	-2.3%
Capital Shortfalls in Forward-Looking Stress Test Models under a CAR minimum of 9% (share of GDP) 3/							
Model 1							
Baseline scenario		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Low-stress scenario		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
High-stress scenario		0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
Model 2							
Baseline scenario		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Low-stress scenario		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
High-stress scenario		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Model 3							
Baseline scenario		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Low-stress scenario		0.0%	0.0%	0.0%	0.0%	0.0%	0.4%
High-stress scenario		0.0%	0.0%	1.3%	3.1%	4.8%	6.3%
Memorandum item:							
Nominal GDP (US$ millions)	1,615	1,666	1,733	1,805	1,881	1,961	2,044

Sources: CBB data; and Fund staff calculations.

1/ Refers to all banks in the banking system.
2/ Effect of shift of loans to large borrowers from the performing to loss category.
3/ Excludes Choice Bank Ltd. and Caye International Bank Ltd. as in the 2011 FSAP.

Annex I. Status of Implementation of FSAP Recommendations

2011 FSAP Recommendations	Actions Taken
Banking regulation and supervision	
Introduce more conservative loan classification and provisioning criteria; which would apply to both secured and unsecured loans.	The prudential guidelines for loan loss provisioning were revised to bring them in line with international standards and to compensate for the elevated risk levels. The revised guidelines became effective as of 1 December 2011 and it applied to all banks and financial institutions licensed under the DBFIA and IBA. The introduction of DBFIA Practice Direction #3 changed the loan provisioning requirements as follows: • All loans and other assets classified "substandard", specific provisions equivalent to twenty percent (20%) of such loans and other assets shall be maintained. • All loans and other assets classified "doubtful", specific provisions equivalent to fifty percent (50%) of such loans and other assets shall be maintained. • For all loans and other assets classified "loss" which are fully unsecured, specific provisions equivalent to one hundred percent (100%) of such loans and other assets shall be maintained. • Specific provisions were instituted for all loans and other assets classified "loss" which are fully secured by mortgages, equivalent to seventy percent (70%) of the outstanding loan balance and subsequently reduced to 50% on April 1, 2013.
Broaden definitions of "a group of connected borrowers" and of "related party of a licensee" to include holding companies, affiliates and other bank-related parties.	The new DBFIA (pg 29) expanded the definition of a "borrower group" to include: (a) a family group comprising an individual and his spouse, parents, children and dependants of the individual; (b) a company in which the family group indicated in (a) has controlling interest; (c) a company in which the family group indicated in (a) has a substantial investment; (d) a group of companies which has a common shareholder with substantial investment; (e) a group of companies which has a common controlling interest; (f) a group of persons in which the credit worthiness, ability to generate funds or the future viability of each, depends on one or other members of the group; (g) a group of persons in which one member has power directly or indirectly to control the other members; (h) two or more

2011 FSAP Recommendations	Actions Taken
	borrowers, whether individuals, companies or unincorporated bodies, whether on a joint or separate basis, who, in the opinion of the Central Bank, are interrelated through common ownership, control or management; (i) any other group of persons whose relationship with each other is such that it may, in the opinion of the Central Bank, lead to a conflict of interest or other regulatory risk; Likewise, section 65 of the DBFIA (pg 128) has broadened the definition for the related party of a licensee to include among others the following: (c) is a financial holding company, holding company, controlling shareholder of the licensee; (d) is a person who holds twenty percent or more of any class of shares of the licensee or of a person referred to in (c); (e) is an affiliate of the licensee; (f) is an affiliate of a person referred to in (c); (g) is a director or officer of a holding body corporate of the licensee;
Remove the possibility to grant exemptions to the limit on large exposures.	This recommendation was not implemented due to the likely negative impact on lending but may be reconsidered in the future.
Establish consolidated supervision of holding companies.	Section 73(3) of the DBFIA (pg 138) establishes consolidated supervision of holding companies. It states that: In accordance with section 79(2) (Central Bank's responsibility for supervision) and section 80 (Central Bank's authority to examine and to appoint examiners) the Central Bank may apply reporting requirements:- (a) to a licensee on an individual basis; and (b) on a consolidated basis, to a financial holding company, to include all subsidiaries and members of the financial group.
Introduce requirements for corporate governance and internal controls.	Section 7 of the DBFIA (pg 46) gives the Central Bank the authority to issue regulations which prescribe certain requirements and standards including the area of corporate governance. Additionally, the Act strengthened corporate governance by establishing minimum requirements for the number of directors and the creation and composition of specific oversight committees of the board. Currently, the Central Bank is in the process of implementing guidelines to the banking sector on corporate governance. The draft practice

2011 FSAP Recommendations	Actions Taken
	direction has already been through the consultation process with the banking sector and should be implemented in the first half of 2014. Section 51 of the DBFIA (pg 117) requires that the board of directors of a licensee should establish and maintain adequate internal controls. A licensee that does not comply will be subject to substantial fines. Also, once implemented, the draft practice direction on corporate governance stipulates that licensees should have an effective internal controls system and a risk management framework (including a chief risk officer or equivalent) with sufficient authority, stature, independence, resources and access to the Board. As regards internal controls, the draft practice direction requires the following: (a)The licensee should maintain sound control functions, including an effective compliance function that, among other things, routinely monitor compliance with laws, corporate governance rules, regulations, codes and policies to which the licensee is subject and ensure that deviations are reported to an appropriate level of management and, in case of material deviations, to the Board. (b) The Board and senior management should recognize the importance of the effectiveness of the internal audit function to identify problems with a licensee's governance, risk management and internal control systems, and should enhance it by: i. encouraging internal auditors to adhere to national and international professional standards; ii. requiring that audit staff have skills that are commensurate with the business activities and risks of the licensee; iii. promoting the independence of the internal auditor by ensuring that internal audit reports are provided to the Board and the internal auditor has direct access to the Board or the Board's audit committee; iv. recognising the importance of the audit and internal control processes and communicating their importance throughout the

2011 FSAP Recommendations	Actions Taken
	licensee; v. requiring the timely and effective correction of identified internal audit issues by senior management; and vi. engaging internal auditors to judge the effectiveness of the risk management function and the compliance function, including the quality of risk reporting to the Board and senior management, as well as the effectiveness of other key control functions.
Remove legal restrictions on information sharing among domestic agencies and make formal bilateral and multilateral MOUs.	Section 84(2)b of the DBFIA (pg 156) empowers the Central Bank to disclose information to any local or foreign regulatory agency or body, that regulates or supervises financial entities for purposes related to regulation or supervision. Also, section 84(4) states that the Central Bank may enter into a Memorandum of Understanding with the entity performing the functions of deposit insurer, the designated authority, or any local or foreign regulatory agency or body that regulates financial entities with respect to sharing information, but the absence of such Memorandum of Understanding shall not prevent the disclosure of information by the Central Bank to such regulatory authority.
Credit Unions	
Revise CUA to set appropriate minimum CAR requirements.	CUA is slated for revision in 2015.
Revise CUA to strengthen internal controls, set stricter administrative penalties for non-compliance, and establish large exposure limits.	
Revise CUA to provide clear time frame for corrective action and resolution of troubled credit unions.	
Crisis management and bank resolution framework	
Amend the CBA to include an explicit financial stability mandate.	While the CBA has not been amended to include an explicit financial stability mandate, the Central Bank established a Financial Stability Unit in August 2012. The work of the unit is supervised by a Financial Stability Committee, which is comprised of the Deputy Governor (Research) and the Directors of the Research and Financial Sector Supervision

2011 FSAP Recommendations	Actions Taken
	departments. The unit was given a mandate to establish a framework for macro prudential surveillance to identify and mitigate systemic risks in the financial sector.
Amend the BFIA to allow for the appointment of a statutory administrator to take control of a problem bank before insolvency and with the powers to restructure; strengthen the bank liquidation framework.	Part X of the DBFIA (pg 160) improved the resolution structure to allow for a Statutory Administrator with sufficient legal powers to undertake restructuring transactions and implement a mechanism for orderly liquidation.
Establish clear procedures for the provision of (Emergency Liquidity Assistance) ELA by the CBB and solvency support by the government.	The Central Bank of Belize is awaiting the approval of the Financial Management Plan for Domestic Banks and FIs from the Ministry of Finance.
Resolve differences with the Financial Services Commission of the Turks and Caicos Islands (FSCTCI) to allow participation in Caribbean Group of Banking Supervisors (CGBS) MOU.	The CGBS was tasked by regional central bank governors to investigate and recommend measures to resolve the dispute on 27 May 2011. On 22 November 2014, the CGBS finally presented its findings to the governors which confirmed that a parallel structure was deliberately created by TCI, in violation of a bilateral MOU they previously signed with Belize.
Finalize and make operational the CBB's domestic and the CGBS's regional crisis management plan.	The Financial Management Plan for Domestic Banks has been drafted and reviewed by the Central Bank's board of directors. The plan was submitted to the Ministry of Finance for review on 10 June 2013. While the CBB has signaled its agreement to the regional crisis management plan developed by the CGBS it has not signed the regional MOU until the parallel banking issue is properly resolved and a new MOU incorporating a member conflict resolution process and suspension of non-compliant members is in place..
Financial Infrastructure	
Establish a legal framework, with an appropriate oversight function, to create a credit reporting system and a moveable property registry.	Assisted by IFC and CIDA, the Central Bank has been working on draft legislation for the establishment of a credit reporting system for Belize with a view to reducing risk, promoting financial inclusion and increasing the efficiency of the credit adjudication process.

Annex II. The Belize National Payments System Development Plan

Pillar	Description	Vision
Pillar I: The Legal Framework	A sound and appropriate legal framework to ensure a sound and efficient payments system. The legal environment includes the following: • laws and regulations of broad applicability that address issues such as insolvency and contractual relations between parties; • laws and regulations that have specific applicability to payments system (such as legislation on electronic signature, validation of netting, settlement finality); and • the rules, standards and procedures agreed to by the participants of a payments system.	Payments System in Belize operates in a sound and robust legal environment that is able to support settlement finality and the efficiency of payment arrangements
Pillar II: Large Value Payments System (RTGS)	• Systems to process large value and time critical payments are the most significant component of the NPS. The Automated Transfer System (RTGS) and Automated Clearing House (ACH) will be the backbone of the NPS in Belize and will replace the existing manual clearing and settlement arrangements for large-value checks, as well as for other interbank retail payment instruments, such as direct debit and credit transfers.	• Settlement mechanisms for large value and time critical payments in Belize are safe and efficient and comply fully with the CPSS-IOSCO Principles for • Financial Market Infrastructures
PILLAR III: RETAIL PAYMENTS SYSTEM (ACH, DIRECT	• A fully automated interbank clearing system (the ACH software module of the ATS) for modern electronic payment instruments (such as electronic credit transfers and debit transfers), will serve as an alternative to the less efficient checks. While the main focus would be on credit transfers and debit transfers, the ATS system will also enable clearing and settlement of checks.	• Retail payments systems in Belize are efficient, sound and interoperable and support the offer of a wide range of payment instruments and services.
PILLAR IV: GOVERNMENT PAYMENTS	• The Government is the largest user of payments system and is a major customer of the Central Bank. The new ATS system would enable electronic payment mechanisms for Government collections and payments. This will allow government payments to be conducted in a cost efficient way in a centralized manner.	• Government collections and disbursements are fully and efficiently integrated with the NPS in Belize and support its smooth functioning.
PILLAR V: SECURITIES	• The CBB will implement an automated Central Securities Depository (CSD) system to provide the necessary functionality to support the Treasury and its domestic debt operations. The CSD will be interfaced with an auction system for primary market operations,	• Securities Depository, Clearing and Settlement. Securities Depository, • Clearing and

	with a trading platform for secondary market trading, and will also be linked with the RTGS system for the purposes of: (i) implementing DvP for the settlement of all securities transactions and (ii) supporting (collateralizing) the CBB's intraday liquidity facilities in the RTGS system.	Settlements are safe and efficient, fully comply with international standards, and support the development of capital markets.
PILLAR VI: **INTERBANK**	• The CBB will seek to establish a modern interbank money market in Belize, which will serve as an important element for liquidity management, to facilitate the timely settlement of transactions in the RTGS system and support CBB monetary policy operations.	• Interbank money markets are fully developed and closely integrated • with settlement systems
PILLAR VII: **INTERNATIONAL** **REMITTANCES**	• The proposed NPS Law and implementing regulations will better articulate CBB's role in the oversight of remittance service providers (RSPs). In addition, the CBB will undertake a stock-taking exercise vis-à-vis the CPSS/World Bank General Principles for International Remittance Services, and will identify specific actions to be taken with regard to already existing and planned payment systems in Belize with the goal to promote the most efficient use possible of the envisaged payment infrastructure for facilitating remittance services.	• International remittances are distributed rapidly and conveniently in Belize, and are cost efficient from the perspective of end users.
PILLAR VIII: **OVERSIGHT**	• The CBB will establish an oversight unit whose functions will be to: (i) ensure that an adequate degree of participant co-operation exists; (ii) verify that individual payment systems satisfy user needs as well as risk and efficiency requirements; (iii) define and implement appropriate actions should participants not comply with published rules and regulations; and (iv) collect and distribute relevant statistical information.	• The oversight and supervisory framework for payments and securities settlement systems is clearly defined, and the CBB exercises its oversight authority effectively in cooperation with other regulators and supervisors.
PILLAR IX: **COOPERATION**	• A Working Group for National Payments System Reform Project has been established as a consultative body to guide the reforms. Over time the Working Group will evolve into a National Payments Council (NPC), which will play the role of a permanent body for high-level cooperation and consultation in the area of payment and settlement systems and services under the leadership of the CBB.	• Effective, structured and fruitful cooperation is in place within the NPS.

Source: Central Bank of Belize.

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BELIZE—TOWARD A FISCALLY SUSTAINABLE WAGE NEGOTIATION FRAMEWORK[1]

Summary

1. **Containing the wage bill (including non-contributory pensions and teachers' salaries under transfers) is key to achieving fiscal sustainability in Belize.** Debt would increase from 76 percent of GDP in 2013 to about 90 percent of GDP in 2019 mainly because of assumed contingent liabilities (about 20 percent of GDP) and low primary fiscal surpluses (only 1 percent of GDP). The growth in the nominal wage bill is projected to add about 1 percent of GDP to spending every year during FY2014/15–FY2019/20. This very rigid spending item must be part of any credible fiscal consolidation strategy.

2. **Belize's wage bill is high by regional and international standards.** Even when one excludes non-contributory pensions and teachers' salaries under transfers, the wage bill in Belize represents about 10.5 percent of GDP, 45 percent of government spending and absorbs 47 percent of government revenues. In other parts of the world, the wage bill is on average 5–8 percent of GDP, represents 15–31 percent of government spending and absorbs 17–30 percent of government revenue.

3. **Weaknesses in payroll controls partly explain Belize's sizable wage bill.** The 2014 Public Expenditure and Financial Accountability (PEFA) assessment noted serious weaknesses in the degree of integration and reconciliation between personnel records and payroll, weaknesses in internal controls of changes to personnel records and the payroll, as well as weaknesses in payroll audits to identify control weaknesses and/or ghost workers.

4. **Belize's wage bill increased significantly since 2000 partly because of massive hiring, including teachers.** From 2000 to 2005, the government payroll doubled to 8,000. Since 2005, it further increased to its current level of 15,600 employees. Teachers in government and government-supported schools account for a significant share of the hiring. They certainly contributed to improving Belize's human capital, though educational achievement in Belize remains well below regional levels.

5. **The wage bill also increased because of very generous salary increases that were well above inflation.** On average, public sector wages increased by 5.5 per year during 2000-2013, compared with an inflation of 2.1 percent per year during the same period. Even during the period where the 2005 wage agreement was suspended, the wage bill continued to increase by an average of over 5 percent per year between FY2006/07 and FY2013/14, possible because the number of public employees increased and the government granted wage increases from previously agreed upon collective bargaining agreements.

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[1] The main authors of this note are Jacques Bouhga-Hagbe and Marcio Ronci (WHD), with very valuable contributions from labor union representatives and the Belizean authorities.

6. **The generous salary increases were granted in the context of wage bargaining frameworks that did not take into account fiscal consolidation.** Government workers usually receive annual salary "increments" of 2.5 percent every year irrespective of performance or inflation. Additional salary increases are granted after wage agreements between the government and public sector unions, usually covering periods of three years. In past agreements, these additional wage increases exceeded 10 percent per year in some instances. Only considerations related to the cost of living have prevailed in public sector unions' wage demands. Fiscal sustainability has always been ignored, forcing the government to renege on its promise when public finances are in a dire situation.

7. **This note proposes a wage negotiation framework for Belize that builds on the existing framework and incorporates features that ensure fiscal sustainability.** The inclusiveness and transparency of the existing framework are preserved in the framework staff proposes. The main new features are the fiscal anchor (say the medium-term debt-to-GDP ratio) that should guide wage negotiations and the technical authority that would design and monitor the technical parameters needed in the negotiations. Once the fiscal anchor is chosen, the wage bill is derived as a residual item after realistic projections are made for revenue and non-wage spending. For illustrative purposes, staff used the FY2019/20 debt target of 70 percent of GDP. Assuming no net increase in the size of the government payroll, the annual salary increase implied by the new framework staff proposes is 2.4 percent, including the salary "increments" government workers have been enjoying. This would be well below projected salary increases for FY2014/15–FY2016/17, which are close to 7 percent per year.

Introduction

8. **Containing the wage bill (including non-contributory pensions and teachers' salaries under transfers) is an important component of the Belizean authorities' efforts to bring the fiscal position on a sustainable path**. Despite its recent restructuring, Belize's debt remains elevated at about 76 percent of GDP at end-2013. The weak primary fiscal surpluses that are projected (only 1 percent of GDP) combined with an assumed increase in liabilities related to the nationalization of two utility companies (20 percent of GDP) would bring debt to about 90 percent of GDP by end-2019.[2] The wage bill, including non-contributory pensions and wage-related outlays under transfers, is the main spending item behind the rigid public spending structure in Belize and the low primary fiscal surpluses. It has increased from 11 percent of GDP in FY2000/11 to an estimated 13 percent of GDP in FY2013/14. With recent increases in public employees' wage and salaries, the burden of the wage bill is expected to further increase to 14.3 percent of GDP in FY 2014/15 and stay around or above that level in the medium term. In the last five years, annual increases in the nominal wage bill explained on average 60 percent of annual fiscal deficits. They are expected to add close to 1 percent of GDP to spending each year during FY2014/15–FY2019/20. Thus, any credible fiscal adjustment strategy will have to bring the wage bill under control.

[2] see Staff report.

9. **The current public sector wage negotiation framework, in which unions play a critical role, does not take into account fiscal sustainability**. Public sector wages in Belize are set through bargaining agreements between the Government of Belize (GOB) and labor unions representing public sector employees. Past agreements set wage increases for a three-year period and imposed salary increases in excess of 10 percent per year (Box 1). Fiscal difficulties have often forced the GOB to renege on its promises under such agreements, reflecting their dent on fiscal sustainability. The most recent agreement was finalized in February 2014 and covers the period FY2014/15–FY2016/17. This agreement also stipulates that half of the annual increase in recurrent revenues during this period will be earmarked for public employees' wage increases (see section A below), wiping out any fiscal space that could be used for fiscal consolidation or growth-enhancing spending. The exact percentage increase in wages will be finalized when the actual revenue outturn for FY2013/14 is determined. Using the current revenue collection estimates, the agreement would imply an increase of about 4 percent per year across the pay scale for the next three fiscal years (April-March), with the first salary increase effective April 1, 2014. This increase is in addition to the usual "salary increments" of 2.5 percent per year that have been granted automatically to all employees, even though they were meant to be based on merit. As a result, the annual wage increase would amount to about 6.5 percent for each public employee for the next three fiscal years. In light of Belize's current fiscal predicament, the most recent wage agreement would clearly jeopardize fiscal sustainability if corrective measures are not taken.

10. **This note proposes a wage negotiation framework that would ensure fiscal sustainability while maintaining the transparent and inclusive approach that has characterized wage negotiations between the GOB and its social partners**. The framework proposed describes how one can strike the right balance between fiscal sustainability, public sector employees' productivity, standards of living, private sector comparators, and best international practices of wage negotiations. It further enhances transparency by urging the GOB to issue timely and accurate reports on the state of public finances, the size and structure of the public service, as well as the projected impact of the GOB strategy on public finances and the size of the public service, including new hiring. "Adjusters" are included in the framework to take into account deviation of macro-fiscal variables from projections. The framework proposes a "Fiscal Sustainability and Compensation Authority", a technical authority on public employees' compensation that could include representatives of the GOB and Unions.[3] Unlike the existing "Budget Working Group", it would ensure that wages are set in a framework that takes fiscal sustainability into account. This authority would also monitor the implementation of wage agreements and publish the monitoring reports set forth in the framework. Applying this framework to Belize and assuming no net new government hiring would have implied annual salary adjustments of about 2.5 percent per worker over the next three fiscal years, reducing the wage burden to 13 percent of GDP in the medium term.

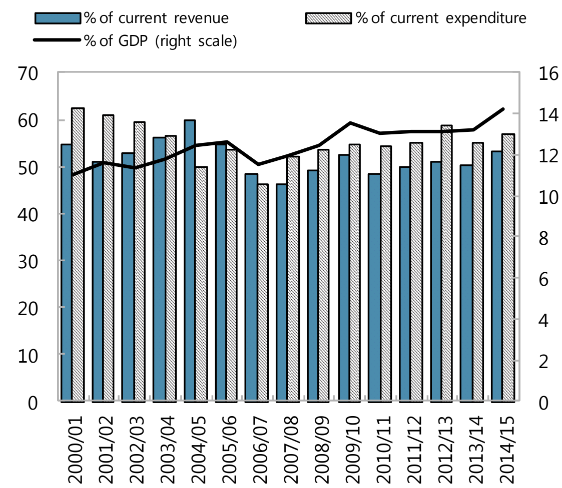
11. **The note is organized as follows**. In section A below, the wage bill is discussed in the context of overall government spending, as well as public sector unions and wage agreements in

[3] In other countries, it is called the "Government Employer's Authority", or " Budget Working Group" as in Belize,

the recent past. In section B, international best practices in public sector wage negotiations are presented as well as the February 2014 wage agreement. General principles of a sound wage negotiation framework and a proposal of a fiscally sustainable wage setting framework for Belize are presented in section C. Concluding remarks are presented in section D.

A. The Challenges With The Public Sector Wage Negotiation Framework

The High Wage Bill



12. **The wage bill represents a significant share of public spending in Belize and has greatly contributed to spending rigidity and to low primary fiscal balances (Text Chart).** At about 12.5 percent of GDP during FY2002/03–FY2013/14, the wage bill, including non-contributory pensions and wage outlays to teachers under transfers, represented on average 47 percent of total domestically-financed spending. In comparison, domestically-financed public investment averaged only 2.8 percent of GDP during the same period or about 10.6 percent of total domestically-financed spending. The wage bill also absorbed 52 percent of revenues during that time. Belize's spending structure is rigid and heavily skewed toward current spending, which represented 87 percent of total domestically-financed spending, and has absorbed 96 percent of domestic revenues during FY2002/03–FY2013/14. The wage bill, which also accounted for about 54 percent of current expenditure, greatly contributed to this spending rigidity. It also hampered fiscal consolidation. Belize's annual primary fiscal balances averaged 1.2 percent of GDP during FY2002/03–FY2013/14. During the same period, the annual growth in the wage bill added on average 0.7 percent of GDP to public spending each year. A more modest growth in the wage bill, say half of the level observed, would have improved the fiscal primary balance by about 0.4 percentage points of GDP each year, putting downward pressure on debt amounting to about 4 percentage points of GDP.

13. **Belize's wage bill is also high by regional and international standards (Text Table 1)**. In the Western Hemisphere, the wage bill is about 8 percent of GDP, 31 percent of public expenditures and absorbs about 30 percent of revenue. In middle income countries, it typically amounts to about 7 percent of GDP, 28 percent of government expenditures and absorbs 28 percent of revenues. In other parts of the World, the wage bill is in the range of 5–7 percent of GDP, represents 15–30 percent of spending and absorbs 17–30 percent of government revenues.

Text Table 1. Government Compensation of Employees 1/

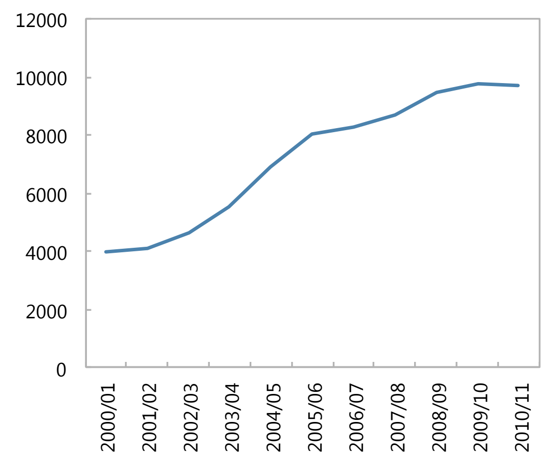
Country Groups	% of GDP	% of Government Expenditures	% of Government Revenues
Africa	6.5	30.4	29.5
Asia and Pacific	5.1	26.2	23.1
Europe	5.7	17.4	17.5
Western Hemisphere	8.2	31	29.6
Belize	**10.5**	**45.1**	**47.5**
Middle East and Central Asia	7.1	28.9	24.8
European Union	5.2	15.9	16.3
Low-Income Countries	5.2	28.6	27.9
Middle-Income	7.3	27.6	26
High Income	6.1	20.4	18.6

Sources: Government Finance Statistics (GFS) database, IMF; and Ministry of Finance of Belize.

1/ Central Government averages for 2000-08.

14. **The wage bill greatly increased since 2000 partly due to massive hiring of teachers, which contributed to improvements in Belize's human capital, even though educational achievement remains well below regional levels**. From 2000 to 2005, the size of the government payroll doubled to 8,000, and then further increased to reach about 10,000 in 2010 (Text Chart).[4] This large increase was partly due to the hiring of teachers, including in government-supported schools, which represented about a third of the new hiring. Despite efforts to increase the number of teachers, school attendance in Belize continues to be among the lowest in the region. Primary school attendance declined from 95 percent in 1999 to 92 percent in 2009, and there has been only a modest progress in expanding education at the secondary and tertiary levels. Nonetheless, preschool, secondary, and higher education have yet to reach the lowest income quintiles, and attendance at the primary level has been on the decline in recent years.[5] Belize's preschool gross attendance rate is about 44 percent, well below the LAC regional average of 71 percent. Only 45 percent of secondary school-aged children attend school, substantially below the regional average of 80 percent. Tertiary-level enrollment is about 18 percent of the tertiary school-aged population, less than half of the regional level.

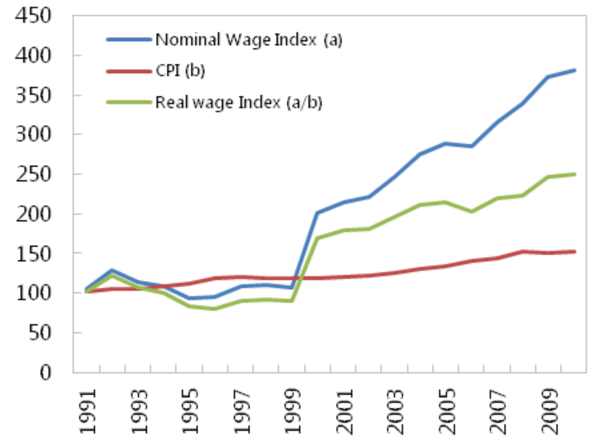
Number of Employees



[4] Data provided by the Ministry of Finance. There is no publicly available information on the evolution of Belize's public sector employees and it is therefore difficult to analyze public employment trends. Alternative sources such as the Statistical Institute of Belize point to a significant increase in public employees to 15,600 in 2012.

[5] See Näslund-Hadley (2013).

15. **The wage bill also increased because of large salary increases that were well above inflation (Text Chart).** Government workers' salaries increased by about 6 percent per year from 2000 to 2010, and then by a further 4 percent per year from 2010 to 2014. Inflation averaged 2.4 percent per year during 2000–10 and 1.1 percent per year during 2010–14, implying significant real wage increases. During 2006–2013, when the 2005 wage agreement was suspended, the government granted wage increases from previously agreed upon collective bargaining agreements, but the increases somewhat lagged behind the cost of living according to labor unions. [6] Government workers in Belize usually enjoy annual salary "increments" of 2.5 percent every year, irrespective of the level of inflation or changes in the cost of living. These salary "increments" were initially designed as merit increases, but they have been granted to all government workers without regard to performance. In addition, sizable wage increases have been granted during negations with labor unions in the context of three-year wage agreements (see section below).



16. **The size of the wage bill also reflects weaknesses in Public Financial Management (PFM), including payroll controls where Belize received a very low rating in the latest Public Expenditure and Financial Accountability (PEFA) assessment**. A preliminary PEFA assessment conducted in February 2014 concluded that PFM reforms are on a strengthening trend but did not change most of the very low ratings Belize received during the 2008 assessment. Controls remain weak and the absence of a medium-term perspective to budgeting hinders the rational strategic allocation of resources. The assessment was made along the following dimensions:

- **Degree of integration and reconciliation between personnel records and payroll.** Payroll records in the Human Resource Management Information System (HRMIS), the "establishment list" maintained by the Ministry of Public Service (MPS), and the personnel records maintained by Ministries, Departments, and Agencies (MDAs) are not electronically linked. Adjustments in payroll are transmitted manually from the MDAs to the HRMIS, leading to many mistakes, including in bank accounts. One should also add that the HRMIS includes teachers in government schools, but not those in government-supported schools. This suggests that the government has no supervision on teachers in government-supported schools even though they enjoy the same benefits from the government through transfers as those in government schools.

[6] See Lafuente (2013).

- **Timeliness of changes to personnel records and the payroll.** Changes in the HRMIS are quickly reflected in the payroll, but changes in the MDAs' personnel records can be made erroneously and transmitted to the HRMIS.

- **Internal controls of changes to personnel records and the payroll.** Internal controls over changes to the HRMIS and the records of the MPS appear robust. However this is not the case at the MDA level, which undermines overall robustness.

- **Existence of payroll audits to identify control weaknesses and/or ghost workers**. The Office of the Auditor General (OAG) prepared a payroll audit in late 2012 though it is not yet finalized. The audit discovered instances of people receiving more than one salary, and retirees still receiving salaries. No other partial or full payroll audits have been conducted and reported during the last three fiscal years or before that.

17. **There are plans to strengthen payroll management, though the expected impact on the wage bill is uncertain**. The Ministry of Public Service is preparing a comprehensive "personnel database" with all relevant staff information. It would include the "establishment list", which it controls. According to the Ministry of Public Service, the amount of personnel information provided in the HRMIS is very limited, mainly just the date of birth. Changes in the establishment list would then be directly reflected in real time in the "personnel database". The new "personnel database" is expected to start functioning by the end of 2014. The impact on the wage bill would depend on the degree of reconciliation with the MDAs' personnel records.

The Labor Unions

18. **The legal rights and obligations of labor unions are well established in the law (Trade Union Act, and Trade Unions and Employers Organizations Act)**. The rights include organizing, collective bargaining, demonstrations and strikes. The obligations include submitting reports on activities of the union to members and to the Registrar of unions.

19. **Labor unions carry various responsibilities in Belize**. The role of a union is captured in its constitution. Collective bargaining is a fundamental role. On behalf of union members, the leadership of the labor union negotiates labor contracts with the government, including wages, work rules, complaint procedures, rules governing hiring and firing, promotion, benefits, safety in the workplace, and general policies.

20. **Public sector unions account for the majority of labor unions in Belize and play a significant role in many important decisions**. They represent the backbone of the public service and teaching professions, and account for about half of labor unions' membership in 2012. About 15 percent of the workforce in Belize is unionized. The unions' influence is significant because they are usually involved in many important decisions, including public sector wage agreements or other agreements between the government, the private sector and social partners. The strength of public sector unions has also increased because of their affiliation to the National Trade Union Congress of Belize (NTUCB), the Caribbean Congress of Labor (CCL) and the International Global Union Federations (GUFs). Today the NTUCB, with its eleven-union organizations, represents the majority of workers in Belize.

21. **Labor unions in Belize have shown their power in the past**. For example, in January 2005, the government announced its proposed national budget for 2005-2006. This budget included major tax increases for real estate, financial institutions, tobacco and rum. It sparked public outrage from local interest groups and organizations. On January 20th, 2005, the NTUCB called for a general strike to protest corruption and the proposed tax increases, which amounted to some US$45.8 million, saying that it would adversely affect the majority of the Belizean people. The unions' demands were for the government to reconsider the tax increases, increase salaries for teachers and public servants, and institute financial reforms to increase citizen participation and decrease foreign debt. Joining in the strike, which included demonstrations through the streets, were the Belize National Teachers Union (BNTU), the Public Service Union (PSU), the Belize Chamber of Commerce and Industry (BCCI), and the Belize Business Bureau (BBB), resulting in most of the schools and 80 percent of business places being closed.

22. **The unions have not had to strike on collective bargaining negotiations with the government**. Governments for the most part have respected unions' rights to collectively negotiate workers' compensation. The unions have only employed demonstrations in the past to get the government back to the negotiation table when talks on compensation broke down or were at an impasse.

23. **In recent wage negotiations, public sector unions have mostly based their demands on the need to recoup the loss of purchasing power caused by increases in the cost of living**. In the most recent negotiation, which started in 2013, and was finalized in February 2014, public sector unions estimated that the cost of living increased by 30 percent since the previous round of negotiations in 2005, even though cumulative price increases amounted about 16 percent from 2006 to 2013. As a result, they requested an adjustment of the salaries of public employees, pensioners and teachers incrementally over three years, from FY2014/2015 to FY2016/2017, to cover the 30 percent loss of purchasing power of public employees and pensioners. The rationale for this request was that purchasing power was reduced over the last eight years and the workers deserved to receive a fair pay for their work.

The Current Wage Negotiation Framework

24. **The February 2014 wage agreement will substantially increase the wage bill (including non-contributory pensions and wage outlays under transfers) in the next three years and considerably reduce room for fiscal consolidation**. The agreement includes adjustments to wages, non-contributory pensions and teachers' salaries under transfers. This is in addition to the automatic annual salary "increments" of about 2.5 percent that have been taking place for years. These features also appeared in previous wage agreements (Box 1). However, the 2014 agreement gives the unions an unprecedented say on how fiscal revenues are used in contrast with international best practices. The main features of the new wage framework are as follows:

- The agreement will cover the three-year period FY2014/15–FY2016/17.
- The amount of the salary increase will be 50 percent of the increase in actual recurrent revenues between the two previous fiscal years. The increase in FY2014/15 will be 50 percent of the increase in actual recurrent revenues between FY2012/13 and FY2013/14.

- The maximum salary adjustment in any single year will not exceed 10 percent of the wage and wage-related grants for the previous years.
- The annual salary adjustment paid to public employees and teachers will continue as currently programmed and is unrelated with this new salary adjustment mechanism.
- All adjustments, once made, become permanent.
- This framework applies to all public employees, teachers and pensioners.
- In the event of any extraordinary circumstances which affect either revenue or expenditure, the government and unions reserve the right to re-negotiate the framework.
- The government and unions agreed to establish a permanent committee to verify and agree on the numbers, improve revenue collections, and advance the other suggestions made by the parties.

Box 1. Brief History of Public Sector Collective Bargaining Agreements, 1992–2005

Collective Bargaining Agreement of 1992

- This Agreement provided a three-year wage increase for fiscal years FY1992/93, FY1993/94 and FY1995/96.
  - For junior public officers, junior teachers and pensioners, the increase was 12.5 percent per annum over 3 years; and
  - For senior public officers and senior teachers, the increase was 10.0 percent per annum over the 3 years.
- The Government honored the first two phases of the agreement by granting the requisite wage increases in April 1992 and April 1993.
- The incoming Government of 1993 sought to halt the third and final phase of the wage increase due in 1994. However, after resistance from the Unions, the Government
  - Granted a 5 percent wage raise;
  - Agreed to give the officers and teachers a government security (bond) to cover the amount of the salary increase that was forgone; and
  - In October 1994, it awarded an additional 1.25 percent increase to junior officers. This meant that junior officers were able to receive 50 percent of the salary increase that was due to them under phase three of the 1992 Agreement.

The 1996 Wage Award

- While the Government retrenched over 800 public officers in December 1995 as a consequence of high wage costs and bloated levels of its employees, it granted a salary raise equivalent to 1.25 percent of GDP.

Collective Bargaining Agreement of 2003

- This Agreement settled on a three-year wage award for fiscal years FY2003/04, FY2004/05 and FY2005/06.
  - For junior public officers, junior teachers and pensioners, the award was 10.0 percent per annum over 3 years; and
  - For senior public officers and senior teachers, the award was 5.0 percent per annum over the 3 years.
  - In addition, it was agreed that the Government would grant a 1.0 percent across the board wage increase, retroactive to April 2003, if the GDP grew by 5 percent and 6 percent in FY2003/04 and FY2004/05, respectively.
- While the Government honored the first two phases of the 2003 Agreement, it aborted the final phase due to mounting fiscal and debt pressures.
- Instead, the Government implemented a salary increment freeze effective July 2005 to June 2006.

The 2005 Agreement

- The Government and the Unions reached a new Agreement in 2005 that specified the following:
  - The Government to honor the third phase of the 2003 Agreement in April 2005;
  - The formation of a Budget Working Group (BWG) with officials of the Ministry of Finance on one side and members of the NTUCB on the other side. The BWG was tasked to review revenue raising measures and expenditure cutting proposals in upcoming budgets.

Source: Ministry of Finance of Belize.

B. International experience on wage negotiations

Selected cases in the Caribbean

25. **The wage negotiation framework in Belize is similar to wage negotiation frameworks in some other countries in the Caribbean**.

- In **St Lucia**, wage agreements cover three-year periods and mandate across-the-board wage increases for a three-year period irrespective of performance. The most recent agreement was concluded in March 2013 and envisaged a wage increases for public workers of 4 percent in 2013.

- In **Barbados**, wage agreements usually cover 3-year periods. Once unions submit their proposals of wage negotiations, the Ministry of the Civil Service arranges for meetings to discuss an agreement. Every effort is made to settle disputes because there is no recourse to arbitration. When the parties do not reach an agreement, the Head of the Civil Service is used to provide conciliation services (Sealy, 2003). The most recent agreement was for 2011–13 and was focused on wage moderation, with wages linked to measures of performance including productivity. Given the profound economic crisis, in December 2013, the Barbadian authorities announced a reduction in the size of the civil service in FY2014/15 by about 3,500, or 15 percent of the total, wage cuts for elected and appointed officials, and a two-year nominal wage freeze. So far, 2,800 public workers were laid off.[8]

- In **Jamaica**, the government negotiates wage agreements with the public sector unions, usually for 2 or 3 years. The current three-year agreement was concluded in February 2013 and envisaged a wage freeze except for increases from promotions and reclassification exercises agreed prior to the wage agreement. In 1992, the Permanent Salaries Review Board (PSRB) was established after consultation between the government and public sector labor unions. The PRSB reviews salaries, fringe benefits and other conditions of service, as requested, of all categories of employees of central and local government and statutory bodies. Initially, the government committed itself to accept the recommendations of the PSRB, but as the national economy deteriorated, the government found it necessary to reject the PSRB's recommendations, and currently the PSRB has only a minor role in the public wage negotiations. The negotiation process often leads to disputes between the parties with the unions resorting to strikes (Jamaica Civil Service Association, 2003).

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[8] On Barbados, see Sealy (2003), and Team of Consultants of Sir Arthur Lewis Institute of Social and Economic Studies (2012).

Selected cases outside the Caribbean

26. **There are good examples of wage negotiation frameworks outside the Caribbean**. International experience shows that countries that have been more successful in negotiating wage agreements are those that have depoliticized wage bargaining with unions such as Denmark, Finland and Sweden. In general, these countries have set up independent management bodies—Government Employer's Authority (GEA)—to negotiate wage agreements with unions. The macroeconomic and fiscal inputs to the wage negotiations come from the Ministry of Finance, while both the GEA and the labor unions contribute comparisons with salaries in the private and local public sectors. It should be emphasized that the GEA and unions do not decide the wage envelope, which is taken as given during the wage negotiations.

- In **Denmark**, the central collective agreement for the national public service is negotiated and signed by the Government Employer's Authority (GEA), an independent management body within the Ministry of Finance. The macroeconomic and fiscal inputs to this process come from the Ministry of Finance, while both the GEA and the trade unions contribute comparisons with salaries in the private and local public sectors. The final agreement has to be approved by the Ministry of Finance. Agreements have excluded retroactively wage adjustments when salary increases in the private and local sectors ended up being higher or lower than those in the public sector (OECD, 2012).
- In **Finland**, agency managers receive a salary budget envelope and have some discretion over how to use it. However, they have less discretion than their Swedish counterparts (see below). The Finish central collective agreement for the national public service is negotiated and signed by the Government Employer's Authority (GEA), an independently managed part of the Ministry of Finance. The salary negotiations are normally preceded by the negotiation of a broad income policy agreement between the government and all relevant social and economic players. This agreement sets limits for acceptable wage increases in each economic sector, including the national service and the local public service (OECD, 2012).
- In **Sweden**, salary setting is delegated to the individual national government agencies. The Ministry of Finance uses a normalized private sector benchmark to determine how budget allocations are to be adjusted for wage increases. This benchmark is based on the average increases of salaries for the private sectors that are exposed to foreign competition (OECD, 2012). The budget allocation ceiling is the only constraint facing agency managers who have the authority to set wages not only for positions but also for individual staff. The Swedish central collective agreement for the national public services is negotiated and signed by the Agency for Government Employees (AGE). Salary agreements signed by national government agencies do not have to be approved by the government and they cannot affect budget allocations, which are set in advance by the Ministry of Finance.

C. Toward a fiscally sustainable wage negotiation framework in Belize

General Principles

27. **Wage negotiation requires transparency, fairness, and a genuinely inclusive approach.** This is particularly important in times of austerity. Transparency requires that the government make available all information it has on the state of public finances as well as the fiscal impact of its fiscal strategy. Information on labor market trends and non-wage rewards, which is key for public sector's competitiveness and efficient provision of services, must be taken into account if available. Fairness requires that wage adjustments take into account the cost of living, wages in comparator sectors, and employees' performance. Fairness also requires that wage adjustments be fiscally sustainable so that they are not later retracted. Inclusiveness requires that all stakeholders have a seat at the negotiation table. Unions' involvement in particular at very early stages of the negotiation process could reduce resistance to changes proposed.

28. **Wage negotiation requires a framework that takes into account fiscal policy constraints and objectives, including the size of the public service (Chart 1).** Decisions to adjust salaries have important implications for public budgets since they involve allocation of limited funds. The dominant practice that relied on across-the-board increases is evolving. Wage negotiations involve two related but distinct decisions. Once a fiscal anchor is set, such as a target on the medium-term debt to GDP ratio, and its implication for the path of annual fiscal balances estimated, the first decision is on the total amount to be budgeted annually for wage adjustments given overall budget constraints, including the annual fiscal balances targeted. The second decision is how to allocate available funds to employees. Part of the increase in the wage bill can be set for new recruits if any, once the desired or optimal size of the public service is determined, and the remainder allocated to wage increases, taking into account the principles mentioned above.

29. **Wage negotiation must be depoliticized and handled within the framework of an independent technical authority**. It is typical for a central authority responsible for human resource management issues (e.g., a Ministry of Civil Service or Civil Service Commission or a similar body) to weigh in on salary structure decisions, while the Ministry of Finance has veto power on issues related to wage bill sustainability. Nonetheless, some countries have established a Technical Authority on wage negotiations such as the "Government Employer's Authority" in Denmark, Finland, or Sweden, or the "Permanent Salaries Review Board" in Jamaica. This technical authority would have a mandate to negotiate wage agreements and manage human resources on strictly technical terms. It would track and monitor expenditure on wage, pensions and teachers' salaries; maintain a general register of public servants and a teachers' database; collect data on wage comparators; design and/or monitor the government's performance-based pay system; and publish frequent reports on its work and findings.

30. **Wage negotiation frameworks should provide for non-binding mediation to help negotiations and reduce conflict, though this could be difficult in a small country like**

Belize (Box 2). One could use a trained, impartial third party to help reach consensus on substantive issues at disagreement among conflicting parties. A mediator must be neutral and perceived as such by all parties. While mediation can be binding or non-binding, non-binding mediation would be desirable as binding procedures are not appropriate for public planning and budgeting. For example, the Advisory, Conciliation and Arbitration Service (ACAS) in the UK, has been relatively successful in mediating public sector wage negotiations between government agencies and public sector unions.[9]

31. **Wage negotiation must respect clear procedures, including a clear timeline linked to the budget cycle, and a calendar for the issuance of all reports that are needed**. Wage negotiations must be finalized before budget circulars are sent to public entities as it would strengthen budget preparation in general and the credibility of budget estimates in particular. All reports that are needed in the negotiation process must be issued by the Technical Authority on wage negotiations before negotiations begin. In particular, reports on the state of public finances, the size and structure of the civil service or government payroll, key macroeconomic projections, the fiscal strategy, including in particular the fiscal anchor, private sector salaries, and the cost of living must be made available before negotiations start.

32. **Wage frameworks must clarify procedures to take when macroeconomic outcomes deviate from projections, and wage agreements should be binding only for the first year of the agreement period and be indicative for the other years**. Given the fact that macroeconomic outcomes can significantly deviate from projections, procedures on how to handle such deviations and their impact on future wage adjustments must be clear to all stakeholders. This would strengthen budget credibility and predictability. Therefore, wage agreements should be binding only during the first year of the agreement because of uncertainty about future macro-fiscal outcomes. Wage adjustments for the other years should be indicative and must be reassessed in light of macroeconomic outcomes and revised projections.

A Possible Wage Negotiation Framework for Belize

33. **In Belize, the wage negotiation principles above are not always respected**. The wage framework recently agreed by the government and unions and discussed in section A is a step in the right direction. Negotiations were transparent and inclusive. There was also an attempt to depoliticize the process through the creation of a permanent committee that would agree on numbers. In addition, there was an attempt to take into account the uncertainty of macroeconomic outcomes as the February 2014 framework allows for the possibility to renegotiate wage adjustments in the event of extraordinary circumstances. However, fiscal sustainability was clearly not taken into consideration as evidenced by the fact that 50 percent of the growth in recurrent revenue will be earmarked for salary increases. This would considerably reduce any fiscal space that could be used for fiscal consolidation or growth-enhancing

[9] See http://www.acas.org.uk/index.aspx?articleid=1342

spending. There was no clear fiscal strategy tied to wage negotiations. Nothing was raised about the desired or optimal size of the public service. Moreover, all salary increases appear "structural" and across the board. Neither employees' performances nor private sector wage comparators were used in setting the salary increase. In addition, the negotiation timeline was not linked to the budget cycle and relevant information was not shared in a preset format. Procedures that would prevail should macro-fiscal outcomes deviate from projections were not clarified. In this case, the right to re-negotiate the wage framework in the event of extraordinary circumstances would not be sufficient as it would maintain unwanted uncertainty about the wage bill and the budget.

34. **The wage negotiation framework staff proposes builds on the existing framework and introduces new considerations to the process (Chart 1).**

- First, the permanent committee established under the February 2014 agreement should become a "Fiscal Sustainability and Compensation Authority" (FSCA) to emphasize the need to assess public employees' compensation in the context of fiscal sustainability, a key principle of sound fiscal policy.

- Second, a clear and simple fiscal anchor must be adopted to guide fiscal policy. As staff recommended during the 2013 Article IV Consultation, the ratio of public debt to GDP would be a very useful fiscal anchor. For example, the authorities could target a debt-to-GDP ratio of 70 percent by end 2019 and 60 percent by end 2024.

- Third, the FSCA should issue a report discussing the latest macro-fiscal developments and projections, including nominal GDP projections and the path of annual nominal fiscal balances that are implied from the fiscal anchors above (i.e. the debt targets). It should be emphasized that such projections of nominal fiscal balances can be prepared using only the existing stock of debt and the medium-term debt targets above.

- Fourth, once the path of nominal fiscal balances is set, increases in the nominal wage bill (including non-contributory pensions and wage payments under transfers) can be determined. One could set the nominal increase in the wage bill after having agreed on realistic increases in revenue collection and non-wage spending. Given the fiscal balances imposed by the debt targets, the wag*e bill w*ould simply be a "residual" with this approach. Targets on revenue collection and non-wage spending must remain prudent and in line with fiscal policy priorities. The desired or optimal size of the public service must also be discussed between all stakeholders.

35. **For illustrative purposes, staff applied the wage negotiation framework it proposes using its "active scenario" projections and derived average salary increases of about 2.5 percent per year during FY2015-19, including the on-going annual salary increments, and assuming no net increase in the number of public employees (Text Table 2).**

- Staff assumed that the main fiscal anchor used by FSCA is the debt-to-GDP ratio 70 percent by end 2019.

- Staff used the nominal GDP projections in its "active scenario".

- This fiscal anchor and nominal GDP projections require a primary fiscal surplus of 4.5 percent of GDP on average and imply an overall fiscal surplus of 1 percent of GDP each year during FY2014/15–FY2019/20.

- Assuming the fiscal balances imposed by the debt targets and realistic increases in revenue collection and non-wage spending, the wage bill envelope is calculated as a residual (Text Table 1). This implies that the annual increase in the nominal wage bill will have to be about half of the nominal GDP growth in FY2015/16–FY2019/20. The total nominal wage bill (including non-contributory pensions and teachers' salaries under transfers) will move from B$461 million in FY2014/15 (14 percent of GDP) to B$519 million in FY2019/20 (13 percent of GDP).

- For simplicity, staff assumed a *zero net* increase in the number of public employees and teachers. In reality the desired or optimal size of the public service should also be discussed between all stakeholders. The government and its social partners would negotiate fiscally sustainable salary increases for each employee, given the wage envelope mentioned above. The average salary increase would be about 2.5 percent, including the ongoing salary increments.

Text Table 2. Belize: Simulation of Public Sector Wage Negotiations, 2013-2019

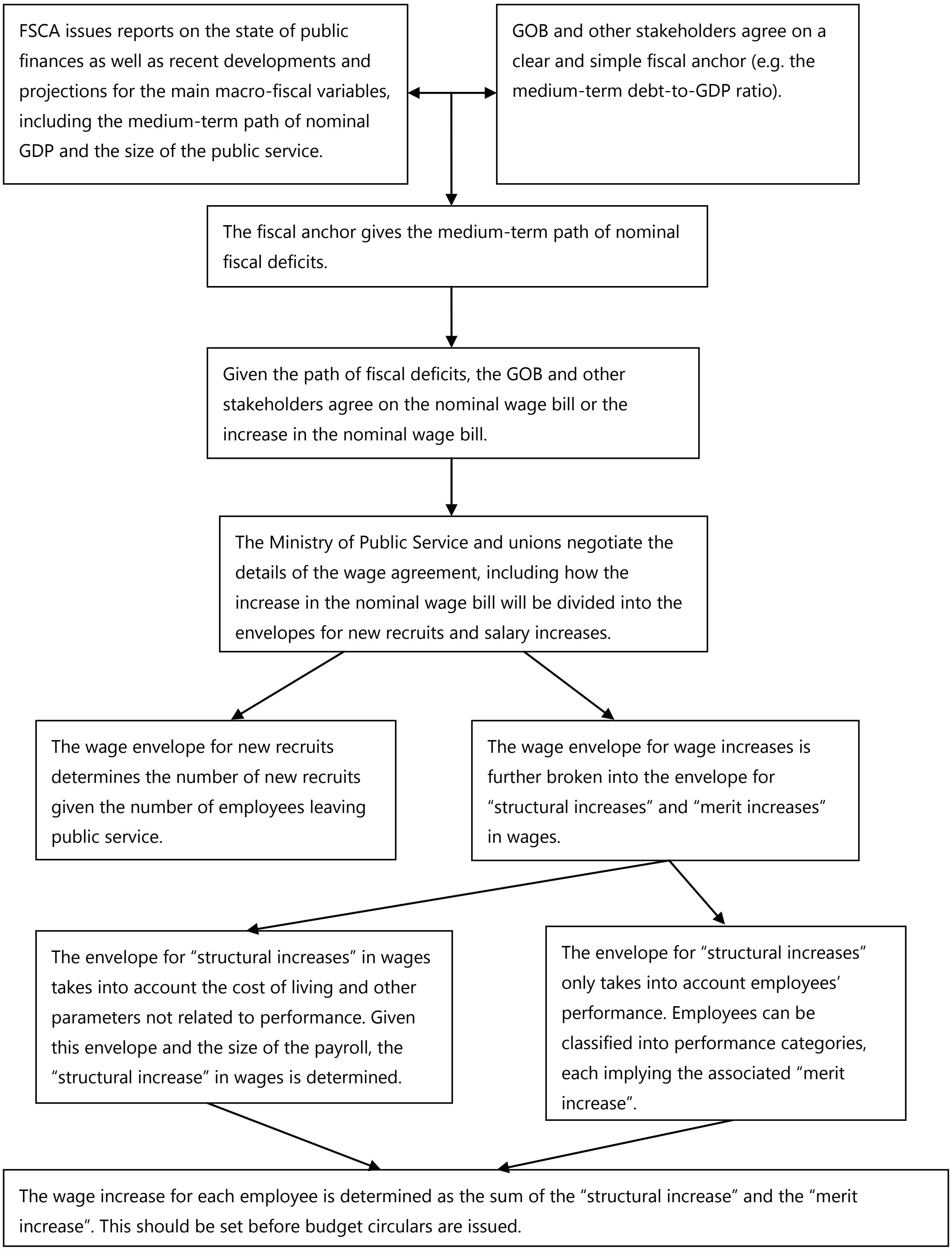
(In Millions of Belize dollars, unless otherwise indicated)

	Est.	Projections					
	2013	2014	2015	2016	2017	2018	2019
Key macro-fiscal variables							
Nominal GDP	3,231	3,332	3,466	3,610	3,763	3,922	4,089
Number of public employees and teachers 1/	9,709	9,709	9,709	9,709	9,709	9,709	9,709
Fiscal projections 2/							
Overall balance	-2.3	0.7	1.9	1.4	0.5	0.6	-0.6
Public and publicly guaranteed debt 3/	77.5	76.8	73.4	91.6	83.2	77.0	70.6
Outcome of wage negotiations 4/							
Payroll envelope	430.2	461.5	470.0	480.7	492.4	505.1	518.7
Average wage increases per employee (% change)	. . .	7.3	1.8	2.3	2.4	2.6	2.7
Memorandum items:							
Real GDP growth	0.7	1.5	1.8	2.6	2.8	3.0	3.2
Nominal GDP growth	1.3	2.5	3.1	4.1	4.5	4.9	5.2
Inflation (end of period)	1.6	1.8	1.8	2.0	2.0	2.2	2.2
Wages and Salaries	312.0	332.4	338.4	344.9	351.9	359.4	367.3
Pensions	54.8	57.8	58.8	60.0	61.2	62.5	63.9
Teachers' salaries	63.4	71.4	72.7	75.8	79.3	83.2	87.6
Payroll envelope (% of GDP)	13.5	14.1	14.0	13.7	13.4	13.1	12.8
Fiscal primary balance	1.0	3.5	4.6	4.4	4.6	4.7	4.7

Sources: Belizean authorities; and Fund staff estimates and projections.

1/ Number of public employees for 2013 refers to data available for 2009.
2/ Fiscal projections are on a fiscal year basis (April to March).
3/ Includes repayment of additional liabilities resulting from past nationalization of utility companies.
4/ Includes pensions and teachers' salaries.

Chart 1. Belize: A Fiscally Sustainable Wage Negotiation Process



Box 2. Mediation in Wage Negotiations

In collective bargaining for a new wage settlement, one can resolve disputes by hiring a third-party to mediate negotiations. There are generally two approaches to mediation. One involves a third-party neutral that intervenes to help the parties reach a resolution. It is a conciliator or mediator that just helps facilitate the process and has no final decision-making authority. The second approach involves a third-party neutral that resolves the dispute with final and binding arbitration.

A conciliator helps the parties reach a settlement by facilitating communication. The conciliator is a good listener, faithfully transmitting the two parties' positions. However, the conciliator just aids in communication and does not suggest compromises.

A mediator facilitates communication and proposes compromises, helping to define the issues involved, seeking to remove emotional content by screening communication between the parties, and suggesting possible solutions (unlike conciliators). However, the mediator (like the conciliator) has no ability to impose a settlement. The two parties must reach an agreement themselves. Facilitative mediation is the most common mechanism used in the UK. The mediator normally plays an active role in guiding the process. Using joint problem-solving approaches, the mediator asks questions to identify the interests and real issues of disagreement, and helps parties to identify and evaluate options for resolution and settlement. The mediator does not suggest solutions, although they may float ideas (ACAS, 2013).

Interest arbitrators are third-party neutrals that fashion collective bargaining agreements between labor and management. They are seldom used in the private sector, being more common in the public sector when a work stoppage or strike would result in the loss of important government services. This type of arbitration must be agreed to between labor and management as a form of voluntary, binding and final arbitration.

D. Concluding remarks

36. **This note presents the fiscal sustainability challenges the wage bill poses in Belize**. In Belize, the wage bill greatly increased since 2000 because of massive hiring and wage salary increases that were well above inflation. The hiring reflected large recruitment of teachers with the view to strengthen human capital, though educational outcomes remain mixed. Wage and salary increases were the result of poorly-designed wage bargaining frameworks that did not take fiscal sustainability into account. Belize's debt is clearly not on a sustainable path, partly because of a rigid spending structure that has been created by past increases in the wages, salaries, non-contributory pensions, and transfers to pay teachers in government schools. Contingent liabilities stemming from recent nationalizations would significantly add to Belize's debt burden in the coming months.

37. **It then proposes an alternative wage negotiation framework that ensures fiscal sustainability**. Policy makers must start adjusting now to avoid a crisis down the road. Adopting a fiscally sustainable public sector wage setting framework would restore discipline and credibility in the fiscal framework. In this note, staff proposed a simple framework that relies on a clear fiscal anchor such as the medium-term debt-to-GDP ratio and a technical authority that prepares the technical parameters of the negotiation, including the overall fiscal balances that are implied by the fiscal anchor. The overall wage bill is derived as a residual item after realistic projections are made on revenue and non-wage spending. Wage negotiations will only set the allocation of the wage bill between new recruits and wage increases. The outcome of negotiation cannot affect neither the wage bill itself nor the path of overall fiscal balances nor debt.

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