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THE EFFICACY OF MONETARY POLICY IN BELIZE

Monetary policy is associated with that portion of a country's overall economic policy which focuses on regulating the level and supply of money in an economy. Generally, the implementation of monetary policy measures is with a view to reducing and/or controlling the level of inflation, improving the balance of payments, achieving a certain level of employment and stimulating growth. Monetary policy falls within the purview of the central monetary authority wihich as 'overseer' of the financial system is equipped with a number of 'traditional tools' to influence economic variables.

Belize's experience with monetary policy can be divided roughly into two periods - the period prior to 1977 during which the central authority played only a passive role and the period since 1977 during which an attempt has been made to alter the power relationship between the central authority and the rest of the financial system. Placed in this context, one would judge that monetary policy and the use of monetary policy tools are relatively new to Belize and the past five years have been a period of experimentation.

The paper analyses the successes/failures of this period of experimentation. The effectiveness of policy decisions made during this period will be examined not only in terms of the impact on targets but also in terms of the institutional framework within which policy-makers have had to operate.

THE BOARD OF COMMISSIONERS OF CURRENCY AND THE ROLE OF MONEY

The Belize Board of Commissioners of Currency being

responsible for the issue and redemption of currency between 1894 and 1976 was theoretically, the first administrator of monetary policy in Belize. Although the Board had its peculiar characteristics, its basic structure was that of the currency board system which operated in many of the colonial possessions of Great Britain prior to the formalisation of a central banking authority.

One of the pecularities of the system operating in Belize until 1949 was that the Belize Board of Commissioners of Currency was administering a currency pegged to the United States dollar and the gold standard, unlike the rest of the British Empire where the currency being circulated was always linked to sterling. This relationship emerged first, as a response to the colony's [1/] rejection of the United Kingdom's silver coin which the Imperial Government attempted to circulate in its Empire in mid-nineteenth century and second, as a result of the growing trade between Belize and the United States. It was not until 1937 when the link with gold[2/] was severed and 1949 when the Belize dollar was linked to the British pound that the system more closely resembled that operating in the rest of the British Empire.

In theory, the Board of Commissioners of Currency was responsible for regulating the monetary system; in practice, it had no control over the supply of money. The legal delimitations placed on the Board's activities prohibited it from performing more than a passive role in the financial system. When the Board began to operate, it was under an obligation to issue the Belize dollar in return for U.S. 'current gold coin' and to redeem these notes in return for silver or gold. Two-thirds of the face value of the note issue had to be kept as gold to meet any

demand for redemption whilst the remaining one third could be invested. This system remained intact until 1937 when the passage of a new Ordinance now required the Board to issue and redeem the local dollar in return for the U.S. dollar on demand. Reserves could now be kept not only in U.S. dollars but also in the form of interest-bearing investments.3/ The Ordinance was amended in 1940 to allow for convertibility between the Belize dollar and sterling.4/ The break between the Belize and the United States dollars came at the end of 1949 when the Belize dollar was devalued and linked to sterling. In September 1949, sterling was devalued by 31.0 percent. Since the Belize dollar was pegged to the United States dollar, the devaluation had the effect of reducing the value of the Currency Board's sterling reserves in terms of Belize dollars and meant an amount of Belize dollars had to be replaced to bring the sterling investments back up to the level of currency in circulation. The loss in reserves together with the slump in the United States' exports from Belize and the growing importance of trade between Belize and the sterling area were all major factors in the decision to link the Belize dollar to sterling at the end of the year. Throughout these stages one aspect of the system remained prominent - the Belize dollar had to be backed fully at all times by gold, the United States dollar or sterling. This feature relegated the Belize Board of Commissioners to the role of a money-changing institution that could not use money to influence domestic economic policy.

Table I illustrates that for most of the period between 1960 and 1974 the Currency Board maintained the required sterling backing for the Belize dollar very easily, in most instances in excess of the required amount. The reserves were maintained in a Note Guarantee Fund. As

TABLE I

Ratio Of Reserves To Currency Liabilities Of The Belize Board Of Commissioners Of Currency

BZE $000

Year	Reserves	Currency	Reserves ÷ Currency (%)
1960	1,708	2,175	78
1961	2,267	2,983	76
1962	2,823	2,847	99
1963	3,328	3,048	109
1964	3,459	3,232	107
1965	3,892	3,522	111
1966	4,490	4,337	104
1967	4,594	4,339	106
1968	5,643	5,195	109
1969	6,102	5,755	106
1970	6,447	5,789	111
1971	7,150	6,106	117
1972	7,945	7,384	108
1973	9,423	8,435	112
1974	11,799	10,773	110

Source: Central Planning Unit - Annual Abstract of Statistics No. 4, August 1966

- Abstract of Statistics 1973 - 1974, October 1966

"Reserves" refers to the Board's holding of sterling notes and securities before interest earned on investments was transferred to the Note Guarantee Fund.

"Currency" between 1960 and 1965 refers only to the note issue. A different Ordinance covered the issue of coin until 1966 and coins were backed not by the Note Guarantee Fund but by General Revenue.

pointed out earlier, the Ordinance allowed investment in Government or Government-guaranteed securities in the United Kingdom and its dominions. In addition to being used to meet the Board's expenses, earnings from these investments were used to provide for any depreciation in the Note Guarantee Fund. With respect to Note Guarantee Fund one percent of the face value of notes being circulated was paid into the fund each year until it reached 110.0 percent of the current issue. If any surplus remained after the Board had met all its expenses, provided for depreciation, and contributed to the Note Guarantee Fund, this amount could be transferred to the General Revenue of Belize. Similarly, if a deficit existed even after contributions had been made to the Note Guarantee Fund, then General Revenue was liable to contribute the difference.

An element of flexibility was introduced into the Currency Board System when in 1958 fiduciary issue of Bze$350,000 was authorised. The failure of the Board to take advantage of the new opportunity to include local assets in its portfolio precluded it from ever becoming an agent of monetary policy. At the time the Board was permitted to purchase bonds, the upper limit was equal to about 15.0 percent of money in circulation. The amount authorised was raised in 1965 to Bze$1.0 million, allowing the Board to hold more than 25.0 percent of its assets in local investments. Over the next five years the Board did make use of the facility, purchasing the full amount in two instalments. By this time, however, the ratio of the fiduciary issue to currency liabilities had dropped to 17.0 percent. Apart from the fact that the amount authorised was not large enough to have any significant effect on money, the treatment of the purchases of the local bonds as "once-and-for-all" transactions meant that the Currency Board

never attempted to use this weapon to influence money supply.

In economies where the currency board system predominated, the agents of money supply control were the commercial banks and the state of the balance of payments.

The banks' influence on money stemmed from their credit creating function. Commercial banks create deposits by increasing their loan extensions. Normally, however, a portion of these newly-created deposits will be withdrawn from the commercial banks in the form of currency. For each unit of currency withdrawn by depositors, the commercial banks had to deposit the equivalent amount in sterling with the Currency Board. In addition, the country's propensity to import is also a major influence on the money supply. The propensity to import, in this case, indicated the extent to which currency withdrawals must be made from the domestic system for conversions into sterling to make payments abroad. Utimately, however, the level of the money supply hinged on the country's ability to acquire sterling.

Commercial bank advances rose rapidly over the period 1950 - 1975. From a low of $1.8 million, it leapt to $51.5 million. Initially the level of money supply was above the level of bank advances but by 1960 the situation had been reversed. Money supply over the entire 25 years, therefore, showed a less rapid rate of expansion than did bank lending. It may be inferred that a substantial amount of the credit created during this period went to financing imports. In an open economy, where production is mainly for exports, the propensity to import is extremely high. The trade deficit during the same twenty-five years jumped from $4.0 million to $38.8 million.

TABLE II

Credit Creation And The Trade Deficit

BZE $000

Year	Bank Advances	Money Supply	Trade Deficit
1950	1,845	3,038	4,026
1955	4,238	4,210	6,153
1960	6,100	5,275	7,538
1965	7,821	7,622	17,524
1970	28,140	9,620	24,277
1975	51,559	23,502	38,830

Source: Central Planning Unit - Abstract of Statistics.
Wyeth, Dr. John - "Belizean Economic History: A History of the Belize Board of Commissioners of Currency" Journal Of Belize Affairs, April 1979.

TABLE III

Sectoral Distribution of Loans

BZE $000

Year	1970	1971	1972	1973	1974	1975
Government Services	835	1,988	2,908	2,887	2,127	1,633
Public Utilities	1,121	1,294	2,032	2,728	3,140	3,101
Agriculture	12,821	12,490	15,632	16,218	19,109	19,993
Manufacturing	696	430	1,308	1,727	1,727	2,893
Distribution	4,904	4,117	9,601	9,783	11,651	14,270
Personal	1,879	2,306	3,638	2,969	3,275	3,313
Other	5,884	4,647	1,602	4,515	5,574	6,356
TOTAL	28,140	27,272	39,889	40,827	46,603	51,559

Source: Central Planning Unit - Abstract of Statistics

In such an economy, the commercial banks became a prime determinant of the direction and pace of development. They perpetuated the country's dependence on sugar exports by pumping the largest proportion of loans into this area while at the same time encouraging the growth of lending for the import trade. Although a detailed breakdown of the sectoral flow of bank is available for only the last few years of the Currency Board's operations, the pattern is quite obvious. In 1970, the agricultural sector (largely sugar) was the recipient of more than 45.0 percent of the banks' loans. By 1975, although bank lending had almost doubled, this sector was receiving only 39.0 percent. In contrast, the distributive sector (the area most associated with the import trade) raised its borrowings more than threefold, thereby increasing its share of bank credit from 17.0 percent to 28.0 percent.

THE MONETARY AUTHORITY OF BELIZE

The transition from the currency board system where the emphasis was on maintaining a currency issue fully backed by the sterling reserves of the Belize Board of Commissioners of Currency to a system in which an attempt was made to regulate banking behaviour in Belize took place with the passage of the Monetary Authority of Belize Ordinance, 1976 and the Banking Ordinance 1976. Banks were given specific instructions about their local operations [5/] and, for the first time, an institution was set up specifically to oversee these operations.

The issue of notes remained the primary function of the new institution. In addition the Monetary Authority undertook to 1) perform banking services for the Government, for the banks and other financial institutions 2) assure monetary stability and to promote monetary conditions

which are conducive to balanced growth 3) mobilise and maximise savings and optimise credit distribution 4) ensure that the operations of banks and financial institutions are consistent with Government's economic policy. To assist in its task of monitoring the financial system to ensure cohesion with general economic policy, the Authority was equipped with the traditional tools of monetary control including the ability to 1) conduct open-market operations 2) change the discount/rediscount rate 3) vary the reserve holdings of the commercial banks 4) vary the liquid assets ratio and 5) impose selective controls.

As banker to the Government, the commercial banks and other financial institutions, the Monetary Authority can extend credit facilities to these institutions either through buying and selling 'eligible paper' or through granting advances. The Authority can hold Government securities (presently treasury bills and debentures), inland and foreign bills of exchange, promissory notes and other instruments maturing within 180 days from the date of acquisition by the Authority.

The rate of interest at which the Authority lends to the public sector and the financial institutions is determined according to an automatic formula. The rate is two percent above the yield rate on Belize Government treasury bills, rounded to the nearest 0.5 percent.

The commercial banks must maintain with the Authority a minimum balance equal to at least 5.0 percent of their average deposit liabilities. 6/ The Banking Ordinance also provides for alteration in the level of and method of computing the minimum balance requirements. In addition, the banks must maintain a minimum aggregate holding of approved liquid assets which, on average, shall be no less than 20.0 percent of average deposit liabilities. 7/

The Authority exercises control over commercial bank loans directly through quantitative restrictions. In the first instance, the Authority can direct the banks to reduce their loans and advances by a maximum of five percent. Any directive issued may be an 'across-the-board' restriction on total bank loans or a selective reduction in various categories of loans and must allow the banks not less than ninety days to fulfil the requirement. Secondly, a commercial bank cannot extend credit to any one customer in excess of twenty-five percent of its capital and reserves without the prior approval of the Authority.

Regular dialogues allow the Monetary Authority to make informal suggestions to the commercial banks about the level and direction of, for example, their lending, deposit growth, reserves and interest rates.

EXPERIENCES WITH MONETARY POLICY

In setting the reserve ratios, the Monetary Authority aimed at protecing the solvency and liquidity of the four commercial banks operating in Belize. The nature of their operations in Belize precluded the banks from meeting the new requirements without significantly re-organising their asset portfolio. The banks maintained no fixed cash ratios and historically had kept their cash balances low. While the Authority hoped to provide a better safeguard for depositors' money, it was also interested in introducing the new clauses with as little disruption as possible. Compliance with the new requirements also posed another problem. Highlighted was the absence of a capital market, and consequently, the lack of a wide spectrum of local assets which were eligible under the new liquid assets classification.

The Authority responded to these short-comings by first, agreeing to grant advances to the banks to help them meet the minimum balance requirements, second using its prerogative to define certain assets as liquid assets and third, attempting to develop a local capital market.

In general, the new ratios introduced were aimed at influencing the extent to which the banks could mobilise existing liquid assets and to this extent they have been successful. Within two months of the Banking Ordinance becoming operative the commercial banks were able to meet minimum balance requirements without any accomodation from the Authority. From then until late 1979 the banks maintained their deposits with the Authority comfortably above the required 5.0 percent level without any support from the Authority.

The Monetary Authority also succeeded in getting the banks to diversify their asset portfolio. At the time the Authority began to operate, loans accounted for 81.0 percent of the banks total assets. By 1981 this figure had been reduced to just over 67.0 percent of bank assets. In addition to their balances with the Authority, the banks' holdings of Government securities maturing in ninety days are being designated as liquid assets. The re-organisation of the banks' portfolio is also evident in the sharp drop in the ratio of advances to deposits, particularly in the first two years of operation. Over those two years, deposit growth out-paced that of advances, providing quite a contrast to the Currency Board era when bank advances were always substantially above the level of deposits.

The implementation of the liquid assets ratio has been less successfull. The accomodation provided the banks by classifying certain

TABLE IV

Ratios Of Advances To Total Assets And To Total Deposits At Commercial Banks

BZE $000

Year	Advances	Total Assets	Advances ÷ Total Assets (%)	Deposits	Advances ÷ Deposits (%)
1976	64,053	79,259	81	61,290	104
1977	59,515	86,687	69	62,278	96
1978	64,996	103,576	63	79,316	82
1979	86,550	125,951	69	83,293	104
1980	91,892	143,754	64	94,143	98
1981	108,909	161,544	67	105,634	103

Source: Monetary Authority of Belize - Statistical Digest, March 1982.

loans as liquid assets was intended to be a temporary one, again to facilitate a smooth transition to the new requirements. The accomodation continues, albeit in a modified form. Using its prerogative to do so, the Authority first designated as liquid assets 80.0 percent of bank loans to the public sector and 10.0 percent of loans to the private sector outstanding as at December 31, 1976. Usage of this classification continued until January 1978 when it was replaced by 100.0 percent of loans to the public sector and 5.0 percent of loans to the private sector. Six months later, only loans to the public sector appeared in the special definition. The new classification introduced at the beginning of 1980 whereby only loans to the Banana Control Board and the Reconstruction and Developement Corporation, two statutory bodies were included under the special provision, is still being utilised.

The assessment that the Authority has had limited success with the implementation of restrictions on the banks' liquid asset holdings is based on three observations - 1) the proglonged usage of the category despite the initial intention that it would be temporary 2) the high percentage of total liquid assets which the special category continues to account for and 3) the fact that the commercial banks as a group would have been able to meet the requirement without the accomodation provided by this category and loans made by the Authority. Although when the Banking Ordinance was introduced in 1977 and the Authority allowed the banks to designate certain categories of assets as being liquid, it did not specify a time limit, the usage of the category was never intended to be more than transitory. The reclassifications introduced over the years are indicative of the contimued reluctance on the part of the commercial banks to adjust present banking practices. The reluctance is even more clearly evidenced in the fact that a large percentage of the banks' liquid asset holdings are still a part of the special provision. Except for a few occasions when it was superceded by treasury bills (and this normally occurred during periods when the banks were very liquid), 'Other Approved Assets' always formed the highest proportion of total liquid assets. The commercial banks as a group, and in many cases as individuals, would have been able to satisfy the twenty-percent requirement without the dispensation and without any other accomodation from the Monetary. In 1979 the commercial banks faced an acute shortage of liquidity following a too-rapid expansion in their domestic credit. The $12.8 million deficiency that would have occurred that year had the special category of assets been removed and had the banks not been able to borrow from the Authority is a reflection of

TABLE V

Commercial Bank Liquidity - Averages

BZE $000

Year Ending	1977	1978	1979	1980	1981
Actual Liquidity	21,719	27,569	21,948	25,945	21,043
Excess Liquidity (Actual - Required)	8,809	11,187	4,514	8,034	6,250
Approved Assets*	10,221	6,163	9,920	5,416	6,072
Approved ÷ Actual (%)	47	22	45	21	29
Loans From Monetary Authority	-	-	7,375	480	-
Net Liquidity	(1,412)	5,024	(12,781)	2,138	178

Source: Monetary Authority of Belize - Statistical Digest, March 1982.

*Assets other than these specified in the Banking Ordinance, 1976 as liquid assets.

the problem.

The introduction of the Banking Ordinance pointed to the need for the development of a local capital market. The commercial banks were in the habit of keeping their surplus funds abroad partly because of the absence of a requirement to hold balances locally, and more importantly because of the absence of suitable assets to hold. Attention was directed to this deficiency at an early stage. Initially, as an inducement to hold some of these surplus funds locally, the Authority paid the commercial banks interest on excess balances held in their accounts. With a view to stimulating the development of a local capital market, Government of Belize treasury bills were first issued in August, 1977. Since then treasury bills issues are made on a monthly rather than a quarterly basis

with the amount of bills outstanding at any point in time expected to be a reflection of the general liquidity conditions in Belize.

In addition to providing the commercial banks with local assets which they could hold, the treasury bills market serves as an easy and automatic financing for Government activities. At the beginning, only $2.4 million was issued in the new market. Since then, the total amount has risen to almost $17.0 million. Over that period too, the discount rate on treasury bills has steadily risen from a low of 5.91 at the end of 1977 to 12.2 percent at the end of 1981.

The subsequent re-organisation in banking behaviour that followed from the introduction of the new Banking Ordinance occurred with relative ease. The smoothness with which the introduction was made camouflaged the salient features of the economy which could inhibit the usage of the traditional tools of monetary control in influencing economic performance. Many of the constraints, however, have been highlighted in the period since mid-1979. The period since then has also given credence to the idea that given certain institutional characteristics of economies like Belize, the more direct methods of monetary control are likely to have the greatest impact.

In open economies with a high propensity to import and a high percentage of bank credit being directed into financing trade, there is a close association between the growth in bank credit and reserve losses. The skewed nature of Belize's production and export basis has perpetuated a situation of high dependence on imports and extreme vulnerability to fluctuations in international commodity prices. The sharp rise in payments for imports over the past five years, largely in response to spiralling oil

prices and the secondary effect on production costs is a reflection of this factor. On the other hand, commodity prices have not only been very unstable but any increases in these prices are normally outpaced by the increase in the prices of manufactured commodities. Table VI indicates that the period during which banks loans grew fastest (1978 - 1979 when the growth in credit exceeded 33.0 percent in contrast to the previous year when the increase was less than 10.0 percent) was also the period when the trade deficit rose by almost $37.0 million (in contrast to the reduction in 1978) and the period when reserves plunged from $25.0 million

TABLE VI

The Relationship Between
Credit Expansion, Trade Deficit And Reserve Loss

BZE $000

Year	Commercial Banks' Loans	Trade Deficit	Net Foreign Reserves
1976	63,928	-67,469	3,414
1977	59,515	-55,987	10,606
1978	64,996	-53,426	24,820
1979	86,550	-90,213	11,801
1980	91,892	-98,456[P]	13,794
1981	108,909	-106,449[E]	7,874

Source: Central Planning Unit - Trade Reports and Estimates.
Monetary Authority of Belize - Statistical Digest, March 1982.

P - Provisional
E - Estimated

to $12.0 million. Increases in bank lending and the trade deficit, coupled

with a depletion in reserves may not themselves be indicative of a structural deficiency if the financing provided by the commercial banks is directed into strengthening the productive base of an economy. In the case, however, where a substantial portion of the banks' credit continues to be channelled into imports of consumption goods, then a persistent or rapid deterioration in a country's reserves becomes a cause for much concern. This is the concern that faced the Authority in 1979 and the policy response was an attempt to get to the 'root of the problem'.

A combination of measures was introduced in late 1979 and the ultimate goal of reducing bank credit achieved within the specified time-frame. The problem faced in achieving this reduction focussed on the fact that the commercial banks in Belize are still affliates of large transnational corporations and while some modifications in their relationship with each other had been made, the banks continued to maintain strong ties with their Head Offices. Such ties restrict the use of the Authority's 'lender of last resort' prerogative as a policy measure. The banks had little difficulty financing their excessive growth in credit in early 1979 because of the large amounts of private capital inflows that began in late 1978 following Hurricane Greta and the settlement of claims by insurance companies. By the closing months of 1979, however, the commercial banks began to experience higher than normal liquidity strains and turned to the Monetary Authority for short term financing. Indications of a reluctance by the Authority to facilitate the banks over prolonged periods were greeted with a sharp rise in the commercial banks foreign liabilities. By the end of 1979, the banks' net indebtedness to their Head Offices topped $7.5 million compared with a net claim of $1.1 million at the end of 1978. So

long, as commercial banks can tap these overseas resources, any manipulation by the Authority of its willingness to lend the commercial banks cannot serve as an indicator to the banks of the direction credit should take.

Events at the end of 1979 also put pressure on the Authority's policy of maintaining stable interest rates in the domestic economy as a stimulant to promoting confidence and growth. For the first three years of its operations, it convinced the commercial banks to maintain the prime lending rate at 9.0 percent. During most of this period domestic rates remained above international interest rates. The pattern was reversed at the end of 1979 when rates abroad, particularly in the United States and the United Kingdom, rose to unprecedented levels, and the differential in favour of international rates widened. It is conjectured that the steep decline in reserves in 1979 was a reflection not only of the larger trade deficit but also of capital outflows to take advantage of high rates abroad. To help stem any leakages from the domestic system that may have resulted from the rate changes abroad and to help check the expansion in credit, the Authority allowed the prime lending rate to rise from 9.0 percent to 11.0 percent in early 1980. Two more changes in the rate occurred after that and by the end of the year the rate had reached 17.0 percent. The doubling of interest rates in 1980 is indicative of the inability of open economies to insulate against price changes.

Direct controls on money have a stronger influence on target variables than do the indirect or market-type instruments. With this in view, a five percent reduction was imposed on commercial bank loans at the end of 1979. The credit squeeze was applied 'across the board' and

the commercial banks were given three months in which to complete the reduction. Following the successful achievement of the target, the Authority urged the banks to continue their restraint. The fact that during 1980 the growth in bank loans was below 6.0 percent is an indication that the plea was heeded.

It is believed that in this instance, the quantitative control of total bank loans produced the same results as would have selective controls. The restriction was imposed at a time when borrowings by the sugar industry the banks' largest agricultural borrower, would have been slack and, therefore, did not serve to dampen activity in this area. In the distributive sector, on the other hand, borrowing tends to rise during the early months of the year as traders build their stocks. With the squeeze, credit to this sector remained stable over the first three months of 1981.

Changes in the level of foreign reserves of a country is one of the best indicators of the state of the balance of payments. As noted earlier, in open economies there is normally a high correlation between credit expansion and reserve loss. Where such credit originates in or is channelled through the commercial banks, direct measures, the most powerful being the quantitative restrictions, produce the best results in any attempt to stifle this loss. Where, however, this credit is directed into the public sector, the response must be different.

Increasingly, support for Government deficits are being sought on the domestic market. The creation of the Monetary Authority with special provision to extend credit facilities to the public sector and the commencement of a trade in treasury bills provided the Government

with an automatic and cheaper source of finance. Constant use of these additional facilities resulted in Government's domestic borrowing rising more than sixfold between 1976 and 1981 and its share in domestic credit jumping from 6.0 percent to 22.0 percent.

TABLE VII

Domestic Credit

BZE $000

Year	To Government (Net)	To Other Public Sector	To Private Sector	Total
1976	3,663	4,044	58,601	58,601
1977	7,756	4,385	54,798	54,798
1978	12,216	6,249	58,747	77,212
1979	12,628	8,126	76,469	97,223
1980	20,216	7,404	82,692	110,312
1981	29,234	8,797	95,946	133,997

Source: Monetary Authority of Belize - Statistical Digest, March 1982.

While the foreign reserve loss in 1979 could be traced directly to the expansion in bank credit to the private sector, the same could not be done in 1981 when the country's foreign exchange reserve plunged to $7.9 million. In the first instance, both the public and private sectors made fairly equal contributions to domestic credit expansions since 1979. Secondly, while the rate of increase to the public sector was exceptionally large, in the absence of information on the import content of the expenditure which credit to the public sector financed, one can only speculate about the role of the public sector in the reserve loss.

The tremendous rise in public sector borrowings, particularly

during 1981 was accomodated largely by the Monetary Authority. Large sales of treasury bills in the closing months of 1981 resulted in the Authority holding more than 85.0 percent of all bills outstanding. At the same time the Government for the first time, made full use of its ability to obtain temporary advances from the Authority. These large claims on the public sector, however, put pressure on the Authority's foreign assets and eroded its external asset position (The external assets ratio by year end bordered close to the legal requirement).

The experiences over the five years of its operations have highlighted a number of anomalies in the system with which the Monetary Authority is faced in trying to gain effective control over the monetary system. In addition, the Authority is faced with institutional constraints on the implementation of policy measures.

The anomalies in the system relate primarily to the confines of the Ordinances within which the Authority has to operate. There is, for example, a contradiction in the level of external assets which the Authority must maintain and the extent to which the Authority can create credit.

Over the past five years, the legal limit on the Authority's ability to lend to the Government has risen more than fourfold. In 1981, the amount topped $86.0 million. On the other hand, the Monetary Authority Ordinance also requires that the institution maintains external assets at a level equal to not less than 50.0 percent of its currency and demand liabilities; this in effect put an indirect restriction on the amount of local assets the institution can hold, given its total assets. Based on the imputed restriction on local assets, one can infer that at all times

TABLE VIII

Limits On The Authority's Lending
To Central Government

BZE $000

Year Ending	1976	1977	1978	1979	1980	1981
Required Holding Of External Assets	6,822	9,288	12,971	11,460	13,816	8,459
Required Holding of Local Assets*	8,037	11,879	19,885	20,373	24,458	30.527
Limit on Advances to Government	5,782	7,044	7,937	9,394	10,984	13,003
Limit on Holding of Government Securities	4,480	14,014	33,173	55,895	66,857	73,220
Total Limit on Credit to Government	10,262	21,058	41,170	65,289	77,841	86,223

Source: Government of Belize - Estimates of Revenue and Expenditure

Monetary Authority of Belize - Quarterly Review

*Required Holding of Local Assets = Total Assets - Required Holding of External Assets.

the amount of credit creation legally allowed was excessive. The total credit the Authority could create rose rapidly and by 1981 was almost three times above the level of local assets the Authority could hold. The anomally, on the other hand, proved to be an indirect check on too rapid an expansion in the Authority's credit to Government. With the external assets ratio hovering close to the legal minimum and with the Authority's advances to Government reaching the maximum, the Authority for the first time had to suspend its trading in the treasury bills market.

The treasury bills market is synonymous with the local capital market and, to this extent, is an indication of the narrowness of the capital

market. Despite the designation of other commercial bills as liquid assets and dialogue between the commercial banks and the Authority regarding the development of a trade in these bills, there has been no positive step in widening the market. The narrowness of the market is depicted not only in terms of the securities being offered but also in terms of the number of participants. Normally trade is between the commercial banks and the Authority, who, together tend to hold at least 90.0 percent of all bills outstanding. It is argued that in countries with a very narrow capital market, limited usage can be made of the rediscount rate to influence credit levels. In this situation large purchases or sales of these securities by the central authority cannot occur without a significant impact on security prices.

The Authority is also operating in an environment in which the commercial banks still have reasonably easy access to overseas funds. This factor impedes the successful usage of the 'lender of last resort' facility to influence credit levels. In the case of the commercial banks, the access allows the banks to ignore any reluctance on the part of the Monetary Authority to lend as a signal of the need to restrict their lending practices. So long as this access continues too, the Monetary Authority's in-built restriction on lending to Government will not necessarily serve as a stop-gap to lending to the public sector. Since the Government has found it increasingly difficult to borrow from the Authority, its borrowing from the banks has risen sharply with a large portion being financed through the banks' Head Offices.

The extent of the banks' easy access to capital markets overseas also prohibits the implementation of an independent interest rate

policy. Movements in interest rates, are normally more defensive than regulatory. In 1979 commercial banks' interest rates rose for the first time in three years and was in response to the high rates being paid abroad. Since then the interest rates have risen several times - all responsive to interest rate changes in the large industrial economies.

Open economies are hard pressed to cushion shocks occurring internationally. The high import content of both consumption and production has created a situation in which monetary expansion in the domestic economy is not necessarily the best indicator of the rate of inflation. It is believed that the high rate of inflation (roughly estimated at over 15.0 percent for 1981) is a reflection primarily of the impact of spiralling oil prices on international prices and the secondary effects on the cost of Belize's imports. The effects are also transmitted to the costs of producing commodities for exports, rendering these products less competitive in the international market where commodity prices tend to be generally low. Policy aimed at controlling the rate of monetary expansion to dampen domestic price increases becomes less potent in this environment and could only serve to aggravate recessionary forces within the economy.

CONCLUSION

The Monetary Authority has taken a very cautious approach to monetary policy over the past five years. With a view of not upsetting the status quo, the Authority has depended, to a large extent, on informal discussions with the Government and the commercial banks as a means of indicating to both institutions the direction which economic variables, particularly domestic credit should take.

The Authority has also had to operate within the confines of

the structural rigidities Belize faces, the most significant being the openness of the economy and, linked to this, the susceptibility of domestic activity to external factors. In the face of these constraints, the most direct controls on monetary variables tend to be the most effective in influencing economic behaviour. The successful implementation of monetary policy measures, however, presupposes not only that the instruments of control will be adapted to suit the environment in which they operate, but also that there will be a close inter-relationship between monetary and other areas of public policy in determining the path development should take.

FOOTNOTES

1. Belize was a British colony until September 1981 when it became independent. The colony changed its name from British Honduras to Belize in 1973.

2. The formal obligation to convert the Belize dollar into gold remained in force until 1939. However, the United States dollar was widely acceptable and, therefore, there were few requests for gold in exchange for the local currency.

3. One of the problems with keeping reserves in gold is that gold is non-interest bearing. This meant only one-third of Board's reserves previously earned interest (the gold portion did earn some interest after 1918 but the amount was not large). Most of the burden to meet the Board's expenses therefore fell on the small interest earning portion.

4. The amendment allowed Royal Bank of Canada branch in London to be agents for the B.B.C.C. The sterling equivalent of Bze$3,000 was deposited in a Special Sterling Account in London. When Belize dollars was presented in redemption for sterling R.B.C. credited the account with sterling and debited it with Belize dollars. Similarly, if sterling was presented in redemption for Belize dollars. In this way, the account held by R.B.C. for B.B.C.C. was balanced by the Currency Commission's liabilities to the branch of Royal Bank in Belize and supported by an account opened with the latter for this purpose.

5. Banks were first given specific instructions with the passage of the Banking Ordinance 1963 and in many ways the new banking ordinance was an extension of the 1963's. Interestingly, while the 1963 Ordinance contained a clause about the banks' liquid assets holdings, the clause was inoperative since it exempted all banks classified as 'scheduled' banks (and all the banks in Belize were scheduled banks).

6. The minimum balance is computed using the average of the amounts outstanding to the account with the Authority as at the close of business on each day. The average deposit liabilities is determined by taking the average of bank deposits as at the close of business on the four consecutive Wednesdays ending with the penultimate Wednesday of the preceding month. The Monetary Authority may vary the minimum balance upto a maximum of 20.0 percent provided that any increase does not exceed two percentage points in any period of thirty days and provided that thirty days of a change in the proportion is given.

7. In calculating the banks' required holding of liquid assets, the average deposits is determined in the same manner as with the

7\. minimum balance requirements. The banks' holding of liquid assets is the aggregate amounts of such assets held at the close of business on the last working day of each week. This proportion may be varied upto a maximum of 35.0 percent of average deposit liabilities provided that any change in the proportion does not exceed five percentage points in any period of thirty days and provided that the banks are given thirty days notice.

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