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MEMORANDUM OF THE PRESIDENT

OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

TO THE

EXECUTIVE DIRECTORS

ON A

COUNTRY ASSISTANCE STRATEGY

OF THE

WORLD BANK GROUP

FOR THE

ORIENTAL REPUBLIC OF URUGUAY

June 5, 1997

Country Operations Unit 2
Country Department I
Latin America and the Caribbean Regional Office

The last Country Assistance Strategy for Uruguay was discussed by the Executive Directors in January 1994 (Report No. P-6144-UR, dated November 30, 1993).

CURRENCY AND EQUIVALENTS

Currency Unit: New Uruguayan Peso (Ur$) (as of June 1, 1997)

Ur$1 = US$0.11
US$1 = Ur$9.36

WEIGHTS AND MEASURES

Metric System

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

AFAPs	Private Pension Fund Administrators
BPS	Social Security Bank
BROU	State Bank of Uruguay
CAS	Country Assistance Strategy
CEPAL	Economic Commission for Latin America
CET	Common External Tariff
CPI	Consumer Price Index
EDI	Economic Development Institution
EFF	Extended Fund Facility
ESW	Economic and Sector Work
GDP	Gross Domestic Product
GEF	Global Environmental Facility
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
LIBOR	London Inter-Bank Offer Rate
MERCOSUR	Southern Cone Common Market
MIF	Multilateral Investment Fund
MIGA	Multilateral Investment Guarantee Agency
NGO	Non-governmental Organization
PAYG	Public Pay-As-You-Go System
SAL	Structural Adjustment Loan
WDR	World Development Report

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COUNTRY ASSISTANCE STRATEGY OF THE WORLD BANK GROUP FOR THE ORIENTAL REPUBLIC OF URUGUAY

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EXECUTIVE SUMMARY

With economic prosperity, based largely on livestock exports, Uruguay was a pioneer in the provision of broad-based social benefits. The major elements of the system were put in place in the first half of this century. After the exhaustion of the import-substitution strategy adopted in the 1950s, the country entered into a long period of stagnation characterized by growing intervention by the state in an effort to maintain standards of living and social benefits. Macroeconomic stability deteriorated, contributing in 1973 to a military take-over that lasted 12 years.

Since that time, the country has been undergoing a slow but steady effort to overcome the legacy of the 1950s—the fiscal and economic burden of a large state role in the economy, unfunded entitlements, and a weak and protected private sector. Attempts by the preceding administration (1990-94) to accelerate reforms were rejected by voters. Despite possible political costs, to its credit the current administration is seeking to advance the reform effort, although more gradually. During the first two years, it has successfully introduced a fully-funded private pillar to the social security system, begun reforming the central administration, and continued with attempts to encourage greater private sector participation.

The World Bank does not have the lead role in external assistance for Uruguay. The Inter-American Development Bank, with a 1996-1998 lending program of $950 million (about four times larger than the Bank's), remains the predominant external financier in supporting the current reform program and Mercosur integration, and is active in virtually all sectors. However, the Government of Uruguay continues to seek financial and technical assistance from the Bank in selected areas where it perceives that the Bank can bring to bear a knowledge-based comparative advantage to assist in moving the reform process along.

The Bank's proposed Country Assistance Strategy would include the following:

- *base case lending of $180-225 million for FY98-00 would include investment lending in key sectors to enhance benefits of Mercosur integration, to increase private sector participation and to rationalize public expenditures (infrastructure, education, and health);*

- *all investment lending would be identified and designed based upon up-front analytical work (putting to use our international experience), would be associated with important policy changes, and would be triggered by satisfactory project performance under ongoing operations;*

- *high case lending of up to $300 million would include a proposed adjustment operation in support of capital market development to help ensure deepening of recent social security reforms, as well as possible additional support for Mercosur-related infrastructure; and*

- *non-lending services would be expanded and concentrated in strategic areas which would benefit most from the Bank's global experience and technical expertise.*

MEMORANDUM OF THE PRESIDENT OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT TO THE EXECUTIVE DIRECTORS ON A COUNTRY ASSISTANCE STRATEGY OF THE WORLD BANK GROUP FOR THE ORIENTAL REPUBLIC OF URUGUAY

A. INTRODUCTION

1. The last Country Assistance Strategy (CAS) for Uruguay was considered by the Board in January 1994. It was prepared after much of the reform momentum of the previous administration had been lost. The focus of that CAS was on supporting efforts by the private sector to respond to an increasingly open economy through: (i) financial sector deepening; (ii) agricultural diversification; and (iii) infrastructure development. The CAS also proposed continuing ESW and technical assistance for studies that might contribute to future efforts to reignite structural reforms. To date, the results on the ground of this support have been mixed, as the negative effects of the regional financial crisis and a lengthy transition period between administrations resulted in many of the new and ongoing investment operations stagnating for over a year.

2. To its credit, however, the new administration has taken measures to support improved project implementation and has renewed the reform effort, albeit at a more gradual pace, with important support from the Inter-American Development Bank (IDB), Uruguay's main external financier. The proposed CAS for FY98-00 would seek to support the Government's efforts and complement IDB assistance in key areas that would enhance the economy's competitiveness and the benefits of Mercosur integration. The next CAS would be prepared in conjunction with the new administration in FY-00.

B. ECONOMIC AND SOCIAL DEVELOPMENTS

Historical Perspective

3. Uruguay's past weighs heavily on its future. The development challenges faced today have their origin in the dramatic rise and decline of the country's fortunes during the twentieth century. This legacy still constrains Uruguay's ability to respond to an increasingly global economy and to the potential benefits offered by membership in Mercosur. By the 1880s, Uruguay became distinguished for its prosperity, based mainly on livestock exports, and for its political stability. At the turn of the century, it was a pioneer in the provision of social benefits, with universal access to education, health, and retirement benefits. However, economic performance started to deteriorate after the 1930s, as the agriculture sector was taxed to support the development of an inefficient manufacturing sector. By 1950, livestock remained by far the most important export activity, but industry had displaced agriculture as Uruguay's largest productive sector.

4. **The Legacy of the 1950s.** In the post-World War II period, as developed countries increasingly adopted more protectionist policies *vis-à-vis* agricultural commodities, and the limited growth potential of Uruguay's own protected industrial sector quickly became exhausted, the

country entered into a long period of stagnation. Uruguayans nonetheless zealously guarded their social achievements and turned to the state for maintaining standards of living and benefits. The state responded by increasing public sector employment and by becoming ever more involved in arbitrating and redistributing rents within society. Macroeconomic stability deteriorated, use of the inflation tax became pervasive, investment declined and emigration of the young to neighboring countries increased. Sustained poor economic performance contributed to a military takeover in 1973 that lasted 12 years.

5. **Restructuring the Economy: 1973-85.** The military initiated reforms that enhanced the role of market forces in resource allocation and increased investment finance through foreign savings. Capital movements and financial markets were liberalized, price controls eliminated, and the tax system reformed. Some trade liberalization also took place. Yet protection to the industrial sector continued under trade agreements with Argentina and Brazil that provided access--particularly for manufactured goods--to those countries' markets. This, coupled with the financial sector liberalization, intensified Uruguay's economic relations with (and vulnerability to) its neighboring economies.

6. The boost to the decaying industrial sector through these new market opportunities, coupled with a very favorable bilateral exchange rate *vis-à-vis* Argentina, triggered a short period of export-led growth. Significant capital inflows from Argentina financed consumption and some investments, particularly in the tourism sector. Between 1973 and 1981, average annual GDP growth reached 3.7 percent. In the early 1980s, however, incompatibilities between the expansion of the domestic money supply--fueled by a large inflow of short-term capital, longer-term borrowing, and fiscal deficits--and the rate of devaluation led to a severe overvaluation of the domestic currency (similar to the process that took place in Chile, Argentina, and Mexico) and the loss of competitiveness. In 1982, when the outbreak of the debt crisis led to a virtual cessation of capital inflows, a severely indebted Uruguay went into a deep recession.

7. **Recovery and Adjustment 1985-89**. The new civilian government in 1985 confronted the recession, debt service difficulties, and a banking system and private sector in serious financial trouble. In addition, two previously dormant issues were assuming new prominence: (i) financing of the social security system and (ii) the size of public employment. A structural adjustment program was designed, focusing on improving public finances, tackling the financial sector crisis, restoring growth through incentives to exports, and reducing the foreign debt overhang. Two World Bank Structural Adjustment Loans (SALs), and an IMF standby program supported these initiatives.

8. The adjustment program helped restore economic activity over the short term, but its effectiveness in addressing longer-term structural issues was limited. Initial achievements in improving the finances of the social security system suffered a severe setback in 1989, when a Constitutional reform increased social security obligations. Improvements in public sector management were limited to a few public enterprises, and public sector employment grew. By 1989, growth was again stagnant, the public sector deficit exceeded 7 percent of GDP, and the annual inflation rate approached 100 percent.

9. **Stabilization and Growth: 1990-94.** The subsequent administration concentrated on restoring stability, furthering financial sector reforms and trade liberalization (including entry into Mercosur), and modernizing and reducing the size of the state. Accomplishments on the latter proved modest, but prudent fiscal management coupled with a favorable external environment, led

by the economic recovery in Argentina and the decline in world interest rates, helped to improve most macroeconomic variables. The Bank-IMF-led debt service reduction program contributed similarly. Annual GDP growth, which had averaged less than 1 percent between 1988 and 1990, increased to 4.4 percent from 1990 to 1994, bolstered by strong demand from Argentina and Brazil. Mirroring developments in Argentina, the high growth was fueled by strong capital inflows that helped finance consumption and imports. As in previous periods of high growth, tourism and other service activities proved to be the most dynamic sectors.

10. Progress with inflation was more modest. Reductions to the fiscal deficit helped inflation to decline slowly from 129 percent in 1990 to percent by 53 percent by the end of 1993, but deeper reductions in inflation proved difficult. First, Uruguay's lengthy inflation experience had induced economic behavior and practices (including indexation—which the administration was trying to reform in the context of public wage adjustments) that tended to magnify inflationary shocks; and, secondly, underlying monetary growth was triggered by a balance of payments surplus, in the context of Uruguay's managed exchange rate regime. The latter is based on a band system within which the exchange rate can freely float. During this period, the band was allowed to depreciate in line with the inflation target. Although inflation could have been further contained by lowering the rate of depreciation, the Government--in agreement with the IMF--opted to forego this option out of fear that this could have lead to further appreciation of the real exchange rate with adverse consequences for the export sector.

11. More significantly, the administration failed in its attempts to accelerate structural reforms. Its program to begin restructuring the social security system and to privatize public enterprises was rejected by voters who overturned these initiatives through plebiscites, and attempts to initiate reform of the central government were reversed by the legislature. By the end of 1994, just as the regional financial crisis was about to hit, the fiscal accounts began to deteriorate seriously because of the need to absorb greater expenditures due to the failure of the social security reform and the expiration of tax adjustments introduced in 1990.

Recent Economic Performance

12. The economy is now rebounding from the regional financial crisis. Growth was about 5 percent in 1996, fueled mainly by investments and exports related to tourism, following on the economic decline of 2 percent in 1995. Inflation, fueled mainly by indexation and by the continuing fiscal deficit, continued its declining trend at 24 percent, the lowest achieved since 1982, and the Government has targeted a 15 percent rate for 1997. Unemployment, which reached its highest level in a decade during 1996, has also begun to decline slowly, but is still around 12 percent.

13. When the current administration took office in March 1995, its first priority was an austerity package of fiscal measures to reduce the fiscal deficit of the public sector that had reached 3.3 percent of GDP at an annual rate. Despite the recession and decline in tax revenues, within a year (by March 1996) the deficit had been reduced to 0.8 percent of GDP (0.9 percent for 1996). Although a significant part of this decline was due to holding the line on public sector wages, about half was attributable to higher public tariffs and investment cuts. Including one-time outlays associated with downsizing of the public sector and reform of the social security system, the fiscal deficit for 1996 was 1.7 percent of GDP.

Social Performance

14. Unlike in most Latin American countries, poverty is not a vital issue in Uruguay, but an egalitarian tradition still places it high on the political agenda (Box 1). Overall, social indicators remain among the best in Latin America--it ranks third in the region in the UN's Index of Human Development. Nonetheless, there is a growing concern with regard to the deterioration in the quality of public education, particularly for lower income groups, and inefficient expenditures for public health services.

Box 1. Poverty and Income Distribution

Uruguay has the lowest level of poverty in Latin America and is one of the few countries in the region to achieved significant and sustained reduction in poverty levels since the mid-1980s. The percentage of households below the poverty line in urban areas declined from 14 percent in 1986 to 6 percent in 1994, and in rural areas from 23 percent to 13 percent over the same period. Extreme poverty, below the indigence line, has been almost completely eradicated. Income distribution reflects the cohesiveness of Uruguayan society. The Gini coefficient declined from 0.39 in 1986 to 0.35 in 1990 and 0.30 in 1994, a level close to that of industrialized countries. The share of total income of the poorest four deciles of households increased from 20 percent in 1990 to 21.6 percent in 1994, the next 3 decile share increased from 24.6 percent to 26.3 percent, while the share of the highest decile declined from 31.2 percent to 25.4 percent during this period (CEPAL).

However, some poverty-related problems persist. The percentage of children in the poorest household quintile has grown in the last decade, and pockets of poverty also exist in the outskirts of cities. Special efforts have been made to assist the most vulnerable groups, such as children of poor families, young mothers, and low-income workers through targeted programs.

Social expenditures, as a percentage of GDP, have increased by over one-half since the late 1980s and averaged almost 25 percent in 1993-95, double the region's average. However, although some increases in outlays were registered in education and health services, the major jump has been in social security and welfare payments, averaging 20 percent of GDP over the last three years. Benefits are generous and are adjusted with the average take-home pay in the economy. As a result, poverty is low among the elderly.

The Bank's Uruguay Poverty Assessment (Report No. 9663-UR) noted that public social expenditures has played an important role in improving income distribution, but that sustaining these achievements in poverty reduction and income distribution will become difficult with the increasing fiscal burden. In particular, it noted that reforms were needed to the social security system, housing support, education and health. With Bank and IDB support, the Government has begun the tasks of reforming the current pension system and of implementing reforms to improve the effectiveness of spending in public health and education, where expenditures have been shown to have the most beneficial impact on poverty reduction and improved income distribution. The IDB has also been active in supporting reforms in housing programs.

C. DEVELOPMENT CHALLENGES IN THE CONTEXT OF MERCOSUR

15. Among the most critical issues for Uruguay's medium- and long-term prospects is the competitiveness of its economy in general, and particularly with its Mercosur partners. Despite the past achievements in stabilization and some structural reforms, significant challenges remain for sustaining economic growth and social welfare. Macroeconomic stability, abetted by a favorable external environment and prudent short-term management, has helped to bring a measure of confidence; however, this has yet to translate into sustained investment by the private sector. The latter is impeded by high labor costs and skill gaps, weak financial and capital markets, the high cost of public infrastructure and services, and relatively high levels of taxation to maintain an over-staffed public sector and generous social security system.

16. The Government that took office in March 1995 announced a short-term stabilization program and an economic development strategy for 1995-99 with the following objectives: achieve export-driven growth; continue with economic stabilization; encourage private investment; and establish a level of social services in line with the country's financial capacity. The program retains the chief elements of the macroeconomic policy carried out by the previous administration and continues structural reforms to enhance competitiveness. As such, the authorities opted to use the exchange rate as the nominal anchor of the price system to reduce inflation, with the pace of devaluation adjusted on the basis of slowing future inflation and with special tax and incentive measures to help mitigate the effects of a possible real appreciation on the competitiveness of manufacturing firms producing tradable goods.

17. Despite the political costs, the current administration has sought to continue structural reform efforts within the parameters set by popular defeat of previous social security reform and privatization initiatives. During the first two years, it has introduced a fully-funded private pillar to the social security system, begun reforming the central administration, and continued with attempts to encourage greater private sector participation. Several other important reform initiatives are also underway, including reforms in the electricity and water sectors to eliminate public monopolies (without privatization of existing public enterprises), and efforts to reduce labor market rigidities and further reduce wage indexation.

Mercosur

18. Even before the recent Mercosur agreement (Box 2), Uruguay's trade with Mercosur countries was on an upswing. Between 1988 and 1993, the share of exports to Mercosur countries increased from 24 percent to 41 percent, with Argentina responsible for a significant increase during the 1990-93 period. The trend in the direction of exports has been accompanied by the development of a considerably broader export base (for example live animals and animal product exports, which were half of the total in the mid-1970s, currently account for only 15 percent). Capital goods imports continue to come mainly from non-Mercosur sources.

19. **Implications for Uruguay.** As in most regional trading blocks, the major growth benefits to member countries like Uruguay are likely to be indirect and dynamic. These benefits will come from two sources: increased investment flows and increased productivity. There are no strong indications that the direct growth impact of Mercosur on Uruguay is large. Estimates indicate a one-time increase in trade of 5 percent, measured in terms of pre-Mercosur imports, partially offset by a trade diversion impact estimated at 1.4 percent of imports. (It is somewhat worrisome to note that trade diversion affects mainly capital goods, given their importance in achieving the dynamic gains discussed below.)

20. Geographic location, the area's best deep-water port and a relatively well-educated population, as well as a tradition in providing financial and tourist services to the region should be the bases for benefiting from membership in Mercosur over the longer term. However, the indirect and dynamic benefits from Mercosur membership for Uruguay are not totally automatic. One benefit is clear. The Government's political commitment to Mercosur is an advantage in that it effectively locks in most of the reforms of the past two decades. Moreover, the need to be competitive in the Mercosur context can be a driving force for further reform efforts. An emerging class of dynamic exporters in Uruguay has already noted important constraints, including infrastructure bottlenecks and bureaucratic obstacles, that restrain their success.

Box 2. Mercosur

Mercosur is an example of the new generation of regional trade agreements that have emerged worldwide. It is currently operating as a customs union. Under the 1991 Treaty of Asuncion and subsequent agreements, Uruguay reached an accord with Argentina, Brazil, and Paraguay, its Mercosur partners, to: (i) systematically reduce most intra-group tariffs to zero by January 1, 1995; and (ii) establish a common external tariff (CET) with 11 rates (ranging from 0 to 20 percent). To ease the transition, all countries were allowed a relatively small number of exemptions to both the intra-Mercosur zero tariff and the CET. Brazil and Argentina are to eliminate these exemptions by 2001 and Paraguay and Uruguay by 2006. (Subsequently, Chile in 1996, and Bolivia in 1997, were granted associate status, which does not require them to adhere to the CET.)

The Treaty, however, calls for more than a customs union. Mercosur is an abbreviation of the *Mercado Común del Sur*, the Common Market of the South. Work is underway under Mercosur on trade in services and on the coordination of technical standards, transport, technology, agricultural policy, fiscal and monetary policy, financial and capital market policies, labor policy, competition policy, and a host of other issues.

Since the inception of Mercosur, rapid increases in intra-Mercosur trade have been accompanied by solid growth in trade with non-Mercosur countries. (Extra-Mercosur imports totaled $56 billion in 1995, 80 percent of all Mercosur-country imports, and have grown by 6 percent per year on average since 1990.) This outcome is the result of its starting position. Unlike earlier attempts in Latin America, Mercosur started with countries that had already sharply reduced both tariff and non-tariff barriers. While difficult to measure, there appear to be dynamic benefits for Mercosur countries in terms of increased competitiveness and the attraction of greater foreign investment. These benefits arise in part because of the mutual reinforcement of member countries' commitment to market reforms.

Mercosur's potential for further gains is also large, but several factors will determine whether that potential will be realized. First, exemptions to free internal trade remain to be eliminated. Second, a scaling back over time of the common external tariff rates (which average 12 1/2 percent) would enlarge member country benefits from Mercosur. Third, past Latin American regional trade agreements have foundered on macroeconomic instability. The success of Mercosur will depend on the success of member countries in maintaining macroeconomic equilibrium.

Comparison of Mercosur Partners
(1996)

	Uruguay	Argentina	Brazil	Paraguay
Population (mn)	3.1	35.0	161.2	5.1
Territory (thsd sq. km)	177	2.796	8.512	407
GDP per capita ($)	6,064	8,590	4,360	1,889
Trade (% of GDP) (X+M Total)	39.2	15.8	13.5	70.4
X to Mercosur (% Total X)	48.1	33.3	15.3	62.5
M from Mercosur (% Total M)	44.0	24.9	15.5	48.4

Savings and Investment

21. For some time, Uruguay has suffered from a low level of investment, and the share of investment in GDP remains among the lowest of upper middle-income countries. The IDB is currently undertaking a study on the dynamics of investment and savings to provide input into government policy. Uruguay's low levels of savings and investment are likely linked to the heavy burden of taxes and social security contributions--indeed, total expenditures for social security rival that of gross investment in the economy--and structural problems associated with the large role of the Government in the economy. While short-term macroeconomic policies have helped to mitigate instability, the economy bears the costs of some continuing inefficiencies and these are more likely to be paid in the form of diminished savings rather than diminished consumption. Investment also is likely to react negatively to periodic adjustments associated with tax hikes (including increases in public tariffs) to help close the fiscal gap caused by constraints in reducing current expenditures. Finally, some companies continue to carry high debt burdens from the early 1980s, further limiting their ability to modernize production capabilities which in turn inhibits their ability to compete internationally.

22. Uruguay benefits from a relatively extensive road network and recent privatization of some services has improved the efficiency of Montevideo's port, but the country's future as an axis between Brazil and Argentina will require important new investments that the Government can ill afford to finance given its fiscal situation. (Already exporters report transportation and port bottlenecks, which will be further strained as major forest plantations near harvest). Greater private sector participation in these infrastructure investments will be needed--particularly for the Colonia-Buenos Aires bridge, if it were to be built--but this is unlikely to materialize in the absence of an adequate regulatory framework that allows appropriate pricing of risks and operating costs.

Financial Intermediation

23. Although Uruguay has traditionally served as a regional financial safe haven, its own domestic credit market is relatively undeveloped and dominated by BROU, a state bank. BROU now charges market rates, and the IDB has assisted in reforms to even the playing field with private banks. However, BROU has a history of being lenient in collecting loans, which contributes to continuing market segmentation. Further, a judicial system perceived as biased against creditors, collateral limitations, and a history of government mandated loan restructuring may also deter greater participation by private banks in the domestic credit market. Moreover, generous benefits enjoyed by bank employees contribute to high costs and a lack of flexibility. Uruguay's tradition as a safe haven is likely to persist for some time, the result of a long history of security and confidentiality that will be difficult to duplicate in neighboring countries in the short term witnessed by the capital influx during the recent regional financial crisis. However, as confidence grows in other financial systems in the region, Uruguay's chance to translate its traditional safe-haven role into that of a regional financial intermediary may be lost, unless it is able to modernize its banking industry.

24. Capital market development has also been quite limited in Uruguay for similar reasons. Market capitalization is less than 1 percent of GDP, compared to an average of almost 10 percent in emerging markets. Financial instruments are limited, and equity, bond and money markets are virtually nonexistent outside of government securities. These missing markets reduce both financing options for firms and the investment opportunities needed to make contractual savings institutions effective. The lack of depth is particularly worrisome given the need to have a

flourishing private pillar of the social security system for fiscal stability. Political considerations are likely to limit significant external investments by social security funds, a natural hedge for a small economy. Indeed, at present they are prohibited.

25. The shallowness of the domestic credit and capital markets reflects an underdeveloped, overly protected private sector. The largest companies in Uruguay are public utilities. In addition, some private firms lack creditworthiness and only continue operating because of restrictive bankruptcy laws (designed to avoid job layoffs) and government-mandated refinancing from BROU.

Labor Markets

26. Imperfections in the labor market weigh heavily on productivity. As a result of high costs and market rigidities, Uruguay suffers from relatively high levels of unemployment and the recent increase in unemployment may be difficult to bring down even with relatively rapid growth. The high cost of labor (including wages, social benefits and social security contributions) is affected by the heavy tax burden, wage indexing, and difficulties in hiring and firing employees. Institutional rigidities are particularly acute in areas such as the public sector and banking. With a lack of agreed norms for settling industrial disputes, labor-management relations are often combative. As small firms are less subject to strict regulation, the tendency has been to reduce firm size, with negative consequences for economies of scale. To reduce labor costs, some firms resort to black market operations, increasing tax and social security evasion (reportedly often in concert with the workers themselves). Finally, while the labor force is relatively well educated, many firms report skills gaps associated with skill migration and a deterioration in the education system.

27. The Government has been undertaking initiatives to help improve the labor market situation. Successful implementation of the social security reform has allowed for some reductions in employer social security payments (currently at 6.5 percent of wages in the manufacturing sector and 12.5 percent of wages in most other sectors). The goal of lowering payments a further 3 percentage points, however, would depend upon improvements in tax collection and social security contributions (paras. 28-29). Wage indexation covers public workers and serves as a reference for many in the private sector. Owing to its ability to lower inflation during the past few years, the Government has gained labor's confidence, and the administration is negotiating a lengthening of the period between wage adjustments from four months to six months, and eventually to once a year. In addition, similar to the strategy employed in concessioning of public services (see para. 30), the executive may also propose legislative changes to allow firms investing in high priority sectors (for example, tourism) to negotiate adjustments in prevailing collective agreements in matters such as wages, work scheduling, vacations, and the cost of firing workers. Finally, with support from the IDB, the Government is seeking to upgrade private training and improve labor-management relations.

Social Security

28. Recent legislation to tighten up the social security system and to introduce a fully-funded private pillar will assist in resolving the financial problems of Uruguay's social security system (Box 3). Much remains to be done to deepen these initiatives, but they may widen political support for further reforms. Major legislation has been proposed to extend recent reforms to the military

and police currently covered by other public systems. If this legislation is passed, it will represent another important step in the reform process.

29. The pay-as-you-go (PAYG) public pillar represents 12.5 percent of GDP, of which only 48 percent is covered by the contributors. The deficit will improve only gradually, as new measures to lower benefits and increase eligibility requirements adopted last year affect only the flow of retirees. Initial affiliation with the new private pillar--at about half the participants in the public system--has far exceeded the Government's expectations. Participants were reportedly responding to incentives offered to entrants and widespread recognition of the financial weakness of the public pillar. Continued success of the new private pillar would be essential as a basis for reducing over the longer term the Government's contingent liabilities for the PAYG pillar. However, appropriate implementation of a fully-funded private pillar would need to be supported by financial sector and capital market development to expand investment options.

Box 3. Summary of the Social Security Reform

The social security reform was implemented in mid-1996. Its **main objectives** are to slow the growth in benefits, permit a reduction in employer payroll taxes, and improve benefits administration. The **basis of the reform** was to establish alongside the public pay-as-you-go (PAYG) system a complementary capitalized system of individual accounts administered by private pension fund administrators (AFAPs).

Pre-reform status: The social security system comprised the main public system, the Social Security Bank (BPS), a military and a police pension fund, and three employee-run private plans (for banks, professionals, and notaries). Benefits paid by the public system amounted to almost 16 percent of GDP in 1995. The system was burdened by rising life expectancy, low retirement ages (60 for men, 55 for women), a high replacement ratio, indexation of benefits to net-of-tax average take-home pay in the economy, poor administration and a high rate of evasion of contribution payments. The system was funded by a 35.5 percent tax on wages (19.5 percent paid by employers, 16.0 percent employees) yielding about 8 percent of GDP, with the remaining 8 percent of GDP financing requirement covered by government transfers (1.6 percent of GDP in government contributions as an employer, and 6.4 percent from general tax resources).

Post-reform status: To reduce the growth in pension liabilities: (i) the retirement age for women was increased by 5 years to 60 years of age; (ii) the age requirement for a noncontributory old age pension for men and women was increased by 5 years to 70 years; (iii) the pensionable wage base was extended from the last three years of employment to an average of the last 20 years of employment; (iv) the replacement ratio was reduced from 60 (65) to 50 percent for men (women) and made subject to having reached 60 years of age and having contributed during a minimum of 35 years, and (v) disability pensions were reduced from 70 to 65 percent of the pensionable wage base.

To improve the administration of the **public system**, the BPS established individual accounts and increased records auditing while reducing costs through investment in new computer systems. The military and police pension funds would also be reformed. The basic PAYG public system would be funded by the employer contributions to the system and contributions of employees that would remain in the public system.

Employees younger than 40 years of age and earning less than Ur$5,000 a month could shift half of their personal contributions to AFAPs, whereas those earning between Ur$5,000-15,000 a month are obliged to shift all personal contributions in excess of the Ur$5,000 wage base to an AFAP. Employees younger than 40 years of age earning more than Ur$15,000 a month may invest their contributions in excess of that base in AFAPs. Employees older than 40 years of age could stay in the public system or could opt to shift to the new private system under the same conditions of employees younger than 40 years of age. (The above amounts are as of May 1996.)

Public Enterprises

30. Uruguay has seven major public enterprises, comprising most of the telecommunications, water, energy, and financial sectors, and parts of the transport sector. While the main public enterprises provide transfers to the Treasury, their monopolies allow them to charge high tariffs, which raises costs for virtually all productive sectors of the economy. An attempt to accelerate privatization of major public companies was forestalled by a plebiscite in 1992. Since then, the reform strategy of the previous and current administrations has been to promote concessions, while eliminating monopolies enjoyed by public enterprises. This strategy has been successful in improving the productivity of port services, and the Government has been successful in targeting services provided to the critical tourism industry by concessioning a major road, the airport and water supply company servicing these areas. This policy is to be expanded to other water companies and to the energy sector.

Government Services

31. **Public Administration**. While the civilian central administration in 1990 employed 2.3 percent of the labor force in Chile and 2.6 percent in Argentina, in Uruguay it employed almost 8 percent. In addition, military personnel absorb a share of the population four times higher than Argentina and 35 percent higher than in Chile. The productivity of public employees is low. Public employees have essentially a constitutional right to their job. Moreover, a flat pay structure not only creates professional level positions with essentially symbolic wages but also rewards lesser skilled positions above what they might receive in the private sector. Given the difficulties in attracting required managerial and technical talent, many professionals are granted special work schedules to allow them to continue working in the private sector. The Government recognizes that a significantly smaller, higher paid central administration focusing on key government functions is a necessary part of the reform process, and the IDB is supporting its current reform efforts in this area.

32. **Education and Health**. Uruguay once had an educational system that was the envy of its neighbors. For some time, however, the quality of public education has been deteriorating, the institutional framework now seems inappropriate to implement needed policy changes, and the sector is plagued by the same rigid employment policies as the central government. There is a significant waste of resources in public education; it is not producing the skills demanded by the labor market; its expenditure allocation discriminates against the poor, particularly at the secondary and university levels. Moreover, large quality differentials exist in the education of higher and lower income groups, even in the public sector. Better off consumers have begun turning to private institutions. The President has taken a personal concern in education, and efforts are underway with Bank and IDB support to reform the system. Ongoing reforms envisage decentralization of school management, modernization of curricula, incentives to improve teacher performance and training, lengthening of instructional periods supported by construction of additional infrastructure, and improved supplies of teaching materials. However, many of the proposed reforms, particularly those related to testing and certification, are being resisted by the teachers' union.

33. The Uruguayan health system is atypical for Latin America, because of the high level of participation by the private sector and almost universal coverage. In urban areas, only about 6 percent of the population lacks health care coverage. However, health care provided by the public sector for about a quarter, mostly poor of the population is not cost effective. With

increasing fiscal constraints, the health system may deteriorate into a two-tier system, with sub-par public services for the poor and uninsured, and a private sector offering quality services to the better off and the insured. The main thrust of public policy being supported by the Bank is to rationalize health sector spending by reducing the role of the public sector in the direct provision of services and encouraging competition from the private sector.

Box 4. Environmental Concerns

The Environmental Action Plan for Uruguay indicates that it does not suffer from many of the environmental degradation and pollution problems that plague many other Latin American countries. Traditionally, low-intensity agriculture has minimized natural resource management issues, but recent intensification, including an expansion of irrigation, is putting a greater strain on resources. Urban pollution problems have also increased, and expansion of the tourism industry presents new issues in management and protection of natural resources. In response to these and other emerging issues, under the Action Plan, the Government is formulating a legislative framework for defining priorities and responsibilities and coordinating environmental activities.

The Bank's ongoing *Natural Resources Management and Irrigation Development Project* is providing support for improved farming practices for watershed management, enhancing irrigation management and protection of wetlands. In addition, a program for the *Reduction of Ozone-Depleting Substances* is being supported under the Montreal Protocol. In the future, improved management of coastal areas would be assisted by a Bank operation, with possible participation by the GEF in supporting bio-diversity, and a review of natural resource management is proposed. For its part, the IDB has focused on technical support for improving institutional arrangements at the national level, including the development of the National Environmental Action Plan.

D. MEDIUM-TERM PROSPECTS AND THE EXTERNAL ENVIRONMENT

34. Uruguay's recent economic performance has been solid. Per capita income has grown at more than 3 percent per annum during the last decade, more than one percentage point above the average for all developing countries, in part reflecting very low population growth. Exports have grown at more than double the rate of GDP, with most of the expansion coming from non-traditional sources, responding to the opening of the economy. (The prime example is the creation of a thriving forestry export sector.) By contrast, traditional light manufacturing has declined significantly as its protection was removed.

35. Uruguay, under current policies, should continue with a healthy per capita income growth in the 2.5-3 percent range over the medium term. Nonetheless, Uruguay's long-term growth prospects could be much more robust. As noted above, the country suffers from a relatively low level of investment. Raising investment by five percentage points would add more than one percentage point to annual per capita income growth, and it is likely that the same reforms that would increase investment would contribute to significant productivity increases, magnifying the gain.

Table 1. Key Macroeconomic Indicators

	1995	1996	1997	1998-00
National Accounts				
GDP (percent change per annum)	-2.0	4.9	4.0	3.2
Total Investment (share of GDP)	13.3	13.1	13.3	13.7
National Savings (share of GDP)	12.1	11.7	11.4	12.2
Foreign Savings (share of GDP)	1.2	1.4	1.9	1.5
Public Sector (all as share of GDP)				
Primary Surplus	0.9	1.3	0.8	0.5
Interest Payments	1.9	1.5	1.3	1.1
Domestic	0.9	0.7	0.5	0.1
Foreign	1.0	0.8	0.8	1.0
Balance	-1.0	-0.3	-0.5	-0.6
Balance of Payments (all as share of GDP)				
Trade Balance	-0.3	-1.8	-2.1	-1.7
Current Account Balance	-1.2	-1.4	-1.9	-1.5
Capital Account	2.4	2.1	2.5	2.1
Memo: GDP, US$ Billion	17.7	20.9	22.6	

36. Macroeconomic conditions are essentially sound and are projected to remain as such. An IMF standby precautionary program, now being negotiated for extension to 1999, bodes well for the continuation of current policies. However, major caveats would be a continued reduction in the fiscal deficit and a consolidation of the ongoing structural reforms, as well as a continuation of the relatively favorable international environment and the absence of external shocks.

37. The external environment for Latin America in general is expected to be less robust in coming years than it was in the early 1990s, with the terms of trade for the region expected to decline slightly. In addition, Uruguay's macroeconomic prospects are tied to the performance of Argentina and Brazil. (Recent CASes for both these countries discuss the economic risk they face.) International interest rates are expected to increase moderately over the short term, but the overall external environment for capital flows is expected to continue to be favorable. Private markets seem confident in the capacity and willingness of Uruguay to service its debts and to weather shocks. Spreads on public sector borrowing in private markets are currently about 150 basis points over LIBOR, less than half the spread on Argentina's sovereign issues of equal maturity. Uruguay's ability to continue to broaden its export base toward non-traditional agricultural products, services, and possibly niches in the manufacturing sector where Uruguay is competitive, would more than offset the somewhat more difficult external environment.

E. EXTERNAL ASSISTANCE

Bank Assistance

38. Bank assistance to Uruguay is largely dictated by two factors: (i) the Government's willingness and ability to act on the pending agenda of reforms; and (ii) the Government's interest in our assistance in specific sectors to complement the predominate role played by the IDB, whose proposed lending program is about four times larger than the Bank's. Within this context, our strategy would be driven by our knowledge-based comparative advantage in sectors where we have long-standing involvement in Uruguay, primarily infrastructure, and where we can bring to bear our global experience to help accelerate the reform process. Selected sectors are key to supporting Government efforts to enhance competitiveness in the context of Mercosur and support efforts to accelerate the rationalization of public expenditures needed to sustain macroeconomic stability. Project design and triggering would be linked to lessons from our portfolio and satisfactory implementation of ongoing operations. Finally, our assistance strategy would include an important component of non-lending services related both to particular Bank expertise in selected sectors and support for a more broad-based effort in defining a future vision of Uruguay in Mercosur and informing the internal debate on needed reforms to realize such a vision.

39. **Progress Towards Objectives in Previous CAS.** The last CAS for Uruguay was considered by the Board in January 1994. It was prepared during the middle of the previous administration, after much of the reform momentum had been lost. The main focus of the CAS was on supporting efforts to enhance the private sector's ability to take advantage of an increasingly open economy through: (i) financial sector deepening; (ii) agricultural diversification; and (iii) infrastructure development. In addition, the Bank sought to provide lending assistance to help rationalize public spending in health and education, as well as ESW and technical assistance to provide the basis for further public sector reform.

40. To date, the results on the ground of this support have been mixed. First, the regional financial crisis and the ensuing recession set back attempts to lengthen the maturity of investment lending and to encourage greater private sector participation in financing local investments. In contrast, diversification of agricultural production and exports has continued. Importantly, forest plantations, for which early Bank work in the 1980s helped identify the potential, are now nearing harvest and the Bank is proposing an infrastructure project to improve the transport of forest products to the point of export. In addition, the production of rice and produce is growing in importance and should accelerate with Bank support for irrigation development and improved natural resource management. IFC investments have also supported diversification efforts (fruits and citrus), but with more mixed results. The IDB's program will provide added impulse by supporting activities in farm restructuring and dairy, and horticulture production. In infrastructure, Bank assistance for public enterprises helped to improve the efficiency of port services, privatize insurance, and increase the efficiency of electricity supply and define a regulatory framework to encourage private sector participation. Finally, while the previous administration was unable to regain the initiative for implementing further public sector reforms, it was able to undertake studies with Bank financing, which ultimately fed into current reform of the central administration being supported by the IDB, and to initiate Bank-financed projects in education and health that are assisting the present administration with reforms in human resource development.

41. **Portfolio Performance and Management.** Uruguay has traditionally been a steady, if somewhat slow, executor of Bank projects. Investment projects invariably have to be extended because of initial delays related to a legalistic approach to procurement and subsequent problems of counterpart availability resulting from the periodic need to cut public investment. (Performance experience under the IDB portfolio is similar to that of the Bank). The portfolio, however, has remained healthy and traditionally the development objectives of Bank lending are largely met (a 95 percent rate of success, significantly above the Bank average).

42. In FY95, however, portfolio performance deteriorated as a result of a change in the administration (and a subsequent lag in putting new officials and programs in place), the ill effects of the "tequila" crisis, and the need for strong fiscal austerity measures. The Bank, with the encouragement of important elements of both the outgoing and incoming administrations, proceeded with several operations in FY94-95 (including *Natural Resources Management and Irrigation Development*, *Private Sector Development,* and *Power Transmission and Distribution*). Nonetheless, implementation of these operations subsequently suffered during a long transition period (over and above the statutory three month period between elections and inauguration). These delays occurred notwithstanding a concerted effort to integrate incoming officials in preparation and appraisal. In addition, the ongoing *Transport I* was negatively affected by budget cuts.

43. Subsequently, through a series of country assistance reviews, the Bank and the Government have resolved most of the outstanding problems. The reviews established a set of benchmarks which were then monitored to track progress. In particular, implementation has accelerated under *Transport I*, triggering the preparation of the *Forest Products Transport Project*; a strong reform push by the Government is being supported with improved implementation of *Basic Education;* and, *Power Transmission* has now been signed, and effectiveness is expected shortly if the legislature approves a law to encourage greater private sector participation (more than 18 months following Board approval). Agreement on reforms for public hospitals will be needed before the *Health Sector Development Loan* will be in a position to meet major project objectives. One project, *Private Sector Development,* was canceled, after it failed to respond to remedial measures to encourage implementation.

44. Despite these improvement, disbursement lags remain an overall concern. In a good year, Uruguay disburses around 15 percent of its undisbursed balance, when, given its level of development, it could well be averaging more in the 20 percent range. Such lags have been almost a defining characteristic of the large infrastructure projects that have traditionally made up most of the portfolio--the *Basic Education Loan* in FY94 and the *Health Sector Development Loan* approved in FY95 are the Bank's first efforts in social sector lending in Uruguay. Typically, the infrastructure projects would suffer initial delays that could never be made up, in part because of occasional slowdowns in implementation because of counterpart funding problems. The current administration's adherence to a five-year budget program appears to have reduced some of the volatility in the availability of counterpart funding, and for the *Resources Management and Irrigation Development* and *Health Sector Development Loans*, special funds were created to further facilitate counterpart availability.

45. Looking back further to Bank adjustment lending to Uruguay in the late 1980s and early 1990s, the record is also mixed. As noted in recent OED evaluations, a large share of the development objectives supported by the operations were eventually achieved but well beyond the anticipated implementation period of the loans. Much of this time disconnect comes from the

disparity between adjustment operations designed to disburse quickly and Uruguay's deliberate pace in concluding sensitive policy reforms. The IDB's sector loans have a similar history.

46. The lessons from the portfolio incorporated into the proposed country assistance program and the design of future operations include: greater attention to ensuring that significant parts of proposed investments are "bid ready" prior to loan effectiveness; backstopping the supervision of projects with the continued use of country assistance reviews for resolving generic issues, setting progress benchmarks for the entire portfolio, and linking new lending to implementation results; and design of adjustment operations to ensure government commitment to timely implementation, with maximum up-front conditionality.

47. **Lending Strategy for 1998-00**. Base case lending of US$180-225 million for FY98-00 would include investment lending in key sectors for enhancing benefits of Mercosur integration, increasing private sector participation and rationalizing public expenditures. (transport, energy, water, education, and health). All investment lending would be identified and designed based upon up-front analytical work, would be associated with important policy changes and would be triggered by project performance under ongoing operations. High case lending of up to US$300 million would include a proposed adjustment operation in support of capital market development to help ensure deepening of recent social security reforms, as well as possible further support for Mercosur-related infrastructure investments. The former would be triggered by government willingness and ability to continue with reforms to enhance the performance of the private pillar of the social security system and to make the necessary policy changes to enhance the development of private capital markets; the latter by accelerated implementation of expected investments and deregulation. The next CAS would be programmed for FY00 to coincide with the start of the next administration.

48. **Social Security**. The reform program supported by the IDB could be a first important step toward reducing the burden of social security on the Treasury, but additional work will be important to help ensure success during this first phase. Given the political constraints to introducing further significant reforms of the public pillar, the continued success of the new private pillar in attracting new participants represents the best alternative for reducing over the longer term the Government's contingent liabilities for the PAYG system. In contrast, failure of the new pillar could derail any attempts in the near future at reforming the social security system. The almost exclusive recourse to low-yielding, public bonds in both public and private AFAP portfolios will make it difficult to provide attractive returns. Besides regulatory changes related to the system itself, reforms would also involve measures to deepen the capital market over the medium term. An adjustment operation related to these issues is a possibility for FY98.

49. **Reform of the State**. The Government is pursuing a program of limited reduction in the size of the central administration associated with restructuring and a redefinition of areas requiring government participation. Constitutional job guarantees and the fiscal costs required to induce voluntary retirement constrain more rapid reforms, but the current program may set the stage for an accelerated program in the future. The IDB is supporting the current effort through a recently approved adjustment operation of US$110 million, mostly to cover severance payments, and is supporting worker retraining initiatives. The IDB is also proposing to support the modernization of the legislative and judicial branches of government.

50. Bank assistance in redefining the role of the public sector would continue to focus on the provision of infrastructure critical to improving Uruguay's competitiveness. Given the political constraints to full-fledged privatization, the Bank would continue, under ongoing and proposed operations, to build upon existing relations with public enterprises to support reforms and encourage greater private sector participation. Specific examples include the *Power Transmission Project* and the proposed *Water Supply II Project* and *Forest Products Transport Project*. The latter would introduce the concessioning of rail freight, for example. The major policy changes to be supported in these projects would be the elimination of monopolies enjoyed by public enterprises, with legal frameworks to encourage private participation and separating public enterprises from regulatory roles in their sectors. The ongoing *Public Enterprise Reform TA Loan* has complemented sector investment operations in defining appropriate regulatory frameworks and provided support for port concessioning and privatization of an insurance entity. Under the proposed *Transport II Project*, we would support restructuring and modernization of the National Road Agency to provide for greater private sector participation in construction and maintenance and concessioning where feasible. If these efforts are successful, the potential payoff would include cheaper service provision and greater private investment.

51. **Financial Sector Development**. The IDB continues to take the lead in supporting financial sector reform. Through a financial sector adjustment operation, it provided much of the support to reduce the privileges granted to BROU, the state bank, and to create a level playing field for private banks. Its assistance for the sector continues under ongoing (and future) global credit operation. Planned ESW by the IDB would review issues related to investment and savings and the implications of Mercosur for the financial sector. The Bank provided earlier assistance related to the privatization of state banks intervened during the financial crisis of the early 1980s, although the results were mixed. Subject to Government request, the Bank would continue to provide non-lending services to assist in the privatization of the two remaining intervened banks. (Privatization of the BROU and the mortgage bank are not currently on the political agenda.) The Bank also attempted to support a greater role for private banking through the *Private Sector Development Loan*, which, *inter alia*, was designed to lengthen the maturity of lending operations and to improve regulatory oversight and supervision by the Central Bank. However, large capital inflows from neighboring countries as a result of the regional financial crisis reduced demand for the funds, and the loan was recently canceled. IFC's lending, however, would continue to support efforts to provide longer maturities for investment financing from the private banking sector. In addition, a proposed MIGA operation would seek to increase the availability of mortgages.

52. **Human Resource Development.** The IDB has taken the lead role in supporting reform in secondary education; the Bank, under the *Basic Education Project*, has focused on primary education. Proposed ESW, in conjunction with the Government and the IDB, would be undertaken in FY98 to review the education sector in light of the demands for increasing competitiveness and human resource development under Mercosur. This would provide the basis for subsequent lending for education scheduled for FY99. Although problems of inefficiencies and inequity in public spending are most acute at the university level, the political costs associated with direct reforms are high. The Government has been following a strategy of encouraging the growth of education provision by the private sector. In health, the ongoing *Health Sector Development Project* seeks to pilot alternatives to public sector delivery of health care, to redefine the role of the public sector in regulation and to improve its institutional capacity in an effort to help rationalize sector spending. A follow-up loan to replicate successful pilots is planned for FY00.

53. **Non-Lending Services.** Under the proposed strategy, the Bank would expand non-lending services strategically--when it has a clear comparative advantage--in support of needed reforms. To date, ESW and dissemination efforts have played an important role in supporting the ongoing debate involving the need for greater private sector participation in the economy and the regulatory environment required to ensure gains in efficiency. Future ESW includes a review of the agenda of reforms for public enterprises and the regulatory framework; legal impediments to financial intermediation; labor market issues under Mercosur; urban transport issues; education; and a policy assessment for the new administration in FY99.

54. The Bank has been providing advisory services in global experience in areas of its comparative advantage, including bank privatization and airport concessioning. Demand for such non-lending services is likely to continue, for example, in the decentralization of public services and related issues in public finance. Along with dissemination of ESW, such services would be expanded to enhance the domestic debate on development issues by providing greater cross fertilization with the experiences of other countries facing similar problems. Support from EDI, which is participating in the Region's Annual Bank Conference on Development (ABCD) to be hosted this year by Uruguay, would also be important in this area. Uruguayan society is quite sophisticated and would benefit from this sort of delivery, drawing on the Bank's experience elsewhere in the world. We would propose to continue allocating budgetary resources for non-lending services, but would begin to explore with Government the feasibility of a cost-sharing mechanism for demand for these services exceeding an agreed level in the future.

Other Bank Group Assistance

55. **IFC and MIGA**. IFC's portfolio in Uruguay, as of end-May 1997, totaled about US$50 million. The IFC strategy focuses on project financing to develop export oriented enterprises (mainly agribusiness) and to modernize existing firms to improve competitiveness under the recent open market policies. Given that most business in Uruguay is conducted by small- and medium-size firms, IFC generally seeks to channel its resources through local financial intermediaries. Where available, IFC pursues opportunities to support private participation in infrastructure, as with its investment in the Punta del Este airport. Despite several active attempts to expand operations, future activity is likely to remain at 1-2 projects (US$5-10 million) a year. Uruguay is also a member of MIGA; although there has not been a MIGA guarantee to date, discussions are underway for an operation to support the expanded availability of mortgages.

Inter-American Development Bank

56. The IDB is Uruguay's main source of public external financing for the current administration's program, with adjustment operations in support of social security reform and reform of the central administration, as well as investment lending and grants in virtually all key sectors of the economy. The IDB has significantly increased its activities in Uruguay since the early 1990s. Its portfolio includes 25 loans totally US$863.7 million, as well as 19 technical cooperation grants for US$12 million, eight small projects totaling US$3.9 million, and six operations under the Multilateral Investment Fund (MIF) amounting to US$7.9 million.

57. The lending portfolio includes projects in animal health, agricultural technology, municipal development, technology development, social investment, multisector credit, housing, potable water and sewerage, technical education, strengthening social areas, modernization of customs and

auditing services, and power transmission. The program in technical cooperation (grants) includes six projects assisting small businesses and cooperatives, ten projects strengthening public institutions, and two supporting social assistance programs. Six MIF grants include youth training, central government modernization, and labor relations.

58. IDB lending for the 1996-98 period is programmed to include 16 projects totaling about US$950 million. Four projects, totaling US$394 million, were signed in 1996 (38 percent of the ongoing portfolio), including adjustment operations for social security and state reform, and investment operations in secondary education and dairy farming. Other lending in the 1996-98 program is expected to include banking (multisector credit), infrastructure (export corridors, sanitation services in Montevideo, municipal development, urban renewal, and electrical power transmission), productive sectors (farm restructuring and technology development), and state reform (agricultural services, modernization of judicial and legislative branches, and public safety).

59. The 1997 grant program for technical cooperation totals almost US$10 million for eleven operations, including nine from MIF, in human resource training, modernization of the Central Bank, energy regulatory framework, Buenos Aires-Montevideo gas pipeline, training institutions, cooperative restructuring, small rural enterprises, concessioning of public works, and Mercosur negotiations.

International Monetary Fund

60. Under the ongoing precautionary Standby, which expired in March 1997, the Government met most targets. They missed, by a narrow margin, fiscal (0.5 percent of GDP) and inflation (20 percent) targets. A new precautionary Standby through March 1999 is being negotiated. While the Fund has actively engaged the Government regarding needed structural reforms, agreement on a possible extended fund facility has not been reached. The Fund has also been providing technical assistance in modernizing tax collection and customs procedures.

F. CREDITWORTHINESS AND RISKS

61. Following successful stabilization efforts over the past two years with the support of the Fund, progress in some structural reforms, and a strong recovery, Uruguay's economy has strengthened. However, inflation levels are still comparatively high and investment and savings levels low, impairing the country's longer-term growth prospects. Moreover, given its small size, open nature, and close trade, tourism and financial ties with Argentina and Brazil, Uruguay is highly vulnerable to crises in these countries as evidenced during 1995.

62. The ratio of debt/GDP is about 30 percent and is projected to remain in this range over the medium term. Servicing the debt should not be a problem, with the debt service/export ratio at less than 25 percent over the medium term. IBRD debt service, which peaked at 20.7 percent of total debt service in 1994, is expected to decline to below 10 percent by 2000. In part because of its record of timely payments, Uruguay's creditworthiness has improved to the point that it has ready access to international markets. Outside rating agencies rate it close to investment grade (two agency marginally above and the two others marginally below).

63. The Government's gradualist reform program involves important economic risks, but it is not clear (given the current political context) that reforms could be accelerated without engendering popular opposition and possible reversal. The ability to continue reducing the fiscal deficit remains the most important short-term challenge. Given current structural rigidities, the Government has little room to maneuver as it continues to reduce inflation. As noted above, unless the Government is able to increase its flexibility in controlling current expenditures, particularly those related to the wage bill, expenditure cuts will continue to come from the investment program and revenues increased through high taxes and public tariffs that both contribute to high cost and reduced competitiveness. Over the medium term, failure to adopt structural reforms to increase the external competitiveness of the economy would dampen growth prospects. To help mitigate these risks, Bank support would seek to assist the current administration in maintaining the pace of reform over the short term, and to use our ongoing involvement to help set the stage for acceleration of the effort in the future.

James D. Wolfensohn
President

by Caio K. Koch-Weser

Attachments
Washington, D.C.
June 5, 1997

THE ORIENTAL REPUBLIC OF URUGUAY

COUNTRY ASSISTANCE STRATEGY

ANNEXES

Uruguay - Selected Indicators of Bank Portfolio Performance and Management

Indicator	1994	1995	1996	1997
Portfolio Performance				
Number of Projects under implementation	11	12	12	11
Average implementation period (years)[a]	3.93	4.54	4.84	5.63
Percent of problem projects rated U or HU[b] (for past years, rated 3 or 4)				
Development Objectives[c]	9.09	8.33	8.33	18.18
Implementation Progress (or overall status for past years)[d]	9.09	25.00	16.67	18.18
Cancelled during FY in US$m	0.00	2.09	3.95	42.93
Disbursement ratio (%)[e]	24.81	14.36	15.11	13.42
Disbursement lag (%)[f]	26.12	29.77	31.51	23.19
Memorandum item: % completed projects rated unsatisfactory by OED	9.09	7.14	7.14	7.14
Portfolio Management				
Supervision resources (total US$ thousands)	358.78	433.14	287.26	315.50
Average Supervision (US$ thousands/project)	32.62	36.09	23.94	28.68
Supervison resources by rating category (US$ thousands/project)				
Projects rated HS or S	26.85	29.25	25.96	30.48
Projects rated U or HU	90.26	56.61	13.81	20.59
Memorandum item: date of last/next CPPR				

a. Average age of projects in the Bank's country portfolio.

b. Rating scale: "HS" denotes "Highly Satisfactory", "S" denotes "Satisfactory", "U" denotes "Unsatisfactory", and "HU" denotes "Highly Unsatisfactory".

c. Extent to which the project will meet its development objective (see OD 13.05, Annex D2, *Preparation of Implementation Summary [Form 590])*.

d. Assessment of overall performance of the project based on the ratings given to individual aspects of project implementation (e.g., management, availability of funds, compliance with legal covenants) and to development objectives (see OD 13.05, Annex D2, *Preparation of Implementation Summary [Form 590])*. The overall status is not given a better rating than that given to project development objectives.

e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: investment projects only.

f. For all projects comprising the Bank's country portfolio, the percentage difference between actual cumulative disbursements and the cumulative disbursement estimates as given in the "Original SAR/PR Forecast" or, if the loan amounts have been modified, in the "Revised Forecast." The country portfolio disbursement lag is effectively the weighted average of disbursement lags for projects comprising the Bank's country portfolio, where the weights used are the respective project shares in the total cumulative disbursement estimates.

g. Supervision resources data, by location, is only available starting in fiscal year 1996.

Note:

Disbursement data is updated at the end of the first week of the month.

Uruguay - Bank Group Fact Sheet
IBRD Base Case Lending Program

	Past		*Current*		*Planned*[a]		
Category	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
Commitments (US$m)	107.5	15.6	125.0	76.0	80.0	60.0	60.0
Sector (%)							
Agriculture/Natural Resources	38.1	0.0	0.0	0.0	0.0	40.0	0.0
Education	29.3	0.0	0.0	0.0	0.0	60.0	0.0
Electric Power & Energy	0.0	0.0	100.0	0.0	0.0	0.0	0.0
Finance	32.6	0.0	0.0	0.0	0.0	0.0	0.0
Population, Health & Nutrition	0.0	100.0	0.0	0.0	0.0	0.0	25.0
Transportation	0.0	0.0	0.0	100.0	75.0	0.0	75.0
Water Supply & Sanitation	0.0	0.0	0.0	0.0	25.0	0.0	0.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Lending instrument (%)							
Adjustment loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Specific investment loans and others	100.0	100.0	100.0	100.0	100.0	100.0	100.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Disbursements (US$m)							
Adjustment loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Specific investment loans and others	41.1	33.3	32.1	45.0	45.0	40.0	35.0
Repayments (US$m)	52.6	66.3	74.2	68.6	67.2	63.5	65.0
Interest (US$m)	39.3	39.9	36.9	29.6	29.7	29.3	27.8

a/ Base case range $180-225 million; high case of up to $300 million could include adjusted operation for Capital Market Development, as well as additional lending for Mercosur-related infrastructure.

Uruguay - IFC and MIGA Program, FY94-97

Category	Past			
	1994	1995	1996	1997
IFC approvals (US$m)	0.00	8.00	6.50	0.00
Sector (%)				
	0.00	0.00	0.00	0.00
Financial Services	0.00	0.00	92.00	0.00
Food & Agro-Business	0.00	0.00	8.00	0.00
Infrastructure	0.00	100.00	0.00	0.00
TOTAL	100.00	100.00	100.00	100.00
Investment instrument (%)				
Loans	0.00	50.00	8.00	0.00
Equity	0.00	0.00	0.00	0.00
Quasi-Equity[a]	0.00	50.00	92.00	0.00
Other	0.00	0.00	0.00	0.00
TOTAL	100.00	100.00	100.00	100.00
MIGA guarantees (US$m)	0.00	0.00	0.00	0.00
MIGA commitments (US$m)	0.00	0.00	0.00	0.00

[a]Includes quasi-equity types of both loan and equity instruments.

URUGUAY

Recent and Proposed Non-Lending Services

FY97	
	Audience
Reform and Regulation of Utilities	Government/Public
A Reform Agenda for the Uruguayan Transport Sector	Government/Public
A Continuing Reform Agenda (informal)	Government
Airport Privatization (advisory services)	Government
Bank Restructuring (advisory services)	Government
LAC ABCD Conference (Regional/EDI)	Bank/Public/Government
Brainstorming on Uruguay and Mercosur (informal)	Government

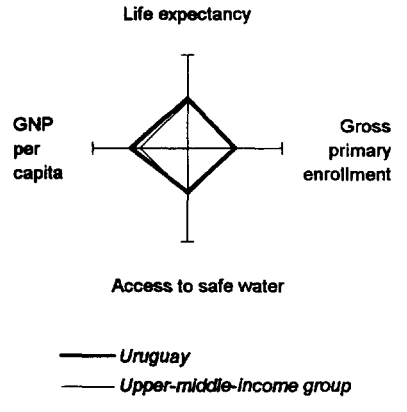
FY98	
	Audience
Labor Markets and Mercosur	Government/Bank
Natural Resource Management	Government/Public/Bank
Education Review (jointly with IDB)	Government/Bank
Program or Study Tours/Informal Studies/ Advisory Services on Demand	Government/Public

FY99	
	Audience
CEM -- Policy Assessment	Government/Public/Bank
Urban Transport Issues	Government
Program of Study Tours/Informal Studies/Advisory Services on Demand	Government/Public

Uruguay at a glance

POVERTY and SOCIAL	Uruguay	Latin America & Carib.	Upper-middle-income
Population mid-1995 (millions)	3.2	480	440
GNP per capita 1995 *(US$)*	5,100	3,300	4,300
GNP 1995 *(billions US$)*	16.2	1,584	1,892
Average annual growth, 1990-95			
Population (%)	0.5	1.8	1.7
Labor force *(%)*	1.0	2.4	2.1
Most recent estimate *(latest year available since 1989)*			
Poverty: headcount index *(% of population)*	..	..	..
Urban population *(% of total population)*	90	74	74
Life expectancy at birth *(years)*	73	68	69
Infant mortality *(per 1,000 live births)*	18	41	36
Child malnutrition *(% of children under 5)*	..	..	..
Access to safe water *(% of population)*	83	81	89
Illiteracy *(% of population age 15+)*	3	13	13
Gross primary enrollment *(% of school-age population)*	109	110	107
Male	109	..	..
Female	108	..	..

Development diamond*

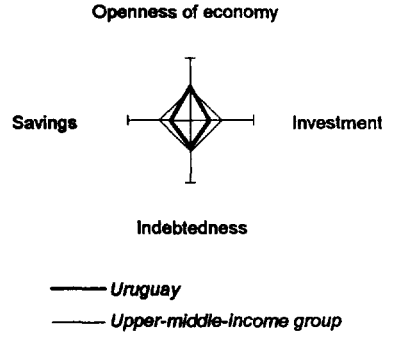


KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1975	1985	1994	1995
GDP *(billions US$)*	3.5	4.7	16.3	17.7
Gross domestic investment/GDP	18.9	11.4	13.8	13.3
Exports of goods and non-factor services/GDP	16.8	26.8	21.2	20.8
Gross domestic savings/GDP	15.4	17.0	13.1	13.7
Gross national savings/GDP	13.0	9.6	11.9	12.9
Current account balance/GDP	-5.6	-2.3	-2.7	-1.2
Interest payments/GDP	1.5	6.2	1.5	1.8
Total debt/GDP	25.7	83.1	31.2	30.0
Total debt service/exports	58.9	42.6	15.2	23.0
Present value of debt/GDP	..	..	29.3	..
Present value of debt/exports	..	..	134.7	..

	1975-84	1985-95	1994	1995	1996-04
(average annual growth)					
GDP	0.6	3.5	6.3	-2.0	..
GNP per capita	-0.5	3.2	5.2	-2.5	..
Exports of goods and nfs	4.6	7.4	14.6	-0.5	..

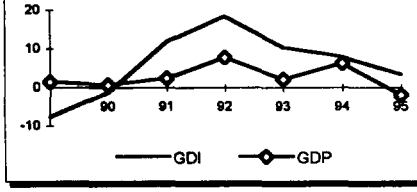
Economic ratios*



STRUCTURE of the ECONOMY

	1975	1985	1994	1995
(% of GDP)				
Agriculture	15.2	13.6	8.7	9.8
Industry	33.9	35.9	26.5	25.9
Manufacturing	25.8	29.4	18.2	17.7
Services	51.0	50.5	64.8	64.3
Private consumption	70.6	68.5	74.2	73.4
General government consumption	14.0	14.4	12.6	12.8
Imports of goods and non-factor services	20.3	21.1	21.9	20.4

Growth rates of output and investment (%)



	1975-84	1985-95	1994	1995
(average annual growth)				
Agriculture	1.0	2.1	9.2	2.6
Industry	0.1	-0.4	2.7	-2.9
Manufacturing	-0.8	0.5	4.0	-2.6
Services	0.8	5.7	7.5	-2.4
Private consumption	-0.5	6.0	8.2	-3.8
General government consumption	3.3	1.9	4.5	0.2
Gross domestic investment	-1.1	5.0	7.9	3.3
Imports of goods and non-factor services	1.0	15.5	16.8	-1.7
Gross national product	-0.9	3.5	5.7	-2.0

Growth rates of exports and imports (%)

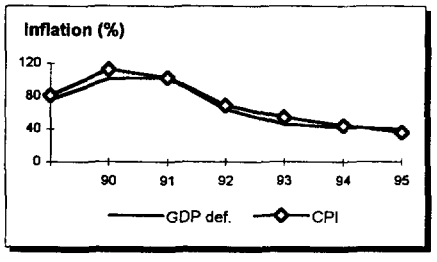
Note: 1995 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Uruguay

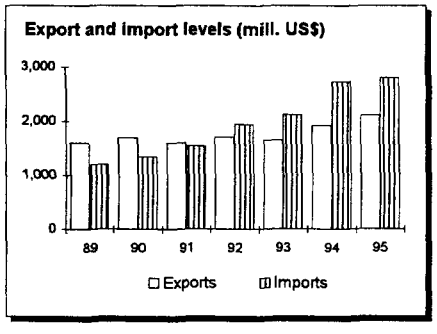
PRICES and GOVERNMENT FINANCE

	1975	1985	1994	1995
Domestic prices				
(% change)				
Consumer prices	81.4	72.2	44.1	35.4
Implicit GDP deflator	66.1	73.9	41.6	39.6
Government finance				
(% of GDP)				
Current revenue	..	14.5	35.5	36.5
Current saving	..	-1.3	3.5	3.2
Overall surplus/deficit	..	-2.8	-1.9	-1.0



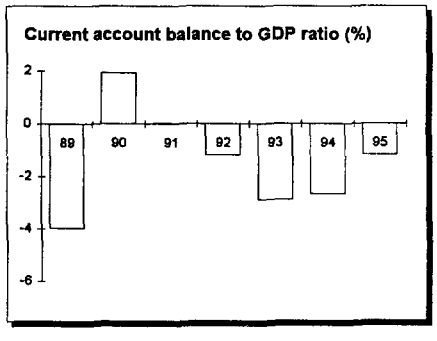
TRADE

	1975	1985	1994	1995
(millions US$)				
Total exports (fob)	384	854	1,913	2,106
Wool	105	164	230	241
Meat	97	111	246	252
Manufactures	..	260	802	838
Total imports (cif)	556	708	2,730	2,802
Food	11	22	166	201
Fuel and energy	..	224	237	272
Capital goods	..	65	355	394
Export price index *(1987=100)*	..	78	122	125
Import price index *(1987=100)*	..	61	79	85
Terms of trade *(1987=100)*	..	127	154	147



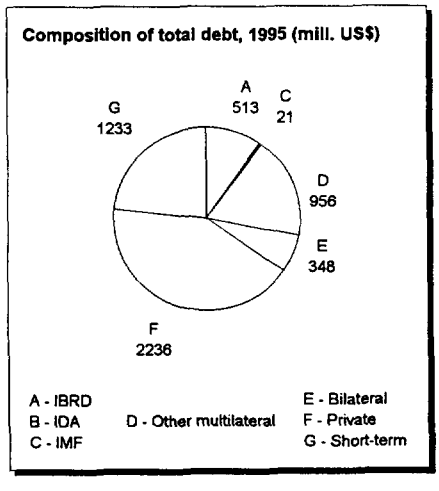
BALANCE of PAYMENTS

	1975	1985	1994	1995
(millions US$)				
Exports of goods and non-factor services	551	1,257	3,248	3,504
Imports of goods and non-factor services	676	1,015	3,485	3,565
Resource balance	-125	242	-237	-61
Net factor income	-71	-351	-243	-227
Net current transfers	-1	0	41	76
Current account balance, before official transfers	-198	-109	-439	-212
Financing items (net)	128	175	201	3
Changes in net reserves	69	-66	238	209
Memo:				
Reserves including gold *(mill. US$)*	555	1,031	1,952	2,161
Conversion rate *(local/US$)*	2.3E-03	0.1	5.6	7.0



EXTERNAL DEBT and RESOURCE FLOWS

	1975	1985	1994	1995
(millions US$)				
Total debt outstanding and disbursed	904	3,919	5,070	5,307
IBRD	69	152	539	513
IDA	0	0	0	0
Total debt service	327	568	535	900
IBRD	11	30	95	117
IDA	0	0	0	0
Composition of net resource flows				
Official grants	0	2	9	9
Official creditors	-8	10	122	9
Private creditors	44	17	156	-11
Foreign direct investment	0	0	170	200
Portfolio equity	0	0	25	1
World Bank program				
Commitments	52	4	108	16
Disbursements	5	23	37	32
Principal repayments	6	19	56	78
Net flows	-1	4	-19	-46
Interest payments	5	11	39	40
Net transfers	-7	-7	-58	-86



Uruguay - Key Economic Indicators

Indicator	Actual			Estimate		Projected			
	1991	1992	1993	1994	1995	1996	1997	1998	1999
National accounts (as % GDP at current market prices)									
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture	10.2	10.3	8.4	8.7	9.8	8.9	8.9	8.9	8.9
Industry	32.9	30.7	28.1	26.5	25.9	26.4	26.4	26.4	26.4
Services	56.9	59.0	63.6	64.8	64.3	64.7	64.7	64.7	64.7
Total Consumption	83.3	85.8	85.9	86.9	86.3	88.7	88.9	88.2	87.9
Gross domestic fixed investment	11.9	12.5	13.8	12.8	11.7	13.1	13.3	13.7	13.8
Government investment	4.1	3.4	4.3	4.5	3.6	4.1	4.4	4.7	4.9
Private investment (includes increase in stocks)	7.8	9.0	9.5	8.3	8.1	9.0	8.9	9.0	8.9
Exports (GNFS)[a]	23.1	22.2	20.7	21.2	20.8	17.8	17.2	17.8	18.1
Imports (GNFS)	19.9	21.3	21.2	21.9	20.4	19.6	19.4	19.7	19.8
Gross domestic savings	16.7	14.2	14.1	13.1	13.7	11.3	11.1	11.8	12.1
Gross national savings[b]	14.6	12.8	13.0	11.9	12.9	11.7	11.4	12.0	12.2
Memorandum items									
Gross domestic product (US$ million at current prices)	10045	11857	13822	16269	17705	20981	22626	23507	24834
Gross national product per capita (US$, Atlas method)	2900.0	3460.0	3930.0	4550.0	5100.0	6020.0	6640.0	7140.0	7480.0
Real annual growth rates (%, calculated from 1983 prices)									
Gross domestic product at market prices	3.2%	7.9%	3.0%	6.3%	-2.0%	4.9%	4.0%	3.0%	3.2%
Gross Domestic Income	4.2%	8.9%	4.3%	7.3%	-0.2%	1.1%	3.8%	3.7%	3.6%
Real annual per capita growth rates (%, calculated from 1983 prices)									
Gross domestic product at market prices	2.6%	7.3%	2.4%	5.8%	-2.5%	4.3%	3.4%	2.5%	2.6%
Total consumption	4.3%	11.9%	4.9%	7.1%	-3.7%	6.9%	3.4%	1.9%	2.3%
Private consumption	5.1%	14.0%	5.7%	7.6%	-4.3%	6.9%	3.4%	1.7%	2.2%

(continued)

Uruguay - Key Economic Indicators (Continued)

Indicator	Actual 1991	1992	1993	Estimate 1994	1995	Projected 1996	1997	1998	1999
Balance of Payments (US$m)									
Exports (GNFS)[a]	2200.9	2558.4	2732.0	3248.3	3504.3	3728.9	3901.6	4182.8	4498.8
Merchandise FOB	1604.7	1702.5	1645.3	1913.4	2106.6	3301.0	3520.4	3714.7	3951.7
Imports (GNFS)[a]	1966.2	2515.3	2929.9	3484.9	3565.2	4116.6	4383.6	4619.3	4910.5
Merchandise FOB	1543.7	2045.0	2325.7	2730.3	2802.4	2397.2	2539.2	2724.2	2928.8
Resource balance	234.7	43.1	-197.9	-236.6	-60.9	-387.7	-482.0	-436.6	-411.7
Net current transfers (including official current transfers)	40.1	28.6	37.6	41.2	76.0	74.0	75.5	77.1	78.9
Current account balance (after official capital grants)	42.4	-115.5	-353.3	-438.5	-211.9	-295.6	-425.0	-392.4	-389.0
Net private foreign direct investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term loans (net)	-38.4	292.8	242.4	266.7	490.2	213.0	431.8	417.8	441.2
Official	140.6	146.5	155.3	121.5	8.8	58.4	73.0	91.2	92.0
Private	-179.0	146.3	87.1	145.2	481.4	154.6	358.7	326.6	349.2
Other capital (net, including errors and omissions)	-231.5	83.7	401.9	409.8	-68.9	226.6	126.7	92.5	93.4
Change in reserves[c]	227.5	-261.0	-291.0	-238.0	-209.4	-144.0	-133.5	-117.9	-145.6
Memorandum items									
Resource balance (% of GDP at current market prices)	2.3%	0.4%	-1.4%	-1.5%	-0.3%	-1.8%	-2.1%	-1.9%	-1.7%
Real annual growth rates (YR83 prices)									
Merchandise exports (FOB)	6.9%	11.7%	1.1%	0.8%	7.3%	7.9%	5.2%	4.3%	4.9%
Primary	-11.0%	13.8%	-6.0%	25.1%	9.0%	4.2%	7.2%	6.7%	5.5%
Manufactures	-27.8%	12.3%	1.1%	8.3%	0.1%	13.5%	4.5%	2.5%	4.5%
Merchandise imports (CIF)	46.1%	21.8%	12.9%	25.1%	-4.4%	10.3%	5.3%	4.2%	4.7%
Public finance (as % of GDP at current market prices)[d]									
Current revenues	36.2	36.6	35.5	35.5	36.5	36.6	36.6	36.6	36.6
Current expenditures	30.9	31.3	31.5	32.1	33.3	32.8	32.6	32.5	32.4

(Continued)

Uruguay - Key Economic Indicators (Continued)

Indicator	Actual			Estimate			Projected		
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Current account surplus (+) or deficit (-)	5.3	5.3	3.9	3.5	3.2	3.8	3.9	4.1	4.2
Capital expenditure	4.0	3.9	4.7	5.4	4.2	4.1	4.4	4.7	4.9
Foreign financing	..	0.9	0.7	1.5	2.6	0.9	1.8	1.6	1.6
Monetary indicators									
M2/GDP (at current market prices)	71.4	59.0	52.1	51.1	54.5	50.8	47.3	47.6	46.9
Growth of M2 (%)	140.5	46.2	34.4	47.6	45.9	25.5	17.5	20.3	17.5
Private sector credit growth / total credit growth (%)	22.6	82.6	86.6	83.8	97.4	13.5	92.5	90.1	87.3
Price indices(YR83 =100)									
Merchandise export price index	122.2	116.1	111.0	128.1	131.4	138.6	139.5	143.5	147.1
Merchandise import price index	82.6	89.8	90.5	84.9	91.1	97.4	98.6	99.8	101.4
Merchandise terms of trade index	148.0	129.3	122.6	150.8	144.1	142.3	141.5	143.8	145.0
Real exchange rate (US$/LCU)[e]	115.0	123.1	145.0	153.3	145.7	147.2	151.6	151.6	151.6
Real interest rates									
Consumer price index (% growth rate)	81.5%	58.9%	52.9%	44.1%	35.4%	24.0%	17.0%	15.0%	13.0%
GDP deflator (% growth rate)	100.8%	64.0%	47.5%	41.6%	39.6%	28.3%	21.3%	16.0%	15.7%

a. "GNFS" denotes "goods and nonfactor services."
b. Includes net unrequited transfers excluding official capital grants.
c. Includes use of IMF resources.
d. Consolidated public sector.
e. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Uruguay - Key Exposure Indicators

Indicator	Actual			Estimate		Projected			
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total debt outstanding and disbursed (TDO) (US$m)[a]	4188.7	4568.5	4846.0	5069.6	5307.0	5994.0	6462.5	6917.8	7397.3
Net disbursements (US$m)[a]	-33.7	429.7	272.5	125.6	1221.0	249.1	468.5	455.3	479.5
Total debt service (TDS) (US$m)[a]	805.9	523.9	586.1	535.1	899.9	846.9	904.2	1016.3	1008.5
Debt and debt service indicators (%)									
TDO/XGS[b]	172.0	164.1	162.5	143.6	135.8	146.1	150.8	151.3	151.0
TDO/GDP	41.7	38.5	35.1	31.2	30.0	28.6	28.6	29.4	29.8
TDS/XGS	33.1	18.8	19.7	15.2	23.0	20.6	21.1	22.2	20.6
Concessional/TDO	2.5	2.6	3.1	4.2	4.6	0.0	0.0	0.0	0.0
IBRD exposure indicators (%)									
IBRD DS/public DS	10.2	16.0	16.6	20.7	15.1	14.8	14.0	12.6	12.2
Preferred creditor DS/public DS	24.4	35.0	33.7	41.3	28.3	31.8	32.0	29.0	28.0
IBRD DS/XGS	2.9	2.7	2.9	2.7	3.0	2.7	2.6	2.4	2.2
Share of IBRD portfolio	0.0	0.0	0.0	0.0	..	..	..	..	..

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

Status of Bank Group Operations in Uruguay
IBRD Loans and IDA Credits in the Operations Portfolio

Loan or Credit No.	Fiscal Year	Borrower	Purpose	Original Amount in US$ Millions: IBRD	IDA	Cancellations	Undisbursed	Difference Between expected and actual disbursements a/	Last ARPP Supervision Rating b/: Development Objectives	Implementation Progress
Number of Closed Loans/credits: 30										
Loans										
L26220	*1986*	*UTE*	*POWER PLANT REHAB*	*45.20*	*0.00*	*0.00*	*11.20*	*11.20*	*S*	*S*
L29210	1988	REPUBLIC OF URUGUAY	WTR SUPPLY RHB	22.30	0.00	0.00	1.69	1.69	S	S
L30210	1989	REPUBLIC OF URUGUAY	TRNSPRT PROJ I	80.80	0.00	0.00	8.35	8.35	S	S
L32210	1990	ADMIN NACIONAL DE USINAS	POWER MODERNIZATION	62.50	0.00	0.00	13.67	12.00	S	S
L31310	1990	REPUBLIC OF URUGUAY	AGRICULTURAL DVLPMNT	65.00	0.00	0.00	1.27	1.27	S	S
L35170	1993	REPUBLIC OF URUGUAY	PUB ENT REFORM	11.00	0.00	3.20	1.77	4.97	S	S
L37290	1994	REPUBLIC OF URUGUAY	BASIC ED QUAL IMPRV	31.50	0.00	0.00	19.09	5.52	S	S
L36970	1994	REPUBLIC OF URUGUAY	IRRG NAT RES MGMT	41.00	0.00	0.00	31.66	19.56	S	S
L38550	1995	REPUBLIC OF URUGUAY	HLTH SCTR DEVT	15.60	0.00	0.00	13.76	4.89	S	U
L39490	1996	REPUBLIC OF URUGUAY	POWER TRNMSN & DISTR	125.00	0.00	0.00	125.00	14.82	S	S
Total				499.90	0.00	3.20	227.45	84.26		

	Active Loans	Closed Loans	Total
Total Disbursed (IBRD and IDA):	269.25	761.21	1,030.46
of which has been repaid:	80.67	523.99	604.66
Total now held by IBRD and IDA:	416.03	237.22	653.25
Amount sold :	0.00	4.62	4.62
Of which repaid :	0.00	4.62	4.62
Total Undisbursed :	227.45	0.00	227.45

a/. Intended disbursements to date minus actual disbursements to date as projected at appraisal.
b/. HS = highly Satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory.

Note:
Disbursement data is updated at the end of the first week of the month.

Uruguay
STATEMENTOF IFC's
Committed and Disbursed Portfolio
As of 30-Apr-97
In Millions US Dollars

FY Approval	Company	Committed IFC Loan	Committed IFC Equity	Committed IFC Quasi	Committed Partic	Disbursed IFC Loan	Disbursed IFC Equity	Disbursed IFC Quasi	Disbursed Partic
1980	Surinvest	0.00	1.79	0.00	0.00	0.00	1.79	0.00	0.00
1985	Azucitrus	7.13	3.90	0.00	0.00	7.13	3.45	0.00	0.00
1988	Surinvest	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1989	Migranja	3.30	2.00	0.00	0.00	3.30	2.00	0.00	0.00
1991	Granja Moro	2.00	.75	0.00	0.00	2.00	.75	0.00	0.00
1992	Azucitrus	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1993	Banco Comercial	2.90	0.00	0.00	0.00	2.73	0.00	0.00	0.00
1995	Consorcio Aerop.	8.00	0.00	0.00	10.00	6.51	0.00	0.00	8.14
1996	Surinvest	0.00	0.00	5.28	0.00	0.00	0.00	5.28	0.00

Pending Commitments					
1996	* MIGRANJA RESTRUC	.50	0.00	0.00	0.00

Table : Uruguay Country Assistance Strategy Matrix, 1998-2000

Development Objectives/Issues	Diagnosis	Strategy/Actions	Progress Benchmarks	Instruments IBRD/IFC/MIGA (FY)	IDB (CY)
ENHANCE SUSTAINABLE GROWTH AND PRIVATE SECTOR DEVELOPMENT ***Private sector has lagged in adjustment to economic liberalization potentially undermining its competitiveness and the potential benefits of MERCOSUR integration.***					
	Integration in MERCOSUR has bolstered reform efforts in Uruguay.	Promote MERCOSUR integration and reductions in Common External Tariff and exemptions .	Uruguay complying with integration timetable.	ESW CEM (96) MERCOSUR (97) CEM: Policy Assessment (99) Labor Mkts./MERCOSUR (98)	Grant Financing Technical cooperation in MERCOSUR integration.
Factor Markets	Strengthened financial sector in regional neighbors and continuing inefficiency in domestic banking undermine past and future role of Uruguay as a financial center an limit its support for investment. Capital market undeveloped, limiting attractive returns for the private pillar of the reformed social security system. Labor is high-cost, markets lack flexibility to improve competitiveness and unemployment levels remain too high.	Enhance regulation and norms for long-term credit operations to increase role of private banking and reduce the market dominance e of BROU. Reduce legal impediments to market development and constraints on private-pillar portfolios. Successful reform of social security system would allow for further reductions in labor taxes.	Strengthened supervision by Central bank and increased role of private banking. Share of Government bonds reduced to near legal limit. Employer contributions reduced by the full 6 percent foreseen under the social security reform.	ESW CEM (96) Project Financing IFC operations MIGA operations Capital Mrkt Dev (98)	ESW Inst. & Savings (97) Financial Sector & MERCOSUR (97) Project Financing Multi-Sector Credit I & II (94, 97) ESW Labor & Globalization (96) Grant Financing MIF Labor Retraining
Infrastructure Development	Infrastructure development has lagged as fiscal pressures limit public investment and lack of competition promotes inefficient operation of public enterprises and high cost for private sector producers.	Increase efficiency in the use of resources in the provision of services and maintenance of infrastructure through private sector partnership. Eliminate public monopolies and improve public enterprise efficiency.	Private sector participation in transport and power. Power transmission network to facilitate power interchange in MERCOSUR.	ESW Transport Sector Review (97) Reform and Regulation (97) Urban Transport Issues (99) Project Financing Power Transmission (96) Forest Products (97) Transport II (98) Transport III (00)	Project Financing Export Corridors (97) Power II (98)

Table : Uruguay Country Assistance Strategy Matrix, 1998-2000

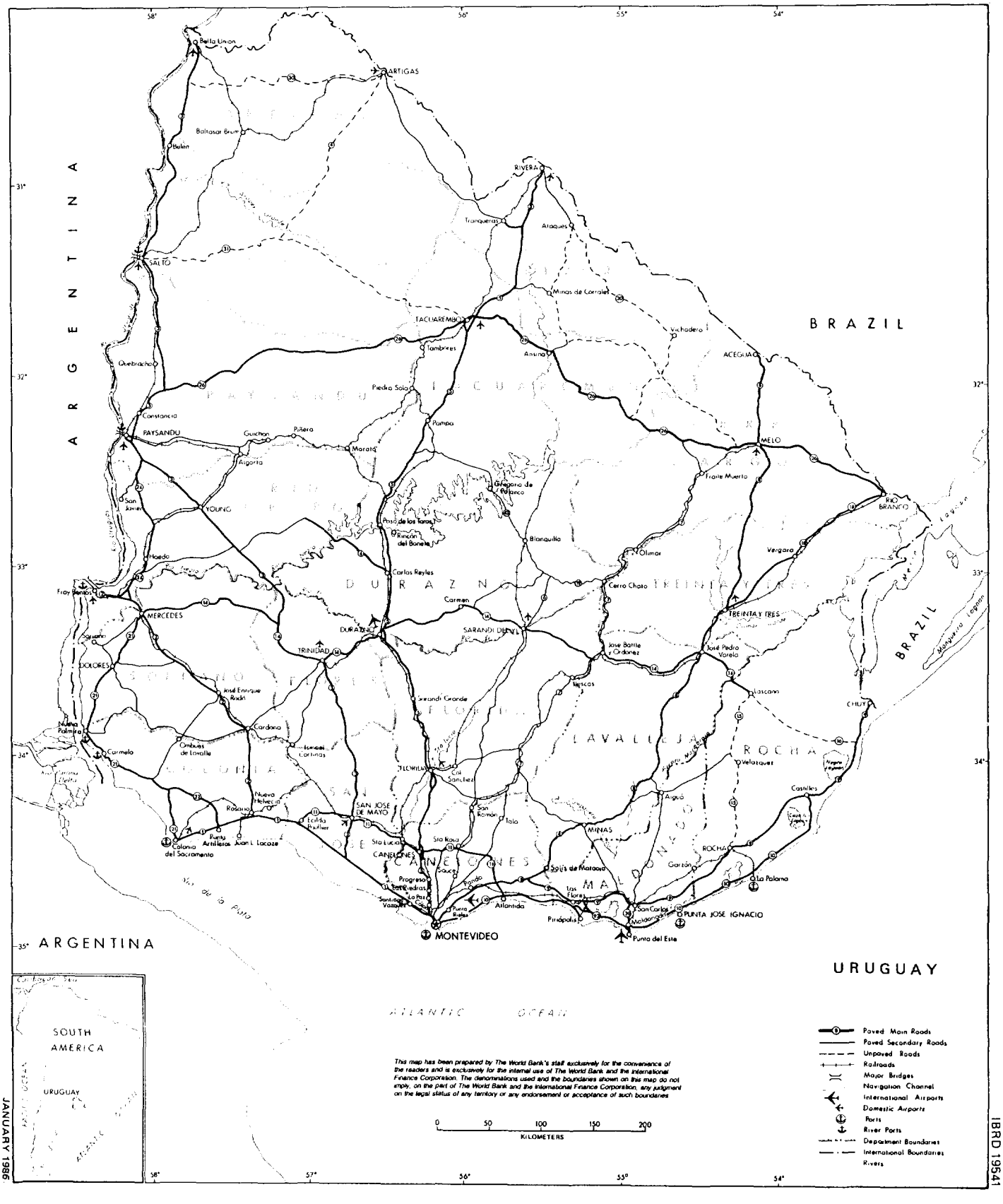
Reduce Pollution	Urbanization and a deterioration in public services has increased urban pollution problems with a negative effect on health and development of tourism. Uruguay also needs to comply with commitments under global environmental agreements.	Assist the Government in redefining the water and sewerage sector to induce greater private sector participation and carrying out needed investments.	Development of options for the required water sector restructuring, increased efficiency of public water enterprise and piloting of private concessions. Process and approval of Montreal Protocol project completed, to reduce CFI output to the atmosphere by 10% compared to 1992 levels.	ESW Water and Sanitation (96) Project Financing Water Sector Reform (98) Grant Financing Project for the Reduction of Ozone-Depleting Substances (96)	Project Financing Potable Water (94) Urban Renewal (97)
Conserve Natural Resources	Shift to more intensive technology in agriculture presents new needs to improve natural resource management and protection.	Promote sustainable management of natural resources through improved on-farm practices. Strengthen efforts to protect bio-diversity.	Transfer of operation and management of irrigation schemes to users' associations.	ESW Natural Resource Mgt. (98) Project Financing Natural Resource Management and Irrigation Development (94) Bio-diversity (99)	ESW Environ. Action Plan (94)
HUMAN RESOURCE DEVELOPMENT					
Education	Social indicators among highest in the Region, but quality of public health and education has been declining, limiting ability to alleviate remaining poverty and undermine future competitiveness in MERCOSUR.	Assist the Government to improve the quality, equity and efficiency of the education system.	Reduction of repetition rates, increased coverage in poor areas. Increased availability of early childhood education, particularly in poor areas.	ESW Ed. Sector Financing (98) Project Financing Basic Education Project (94) Education (99)	Project Financing Social Investment (94) Secondary Education (96)
Basic Health Services		Rationalize health sector spending by increasing role of the private sector.	Initiate and replicate successful pilots to increase autonomy of public hospitals..	ESW Health Sector Study (96) Project Financing Health Sector Development (95) Health II (00)	
REDUCE FISCAL DEFICIT AND MODERNIZE ROLE OF THE STATE	Structural fiscal deficits undermine efforts to reduce inflation and limit ability to muster required savings for investment.	Modernize role of the state, reduce fiscal strains of social security system and overstaffed administration.	Viable fully-funded private pillar in operation.	ESW CEM (96) Social Security (96) Project Financing Capital Mrkt Dev (98)	ESW Labor & Public sector (96) Project Financing Modernization Customs (94) Modernization Audit (94) Social Security (95) State Reform (97) Municipal Governments (97) Technical Development (97) Agricultural Services (97) Mod. of Judiciary (98) Mod of Legislature (98) Public Safety(98)

URUGUAY

CAS Decision: Balancing Risks and Rewards FY98-00 (High Case)

	RISK		
Project (Ranked by Reward) a/	**Low 8% (Vol.)**	**Medium 63% (Vol.)**	**High 29% (Vol.)**
Capital Markets			x
Education		x	
Health		x	
Transport II & III	x		
Water II		x	
Natural Resources Mgt	x		

a/ Higher to lower.



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