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THE INTERAMERICAN MANAGEMENT CONSULTING CORPORATION

POLICY PRIORITIES FOR BELIZE

By

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FOR
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SUMMARY

The general policy position of AID/Belize is to assist the country to achieve self-sustaining economic growth in the long run. AID will continue to endorse the policy reforms, initiated over the past five years, that have brought considerable progress in monetary and fiscal matters, improved efficiency within the Belizean economy and brought the private sector into the mainstream of the country's growth. During the new CDSS period, policy initiatives will be taken to:

1. modernize and reform the Belizean tax system,
2. protect Belize's environmental resources.

These policy thrusts will be supplemented by projects designed to remove constraints to growth, particularly in the agricultural and tourism sectors.

The current tax system is antiquated. It relies heavily upon taxes on international trade which are widely recognized as damaging to efficient resource allocation. Other problems include a system of import duties that may not serve Belize's development interests, tax avoidance and myriad exemptions and exceptions. The GOB has requested assistance in developing a policy on tax reform. Furthermore, tax reform complements other reforms achieved over the past five years.

Environmental protection is also a question of efficient resource allocation. Belize's natural resource base is the main determinant of its comparative advantage and the pillar of the country's dynamic sectors, particularly tourism and agriculture. Deterioration of the environmental base would shift resources away from those sectors. Also, environmental protection is related to tax reform since specific taxes and user fees may be useful in making those who use environmental resources feel the cost of maintaining them.

The policy dialogue over the next five years differs from that of the past. With the termination of the ESF program AID/Belize will no longer have the leverage that it once had. Persuasion and logic must play the role that cash transfers once

played. Other leverage exists. AID will focus its projects in the agricultural and tourist sectors which will match the priorities set by the GOB. AID will continue its road projects, also a priority area for the GOB. It is felt that by focussing projects on the areas of interest to the GOB, AID can gain some leverage in helping the GOB meet its own stated goals. It is also felt that the GOB is very receptive to considering tax reform. Tax reform can have political appeal if it can be demonstrated that an efficient tax system can be designed which allows revenue to grow as the economy expands without having to tinker with the rate structure every year. An efficient tax system can also improve upon the investment climate and provide some automatic stabilization over business cycles. Thus, leverage associated with AID projects will be directed mainly toward promotion of progressive policies on environmental matters.

POLICY PRIORITIES FOR BELIZE

It is the policy of AID/Belize to assist the country to achieve self-sustaining economic growth in the long run. AID's strategy is to help the Government of Belize (GOB) develop the capacity to rationally plan and manage its resources to effectively guide economic growth, while addressing key constraints to growth. The strategy, and that of the GOB, is based upon private sector activities, motivated by conditions and policies promoting efficient resource allocation.

1. PRINCIPLES OF POLICY FORMATION

Development policy in Belize, as elsewhere, should be as comprehensive as possible. Policy should be "macro" in character, setting the overall economic environment within which the country, or entire sectors operate. This is particularly important where growth is based upon private initiative. Primarily, policy should be designed to create the conditions under which private parties see and feel the economic incentives which promote efficient economic behavior. A secondary part of policy design is to identify and remove constraints that would normally block efficient economic behavior. Removal of constraints can only bear fruit if the overall conditions are appropriate. For this reason, AID/Belize has in the past, and will in the future, emphasize broad-based, macro-policies designed to create conditions appropriate to market-oriented economic growth. As a supplement to this, AID/Belize will continue to support a number of projects that have been identified to remove constraints standing in the way of progress.

Over the past five years, AID/Belize has been instrumental in assisting the GOB in identifying and pursuing macro-economic policies that have not only relieved many of the economic problems facing the country, but have resulted in considerable prosperity. The financial support and leverage of the ESF program has helped install monetary and fiscal policies that have

worked so well that they may be envied by other developing countries. AID/Belize's influence has been instrumental in removing many of the economic distortions plaguing the Belizean private sector and AID projects have significantly reduced the constraints to economic progress. Results have come in the form of budgetary balance, monetary stability, export growth and diversification and a growing economy.

Some problems remain. First, recent growth has been led by significant export expansion and diversification, but the expansion and diversification that has occurred is not secure. The four main goods exports, sugar, garments, citrus and bananas all rely upon trade preferences¹ offered by either the U.S or U.K. Major changes in these preferences could severely affect Belize's export performance. Only tourism is based, in a non-preferential way, upon Belize's international comparative advantage. Thus, one cannot assume that because Belize has grown well in the past four years, that growth is now self-sustaining. Therefore, policy should continue to focus on the macro conditions that are conducive to long-run, diversified growth. Such policies would serve Belize well should the current engines of growth falter, and should they persist, they will be stimulated by an ever more favorable economic climate. Second, significant economic distortions remain, mainly associated with tariffs and other taxes on trade, but also stemming from the

¹ Sugar's price problems are well known and Belize is heavily dependent on it's share in the U.S. sugar quota (which was cut in 1985) and in quotas offered by the EEC (which now predominate the market for Belizean sugar). Garments are offered preferential treatment in the U.S. under the CBI. Also, Belize is not well diversified within the garment industry. One manufacturer accounts for most of the country's garment exports. Citrus production (mostly citrus concentrate) receives special treatment in the U.S. under CBI. Free trade in citrus concentrate would probably eliminate Belize as a supplier to the U.S. Banana exports have boomed in the 1984-88 period, but these exports are based upon U.K. preferences offered under the Lome Convention. The future of these preferences is in doubt owing to the changes due within the EEC in 1992.

administrative controls on trade that have not yet been removed. Removal of these distortions is no small matter since over 60% of Belize's tax revenue is generated by these taxes. Yet, without their removal, Belize can make little progress in developing efficient, market-based economic activities. Third, environmental deterioration could threaten Belize's growth. Tourism is expected to continue to grow rapidly, but this expectation is based upon the assumption that the things that attract tourists to Belize will remain as they are. Uncontrolled settlement of Belize's interior and exploitation of its fishery also threaten the long-run production that is expected to be based on these resources. How Belize employs its unique environmental endowment is a major question for the country's efficient resource allocation.

In choosing the policy thrusts to be emphasized over the next five years, AID/Belize faces a substantially different task than the one facing the framers of AID policy in the last CDSS period. In 1984 AID/Belize could count on the considerable leverage offered by the ESF program to influence policy reform that the GOB might otherwise be slow to adopt. Now AID/Belize must identify a policy position which can best be influenced by persuasion and logic, yet choose policy areas that are of significant importance in achieving overall policy goals of self-sustained growth. Indeed, in making this choice we have kept in mind the policy interests that the GOB has expressed as well as the relative scarcity of GOB resources for pursuing their interests.

For these reasons AID/Belize has identified two major policy thrusts to be pursued over the next five years. These are:

1. modernization and reform of the Belizean tax system,
2. protection of Belize's environmental resources.

These major policy thrusts will be supplemented with projects that are selected to relieve constraints that are deemed to be holding back progress for the Belizean economy. Projects will focus on constraints most closely associated with:

1. agriculture,

2. tourism.

The GOB has expressed interest and requested assistance in both tax reform and environmental policy. It has also placed its own priorities on the promotion of agriculture and tourism, priorities with which AID/Belize agrees. It is therefore felt that projects in agriculture and tourism can best be used as leverage to achieve overall policy improvements in the tax system and in environmental policy.

2. MODERNIZATION AND REFORM OF THE BELIZEAN TAX SYSTEM

Why focus on the tax system? Over the past five years, AID/Belize has consistently supported macro policies designed to reform Belize's fiscal and monetary system, and advocate creation of an environment that promotes economic growth based on private sector initiative. Many, if not most, of the hoped-for policies have been put in place and those that have not are still moving toward their targets. We continue to support the GOB and the private sector in pursuing the policies put in motion in the past few years. To do only this would show little initiative. There are still major barriers to efficiency in Belize, despite the successes of the past five years. Of the barriers to efficient, private-sector production, we have identified the tax system as the factor remaining which is both broadest and potentially most damaging. In addition, it is an area in which the GOB has requested assistance.

Over the past five years the proportional makeup of tax receipts of the central government were approximately:

Income taxes	22%
Property taxes	1.5%
Taxes on goods and services ²	13%
Taxes on international trade	61%

It is common that small countries at early stages of development rely heavily on taxes on trade, but as the fiscal systems of

² Excise taxes on spirits, beer, cigarettes, soft drinks, entertainment and a hotel tax.

countries develop, taxes on trade fade in importance and other, more efficient taxes take their place. Compared to other countries at the same level of development, or compared to other caribbean countries Belize is much more dependent upon its taxes on trade.

The Belizean tax system was not planned. Rather, the system evolved into its current form in a rather ad hoc manner. Import duties established by CARICOM were adopted by Belize when it became a member. The common external tariff (CET) of CARICOM was established to promote import substitution in the Area. Duties are highest on finished consumer goods, lower on intermediate goods and lowest or non-existent on inputs and capital goods.

Belize has added two additional duties to the common external tariff. When Belize joined CARICOM its pre-existing duty rates were higher than what was eventually adopted as the CET. By agreeing to the CET, Belize would have suffered a revenue loss had it not imposed additional duties. Thus, an import surcharge called a Revenue Replacement Duty (RRD) was added. The RRD varies depending upon the item imported. In addition a stamp tax (currently 12%) is levied.³ In theory, the stamp tax is applicable to all goods of specified types no matter the origin. However, because the stamp tax applies to goods which are not produced in Belize, it amounts to an import surcharge. The effect of the stamp tax and the RRD is to raise the tariff equivalent of the combined taxes to rates considerably above those of the CET.⁴

³ The history of the stamp tax illustrates the ad hoc nature of the Belizean tax system. When first introduced the stamp tax was 5% of the value of the item taxed. Since then the rate has been changed to 6% then, 8% then 10% and most recently 12%. In every case, adjustments in the rate were motivated by a need to raise revenue and not because the stamp tax was considered to be a good tax.

⁴ Members of CARICOM can add certain surcharges to the common external tariff without violating their agreements. The CET was designed for "protection" and not for revenue. Member countries may add duties for revenue purposes. This distinction is economically irrelevant.

Taxes on trade are particularly distorting. They are typically not found in countries that have been successful at exporting and growth. Currently these taxes constitute over 60% of Belize's tax revenue, and that proportion may be rising. The main distortion arises because of the tariff structure. Since the structure of the CET places higher tariffs on final goods and lower tariffs on inputs, the level of effective protection is higher than the level of the nominal tariffs.⁵

While important economic distortions are introduced into Belize because of the high taxes on imports, the distortions become aggravated by Belize's attempts to give duty exemptions as an investment incentive. Since duties are so high in Belize many investments, particularly for export production, look unattractive. To improve the attraction, Belize offers duty exemptions to some investors. In doing so, effective rates of protection for production in the domestic market are raised even higher than they would be under the standard tariff rates. The distortion is complicated by the "competition" of firms operating without concessions along with those that have concessions, both operating in the same market. The system of so called "development concessions" is an important issue in Belize precisely because of the high taxes on traded goods. If there were no taxes on imports, or if they were at modest levels, the granting of development concessions would be a minor issue.

For a tax/expenditure system to be non-inflationary, taxes should reduce expenditure by the parties being taxed by the same

⁵ Effective protection refers to the protection afforded domestic production activities. If goods are produced domestically with imported inputs that come in duty-free, but the final good is protected by a tariff then the effective protection of the production carried out domestically is higher than the tariff rate on final production. For example, assume there is a 50% duty on the value of a final good. If the good is produced domestically by importing 80% of the inputs, only 20% of the final value of domestically produced goods is domestic value added. The protective effect of the 50% tariff on the final good provides 250% effective protection for the part of production (20% of the total) done domestically.

amount that public expenditures expand. In general, one would prefer taxes which do not have an adverse affect on production, and/or taxes which fall more on consumption than savings. In order of their adverse effect on production, taxes on trade come first. The order would be:

- taxes on trade,
- excise and sales taxes,
- income taxes,
- consumption taxes.

It is generally best to seek a small number of broad-based taxes rather than a large number of narrowly applied taxes. Not only is there a payoff in terms of economic efficiency but a few broad-based taxes impose a much lighter administrative burden as well. Taxes on inputs (eg. on imported inputs) are much more destructive of production than taxes on income; taxes on consumption are better yet, for they remove purchasing power at the same rate that the public sector gains purchasing power, without inserting a point of inefficiency into the production process.

Belize does have an income tax, which generates about one fifth of the central government's revenue. However, indications are that the income tax net is very weak. An IMF study (1986) indicated that in 1983 only 7792 individuals filed income tax returns. The World Bank put the Belizean labor force at 51,000 in that year. If we assume that one third of them are agricultural workers who can easily escape the income tax net and that one third of those remaining are either too poor to pay tax or are unemployed, we still would have about 23,000 people who should have filed tax returns in 1983. In fact only about 34% of them did⁶. While examining the company income tax returns, the IMF

⁶ We could assume further that all public employees file income tax returns. In 1983 there were about 3,000 public employees. Thus, of the 7792 returns filed, only 4792 were filed by private sector employees. But, there were approximately 20,000 who should have filed. Apparently only about 24% of private

pointed out that only 7% of registered companies filed returns. The IMF examined all returns filed by companies in 1983. There were only 85 of them. Of these, 72 did not have concessions that relieve them of tax liability. Of those only 32 paid any tax at all! Clearly, there is much to do in administering the income tax.⁷

A brief empirical review of Belize's tax revenues, which appears in Appendix A, indicates that the system may be becoming more dependent on trade taxes as time goes on. Also, trade taxes may be taking in too much revenue as income expands. This could easily encourage excess public expenditure and could act as a brake on economic development even ignoring the effect that trade taxes have on efficiency.

A better tax system for Belize is easily imagined. Such a system would depend much less on taxes on imports, and import duties that remain should be at much lower rates and more uniform across categories of goods. There should be no taxes on exports. Greater emphasis should be placed on income or consumption taxes. The income tax should be simplified⁸ and broadened. Consideration should also be given to taxes based on consumption, such as a value added tax or an expenditure tax. In the case of any tax it should be broadly based and apply with very few exceptions or adjustments. AID/Belize does not now take a position on what taxes should be employed in Belize, for

sector employees who might be expected to file did file. These assumptions would require extreme adjustments before one would reverse the conclusion that the Belizean income tax net is rather weak.

⁷ No studies of Belize's tax system are available which are newer than the IMF's 1986 study. However, there is no obvious indication that the situation existing then has changed.

⁸ Some simplification has already occurred. In January, 1989 the threshold above which taxes are paid was raised from BZ\$5,000 to BZ\$7,000, eliminating 6,000 low-income taxpayers. The number of tax brackets has been reduced from 12 to 4 and the range in rates from 5-50%, to 15%-45%.

studies of this remain to be done.

Several important problems for tax reform exist in Belize.

1. A shift away from trade taxes risks a loss of revenue that Belize may not be willing to take. Belizean policy makers have worked hard to get the country's revenue/expenditure balance in order and would probably be unwilling to risk returning to the deficits and budget cutting of years recently past.
2. Tax administration is weak and will probably remain so. To some extent this can be overcome with technical assistance, but a more realistic solution lies in designing easily enforced, broad-based taxes. Nevertheless, poor administrative capabilities will remain a feature in Belize.
3. CARICOM will continue to be seen as an obstacle to tax reform.

Despite these problems there are possibilities for reform and it is certain that detailed research will reveal others. The income tax structure is being improved but as yet little is being done to extend its coverage to more taxpayers. Indeed, the recent reforms imply a reduction in tax revenues in the short run. Several important kinds of consumption-based taxes have never been considered for application in Belize, such as the value-added tax or an expenditure tax. Property taxes seem to be very underused and more efficient sales taxes could easily be envisioned. User fees are not common in Belize and may play an important role in connecting those who depend upon Belize's environmental resources, roads, ports, etc. with the services required to keep those resources intact (more on this below). Finally, there may be important ways in which Belize can respect its agreements within CARICOM and still adjust its taxes on trade. Other CARICOM countries (eg. Jamaica) are adjusting their import duty systems despite the CET. Also, in Belize, elimination of the stamp tax and RRD on trade would go a long way toward reducing the distortions due to trade taxes without changing the

CET. Indeed, a great number of alternatives are available which have never been considered in detail, but which seem reasonable to consider in the Belizean case.

AID/Belize will support a policy of tax reform over the next five years. The objective will be to move Belize from a tax system that came about for largely ad hoc reasons, to a system designed for economic efficiency. The policy will emphasize moving away from dependence on taxes on trade and movement toward taxes that are more neutral in their economic impact. In pursuing this policy AID/Belize will continue to support the efforts of the GOB to maintain the fiscal and monetary discipline that they have achieved over the past five years. One of the main factors that allows us to now consider tax reform is that other, more pressing problems have already been attended to. Without the monetary and fiscal balance that now exists in the country, tax reform would achieve little.

The timing is particularly good for pursuing a policy of tax reform. No major crisis now exists and incremental change can be introduced in a non-disruptive setting. There are encouraging signs that policy makers are receptive to tax reform and have indeed sought AID assistance in this area. Policy makers are also particularly well placed to attempt change, for they have dealt successfully with the crises of the recent past and have brought an encouraging growth pattern to Belize. The series of events that may accompany a reasonable tax reform policy is as follows⁹:

⁹ Some may think that the schedule that I have laid out is too leisurely. Elections will occur in Belize prior to March, 1990 and a new government will be installed shortly thereafter. Not much progress could be expected until after elections and after any cabinet reshuffling occurs. Much of tax redesign will hinge on the results of the income and expenditure survey scheduled for 1990. It is optimistic to think that the survey results will be fully available before very late 1990. Also, AID does not have strong leverage to apply promoting tax reform. Promotion must be done by careful reasoning and persuasion which may occur slowly. In addition, the economy of Belize is a fragile one, though recovering nicely for the moment. Caution should be applied to ensure that recovery continues and that tax

1989-90: Changes in the income tax were made in 1989 which will imply a decline in revenue for 1989 and 1990. Thus, one would not want to introduce other reforms until the importance of this revenue impact is seen. However, studies are required on the current tax system in Belize, and this period can be used for that purpose.

1990: This is a census year and AID is assisting Belize conduct an income and expenditure survey concurrent with the census. Normally, tax reform requires an income and expenditure survey as the basis for tax design. Belize is fortunate that this survey is being done anyway, so little extra cost will be involved in obtaining the information for tax design. Effort should be spent ensuring that the income and expenditure survey solicits the information needed. The year should also be spent gaining familiarity with the tax reform experience of countries that are in some ways similar to Belize (eg. Jamaica, Dominica, Granada). Much of the experience of these countries will have some applicability to Belize. Finally, 1990 can be used to improve upon the administration of the income tax which was modified in 1989.

1991-92: Alternative tax systems for Belize can be designed and recommendations for reform made. This takes advantage of the results of the income and expenditure survey of 1990.

1993-94: Introduce reforms. Obviously, the introduction and timing of reform will depend upon what reforms are recommended.

The policy dialogue on tax reform will be very different

revenue sources are protected as reforms occur gradually.

from the dialogue occurring over the past 5 years. Progress on achieving monetary and fiscal reform and in reducing economic disincentives in Belize was conducted in the context of the ESF program. The leverage applied by AID was clear to all concerned. Indeed, the leverage of the ESF program was instrumental in bringing about important changes in the Belizean economy.¹⁰ Without an ESF program persuasion and analysis must play the key role. Without the leverage of ESF, the dialogue per se becomes most important. Fortunately, policy makers in Belize seem receptive to modernizing their tax system. AID has received requests for technical assistance on tax reform. Since no apparent economic crisis currently afflicts the country, conditions are ideal for a gradual tax reform that does not overly threaten revenues. Some revenue protection can also be forthcoming from AID-funded efforts to privatize the financing of activities that have been paid for by the public sector. AID's health care financing activity is an effort along these lines. Furthermore, it is likely that studies will indicate that sources of revenue can be found that are politically and economically less disruptive than the heavy taxes on trade and that security in the source of revenue will be a characteristic of reform that Belizean policy makers find attractive. AID involvement in a policy dialogue can use several points of departure. These include:

- o projects such as the health care financing activity can be offered as a means to relieve the pressure on current revenues as well as an example of getting recipients of services "feel" the cost of the services. Projects of this type are like tax reform in that they are designed to improve upon efficiency by "getting the

¹⁰ Most notable was the impact of conditionality associated with the removal of price controls and many administrative controls on imports. Without specifying that price controls and QRs on imports must be substantially reduced before ESF funds were disbursed it is unlikely that much change would have occurred.

signals right". There may be some leverage associated with these projects as well since they can reduce some revenue concerns.

- o help in implementing the income tax changes of 1989.
- o comprehensive details on the impact of the current tax system can be developed during 1990,
- o The 1990 income and expenditure survey design is already under way with AID support.
- o Analyses of the income and expenditure survey can be used to analyze alternative tax systems for Belize and "test" the likely effects of implementing any of the alternatives. This could occur primarily during 1991.
- o During 1991 and 1992 the Belizean government can be brought into a dialogue about the advisability of alternatives once they are well specified. At this stage careful attention will be paid to Belize's revenue concerns and to the experience of other countries with tax reform.
- o During 1992 a strategy for implementation can be developed.
- o Implementation could occur during 1992-93. Elements of strategy, administrative requirements and scheduling will remain to be worked out.

3. PROTECTION OF BELIZE'S ENVIRONMENTAL RESOURCES

The environmental policy envisioned by AID/Belize has similar objectives to those sought by the tax reform policy. We have focused on tax reform largely because of the resource allocation improvements that may be made. For the same reason we focus as well on the protection of Belize's environmental resources. Furthermore environmental policy is closely related to tax policy. Belize currently levies few user fees on those parties who may, by their economic activity, impose an environmental cost on Belizean society. In many cases in other countries, user fees and other forms of tax are used for environmental protection. To the extent that they could be used

in Belize, these taxes and fees should be integrated with a general overhaul of the Belizean tax system. While environmental protection and preservation may be done for reasons extending beyond purely economic considerations, the latter will be stressed by the policy pursued by AID/Belize.

Objectives of environmental policy should include:

- o Promotion of self-sustained growth. Many of the dynamic sectors in Belize would be severely damaged by significant environmental deterioration. Tourism is almost entirely driven by Belize's natural endowments. Fishing, timber and many agricultural pursuits are also dependent on maintenance of reasonable environmental quality.
- o Diversification of exports. Environmental deterioration can cause the basis for an export to deteriorate as well. The obvious example is in tourism (the export of a service). People visit Belize for its natural attractions. Should those attractions disappear, tourism would decline and Belize's export base would become more concentrated. Since generally, Belize's comparative advantage lies in its natural resource base, maintenance of the environmental conditions surrounding that resource base promotes the diversity of activities associated with Belize's natural resources.
- o Improvement on efficiency. An efficient environmental policy should "internalize" the "external" costs of development. Often an economic activity imposes costs on society at large, but in a context where the economic actor imposing the cost does not have to "pay" for those costs. A polluting activity is a standard example, but so is overfishing, overcutting of timber, and so forth. Under these circumstances, efficiency is improved if the economic actor is forced to pay for the external costs that he imposes.

It is this latter aspect of environmental policy that integrates it with tax reform. Externalities are normally "internalized" by charging a tax to those parties responsible for the external impact. The tax is supposed to be designed to reflect the cost of externalities (eg. pollution, destruction of forests, etc.) so that economic actors feel the true costs of their activities. Tax revenues generated in this way may then be dedicated to the correction of whatever environmental damage occurs. Since one of the principles of tax design is to keep things simple, one would not want unnecessarily to proliferate a great number of special taxes. Thus, care should be taken during the course of tax reform to make sure that whatever taxes and charges are instituted to protect Belize's environment, that they are most compatible with the general system of taxes being proposed. Furthermore, it should be guaranteed that taxes collected for this purpose are actually used for the purposes for which they have been collected.

The timing for developing the environmental policy is also particularly good. Tourism has "boomed" in the past few years. Belizeans are beginning to recognize that the carrying capacity of its traditional tourist pursuits is reaching its limit. Further development in the traditional areas is in danger of causing deterioration in the conditions facing everyone. Also, tourism has shifted its attention (in part) from the cays and reef to the interior. Many people visit Belize for its unique interior ecology. But that ecology is a fragile one and its carrying capacity unknown. Other environmental problems have also surfaced of late. The fishing industry is beginning to suffer a deterioration in the quality of their catch due to overfishing, thereby threatening what would otherwise be a growing export sector. Immigration, much of it illegal, to forested areas in Belize, have increased damage done by slash-and-burn agriculture. Since much of the country's export growth is expected to come from the land (as it has in the past) greater care must be taken to protect Belize's land resources.

Some of the milestones that we can see in the pursuit of a policy to protect Belize's environmental resources include:

- 1990-91 Inventories of environmental needs and carrying capacity of important resources such as those supporting tourism, fishing, agriculture and timber. A Land Resource Survey, supported by the U.K.'s ODA is scheduled for completion in 1991. A Tropical Forest Action Plan, supported by FAO has been completed.
- 1992-93 As part of tax reform and tax system design, include consideration of a system of user fees and/or taxes designed for environmental protection.
- 1993-94 Implementation. Some measures will probably be implementable separately from tax reform. Indeed, AID is already active in institution building in the areas of Agriculture, forestry, fisheries and tourism. Others measures will be part of tax reform and must be integrated with it.

The policy dialogue on environmental protection suffers from one of the same difficulties as the tax reform dialogue: a lack of leverage on the part of AID. Benefits from a program to protect Belize's environmental resources may be more difficult for GOB officials to "see", especially if they view user fees as an obstacle to the development of specific activities. Also, unlike with the tax system, GOB officials are not used to thinking in environmental terms. The need for revenue causes a continual focus on taxes and so tax problems are familiar. Environmental problems are not always evident and in many cases can be ignored, at least for a while. Thus, the policy dialogue on the environment will require a greater effort to build awareness than is required of the dialogue on taxes.

The design of the policy dialogue on environmental matters requires more development. The number of possible interventions for environmental protection in Belize, as elsewhere, is very

large. AID/Belize must identify which areas of environmental concern are critical in Belize. From that identification a series of projects can be designed to promote effective environmental management. Currently the policy dialogue design is underway. AID/Belize is now active in identifying problems of efficiency, resource management, regulation and protection in key areas. This activity is focussed on the forestry, fishing and tourism sectors. The work that is underway will identify the specific key concerns that will eventually become the object of several AID projects. Project design must await the outcome of the identification process.

In some cases, AID/Belize already has projects that may be used to exert leverage. When project-related leverage can be applied, it will be directed toward pursuing an environmental protection policy. It is our assessment that the awareness and interest that the GOB already possesses with respect to tax reform will induce them to pursue progressive policies in that area without the exertion of much leverage. The task of building an environmental policy is somewhat more difficult and something more than simple information may be needed.

One element of leverage is the AID roads program. Indeed, the roads program is the most tangible item planned by AID which could be held out as the "carrot" to the GOB for taking progressive steps on the environment. The GOB has stated its intention to build and upgrade the country's road network.

Other than roads, AID/Belize has chosen to focus its projects in the areas of tourism and agriculture. The reasons for this are several. First, these are the areas that the GOB has committed itself to as their highest priority interests. Thus, AID projects that help them pursue their own priorities should have more leverage than projects in other areas. Second, these two areas best reflect the likely sources of self-sustaining growth for Belize. Removal of constraints in these sectors is therefore felt to have the greatest possible impact on near-term growth. AID projects are designed to remove constraints (many of

which were identified in the CDSS). Third, these are the two areas that would be most adversely affected by unfavorable environmental changes. Therefore, it is easy to link an interest in these areas, and projects aimed at them, to environmental concerns. Fourth, it is in these sectors where private sector activity and support is most active. Thus, it is felt that private sector support for environmental concerns, and the political support that it engenders, can be best developed by focussing on agriculture and tourism.

APPENDIX A

NOTES ON TAX BUOYANCY IN BELIZE

When beginning analyses of tax systems it is conventional to compare tax revenues from a given tax with the tax base for that tax. Normally this is done by calculating tax elasticities, which are the proportional rate at which tax revenues change relative to proportional change in the tax base, when tax rates and application are held constant. A tax elasticity of 1 indicates that the rate at which tax revenues change is the same as the rate at which the tax base changes. Numbers greater than one indicate that tax revenues change relatively faster than the tax base, and the number tells us how much faster. Numbers less than one indicate the opposite.

In general it is desirable to have total tax revenue which increases slightly faster than increases in its base. That is, elasticities overall should be slightly greater than one. Tax elasticities in the range of about 1.0 to 1.05 are fairly typical (but whether they are "good" or not depends on the circumstance). Total tax revenues that expand more slowly than the tax base fail to automatically generate revenues that are adequate to support public services, and are in continual need of rate adjustments or other tinkering. Tax revenues that expand too fast when their base expands take too much purchasing power from the economy when it is expanding and act as a brake. Perhaps more importantly, revenues that expand too fast can encourage public spending in excess of what is needed.

It is not possible now to calculate tax elasticities for Belize. A detailed study would be needed to separate out the effects of rate changes and other changes in application, from what would have happened in the absence of rate changes. Nevertheless we can calculate tax "buoyancies". Tax buoyancy is the rate at which tax revenues change relative to its base when all influences are combined, including rate changes. Overall tax figures and tax buoyancies for Belize are shown in the accompanying table. The figures are for the period 1984-88 and are in millions of current Belize dollars.

The table is revealing in two major ways. First, it shows that relative to total revenue, income taxes are generating relatively less revenue and trade taxes relatively more revenue over the period shown. In general, income taxes are considered "better" taxes than trade taxes and so this observation should raise some questions about the efficiency of the Belizean tax system. This "trend" will not likely turn around in the next few years since income tax rate reform in 1989 implies that revenue from income taxes will probably drop for a few years before they begin to increase again. Meanwhile, the stamp tax falling on imports has been raised from 10% to 12%, and tariffs have been raised (in fiscal 86/87) due to a CARICOM decision, so the proportion of trade taxes should increase. Second, while the buoyancy of income taxes is about what one would expect (ie. 1.02), the buoyancy of trade taxes with respect to national income is extremely high (2.06). Indeed, relative to its base,

imports, trade taxes have shown even higher buoyancy (2.19)¹. Because trade taxes are so buoyant and are such a large portion of total tax revenues, overall tax buoyancy is very high (1.65). These observations warn of an increasing importance of trade taxes in Belize - exactly the opposite of what one would want and expect in a country at Belize's stage of development.

¹ Some of this may be due to the removal of quantitative restrictions on trade which has occurred during the 1884-89 period. In 1984 many imports were prohibited and many more were subject to import licensing which was so strict as to be equivalent to prohibition. As a result smuggling was rife. One would expect that as quantitative restrictions are removed and the incentive for smuggling decreases, more imports come in through legal channels and are therefore caught in the import duty net.

There was also an import duty increase of 15% in 1986/87 due to decisions by CARICOM. Even if import duties were adjusted downward by this amount, total trade tax buoyancy with respect to imports would remain very high.

TABLE 1: MAJOR TAX RELATIONSHIPS IN BELIZE
 MONETARY FIGURES IN MILLIONS OF CURRENT BELIZE DOLLARS

	1984	1988
NATIONAL INCOME	285.8	402
IMPORTS	219.6	303.8
TOTAL TAX REVENUE	81.8	136.6
INCOME TAXES	20.5	29
TRADE TAXES	47.6	87.5
PROPORTIONS OF TOTAL TAX		
INCOME TAXES	0.25	0.21
TRADE TAXES	0.58	0.64
BOUYANCY		
INCOME TAXES WRT NATIONAL INCOME		1.02
TRADE TAXES WRT NATIONAL INCOME		2.06
TOTAL TAX WRT NATIONAL INCOME		1.65
TRADE TAXES WRT IMPORTS		2.19

SOURCE: IMF, MAY 30, 1989. FIGURES FOR 1988 ARE ESTIMATES.

TO: AID/Belize

July 25, 1989

FROM: Bill Loehr

RE: Projects associated with tax reform in Belize.

Tax reform has been identified as a policy thrust to be supported by AID/Belize over the next five years. The purpose of this memo is to begin to specify the kinds of technical assistance that will probably be required to support tax reform. I will try to specify as much detail as I can about each step as well as suggest approximate timing.

1. Inventory the current tax system. This should be done soon, ie. late 1989 or early 1990. The objective would be to place AID firmly in the center of whatever dialogue on tax reform occurs. Indeed, it would give AID the information needed to strike up debate on tax issues. It should also collect the information required about the current tax system that will serve as a base for understanding the current strengths and weaknesses. Some of the elements in the inventory would be:

- o An itemization and description of all taxes in terms of the tax base for each tax, rules and procedures for applying each tax, a listing of exemptions and the revenues associated with each tax.
- o Quantification of actual collection of revenues from each tax compared with the theoretical revenues available.
- o An itemization of all user fees and descriptions of the rules for applying them.
- o Assess the impact of each tax and user fee on economic efficiency. If possible, isolate the impact of efficiency within specific sectors.
- o Estimate the level of effective protection for Belizean industry implied by taxes on trade and their application. (A contractor doing this should be advised in advance that the application is important since

there are some import licenses and exemptions from duties that would affect effective protection.)

- o Assess capabilities for administering taxes. (Note: a full assessment of administrative capabilities will not be possible before tax reforms are being considered. See point 4 below.)
- o Identify all constraints placed on Belize's trade taxes by CARICOM.

2. Take full advantage of the income and expenditure survey

planned for 1990. Normally, comprehensive tax reform requires a survey of this type before alternative taxes can be assessed. The fact that a survey is going to occur anyway is a great opportunity to get the requisite information at little extra cost. AID should involve a tax specialist in the construction of the instruments to be used as part of the survey to make sure that the right information is collected.

3. Tax alternatives should be designed given results of the income and expenditure survey.

This should occur after the results of the survey are in and compiled (early 1991 perhaps). This work should include:

- o An application of the current tax structure to the tax base to project tax revenues over a four or five year period. The incidence of the current tax structure should also be evident. This projection will later serve as a base against which the revenue expected from modified taxes can be compared.
- o Modifications of the current tax system should be simulated and the revenue impact of so doing estimated. The modifications that are "tried on" should include the simplification and broadening of existing taxes.
- c Alternative taxes should be proposed. The objective of alternatives should be to seek simplicity, reasonable economic efficiency and revenue stability.

- o The revenue and incidence of the alternatives should be specified.
- o Recommendations should be made as to tax reform measures most suited to Belize.

4. Administrative capabilities should be assessed. Often administrative capability "falls through the cracks". Tax reforms that are too complicated to administer are not worth pursuing. Therefore, a specific project should focus on the administrative needs of the tax reforms recommended in step 3.

5. A project should be designed to exploit the experience of other countries, particularly some of the Caribbean ones that have gone through the tax reform process. (eg. Jamaica, Dominica, Granada) This should be done soon after the recommendations on alternative tax reform measures are available from step 3, probably in late 1991. There are two objectives in doing this. First, There has been a lot of work done on tax reform in these places, much of it funded by AID, and all of it oriented around the needs of small, open, developing countries. Much of the work should have applicability to Belize. Also, the experience of these countries will reveal the practical difficulties (or ease) of implementation. Much information should be gained at modest cost. Second, this effort should serve to build confidence among Belizean policy makers that tax reform can be done and that they can do it. This project might be constructed as follows:

- o A consultant could sift through the experience of other countries for the relevant analyses and experience. The consultant should visit with officials who have been involved in these countries to get first-hand information.
- o A report should be prepared detailing how the experience of other countries applies to the kinds of reforms being considered for Belize (step 3) and Belize's administrative capabilities (step 4).

- o Visits should be arranged for Belizean policy makers with officials in several other countries so that they can gain some insight into experience elsewhere. These visits should be orchestrated either by the consultant who did the survey of the countries and/or by someone within AID. That is, the person or people to be visited, and the substantive reason for the visit should be determined and arranged in advance. The consultant (or AID person) should precede the visit to set the agenda with the officials being visited, then accompany the Belizeans to help maintain a focus on the predetermined issues of tax reform.

This last feature has a dual purpose. First, substantive knowledge will be gained by Belizeans. Second, and more important, confidence and hopefully political support will be gained by placing key Belizeans squarely within the dialogue and giving them everything necessary to make reasonable judgments. It would also build their stature within Belize as someone knowledgeable on these matters.

6. Specific tax reform measures should be recommended. This should be based on the recommendation of step 3, the observations made on administrative capabilities in step 4 and the experience of other countries revealed in step 5. A schedule for the gradual introduction of reform measures should be drawn up along with projections of revenue impacts associated with each step.

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