

Country Assistance Strategy for The Oriental Republic of Uruguay **2005 - 2010**



THE WORLD BANK

**Country Assistance Strategy for
The Oriental Republic of Uruguay
2005 - 2010**

The last Country Assistance Strategy for Uruguay was discussed by the Executive Directors on June 6, 2000 (Report No. 20355-UR dated May 5, 2000) and the last Country Assistance Strategy Progress Report was discussed on August 8, 2002 (Report No. R2002-0147 dated July 26, 2002 and Report No. R2002-0147/1 dated August 7, 2002).

CURRENCY EQUIVALENTS (as of May 1, 2005)
Currency Unit = Uruguayan Peso (UYP)
1 US Dollar = 25.08 Pesos

FISCAL YEAR: January 1 – December 31

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Document Of The World Bank For Official Use Only, Report No. 31804-UY
Inter national Bank For Reconstruction And Development
Country Assistance Strategy For The Oriental Republic Of Uruguay
For The Period Fy05-fy10, May 10, 2005

Argentina, Chile, Paraguay and Uruguay Country Management Unit
Latin America and the Caribbean Region



Acknowledgements

The World Bank greatly appreciates the close collaboration with the Government of Uruguay in the preparation of this CAS.

The CAS team would like to thank the entire country team for their contributions, including from the Country Management Unit: Felipe Sáez, Anthony Gaeta (Client Survey), Yanina Budkin, Lisandro Martin and Maria José Ravalli (Consultations with Civil Society), Mariano Lafuente (CAS Annexes), and Frank Earwaker (CAS Completion Report); from the Poverty Reduction and Economic Management Department: Daniel Oks (Growth Strategy), Alejandro Guerson (Macro Framework and Debt Sustainability), and Lisa Bhansali (State Modernization); from the Environmentally Sustainable and Social Development Department: Carter Brandon, Macdonald Benjamin, Michael Carroll, Marisa Miodosky, William Reuben, Alvaro Soler and Horacio Terraza; from the Human Development Department: Jesko Hentschel, Emiliana Vegas, Ricardo Silveira, Luis Perez, Jack Fiedler, Cristian Baeza, Truman Packard and Rafael Rofman; from the Finance, Private Sector and Infrastructure Department: Juan Gaviria, Daniel Pulido, Andres Pizarro, Jorge Rebelo, Carlos Velez, Philippe Durand, Mariluz Cortes, Sophie Sirtaine and José Luis Gausch. In addition, special thanks to several colleagues in the LAC region and across the Bank including Ulrich Zachau, Todd Crawford, Barbara Mierau-Klein, Stefan Koeberle, Erika Jorgensen and Gloria Grandolini. We would also like to acknowledge the valuable contributions of colleagues in the IADB, IMF, IFC, MIGA and WBI. Special thanks to Maritza Bojorge and Maria Estrella for formatting and compiling the final document.

Abbreviations and acronyms

AAA	Analytical and Advisory Activities
ADME	Electricity Market Administration
ANCAP	National Administration of Fuels, Alcohol and Cement
ASSE	Public Health Services Administration
BHU	National Mortgage Bank/Banco Hipotecario del Uruguay
BROU	Republic Bank/Banco de la República Oriental del Uruguay
BPS	Social Security Fund/Banco de Previsión Social
CAS	Country Assistance Strategy
CEPAL	Comisión Económica para América Latina/Economic Commission for Latin America and the Caribbean
CFAA	Country Financial Accountability Assessment
CMU	Country Management Unit
CPAR	Country Procurement Assessment Report
DFID	Department for International Development/United Kingdom Development Agency
DGI	Tax Administration Department
DPL	Development Policy Loans
DPR	Development Policy Review
ESW	Economic and Sector Work
EU	European Union
FA-EP-NM	Frente Amplio - Encuentro Progresista – Nueva Mayoría
FAO	Food and Agriculture Organization
FCES	Foro Consultivo Económico-Social del MERCOSUR
FSLs	Fixed Spread Loans
FTAA	Free Trade Area of the Americas
GDLN	Global Development Learning Network
GDP	Gross Domestic Product
GEF	Global Environment Facility
GoU	Government of Uruguay
GTZ	Gesellschaft für Technische Zusammenarbeit/German Development Agency
IADB	Inter-American Development Bank
IAMC	Collective Mutual Care Institutions
IBRD	International Bank for Reconstruction and Development
IDF	Institutional Development Fund
IFIs	International Financial Institutions
IICA	Inter-American Institute for Cooperation on Agriculture
ILO	International Labor Organization

IMF	International Monetary Fund
INE	National Statistical Institute
IWA	Institute for Women's Affairs
JICA	Japan International Cooperation Agency
MDGs	Millennium Development Goals
M & E	Monitoring and Evaluation
MEF	Ministry of Economy and Finance
MIGA	Multilateral Investment Guarantee Agency
MOH	Ministry of Health
MERCOSUR	Common Southern Market/Mercado Común del Sur
NBC	New Commercial Bank/Nuevo Banco Comercial
NGO	Non Governmental Organization
OECD	Organization for Economic Co-operation and Development
OPP	Office of Planning and Budget
OSE	Public Sewerage Works Administration
PAHO	Pan-American Health Organization
PANES	Social Emergency Program/Plan de Asistencia Nacional a la Emergencia Social
PC	Partido Colorado
PN	Partido Nacional
PPA	Power Purchase Agreement
PPP	Public-Private Partnerships
PSIA	Poverty and Social Impact Analysis
RER	Real Exchange Rate
ROSC	Report on the Observance of Standards and Codes
SAL	Structural Adjustment Loan
SSAL	Special Structural Adjustment Loan
SBA	Stand-by Arrangement
SICE	Integrated State Purchasing System/Sistema Integrado de Compras Estatales
SME	Small and Medium Enterprise
SSAL	Special Structural Adjustment Loan
TAL	Technical Assistance Loan
TOCAF	Code of Accounting and Financial Management/Texto Ordenado de Contabilidad y Administración Financiera
UI	Inflation-indexed Deposits
UNICEF	United Nations Children's Fund
UNDP	United Nations Development Programme
URSEA	Regulatory Agency for Energy and Water
URSEC	Regulatory Agency for Communications
VAT	Value Added Tax
WBI	World Bank Institute
WSS	Water Supply and Sanitation
WTO	World Trade Organization

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MAP

IBRD 33507



I. Executive Summary

Uruguay is currently in the midst of a dual transition. First, there is an economic transition from the 2002 crisis towards a path of equitable and sustainable development, as the economy continues to recover strongly. Second, there is a political transition, as the victory of the Frente Amplio – Encuentro Progresista – Nueva Mayoría coalition in the October 2004 elections marked a new phase in the country's political history.

The Government faces three main challenges in order to succeed with the economic transition, namely: (i) reducing vulnerability; (ii) sustaining growth; and (iii) improving living standards.

The challenge of reducing vulnerability relates to debt sustainability, fiscal management and financial sector reforms. Debt sustainability will continue to be a major development challenge in the medium term given the sharp increase in the public debt to GDP ratio as a result of the crisis. Heavy amortizations due in the period 2006-07 constitute a particular source of vulnerability. Strong fiscal management will be the key to reducing the debt burden over time while ensuring an environment of price and exchange rate stability. Policymakers can build on Uruguay's impressive fiscal performance since the crisis which culminated in a primary surplus of 3.8 percent of GDP in 2004.

Meeting the challenge of putting Uruguay on a path of higher longer-run growth will depend upon structural reforms aimed at increasing investment, enhancing competitiveness, and creating an enabling environment for the private sector. Uruguay's strong rebound from the crisis, with 12.3 percent growth in 2004, has helped create a sound basis for these reforms.

In improving living standards, the new administration faces the challenge of bringing the escalating costs of public pensions and health care under control in order to free up fiscal space for essential social investments including an expanded social safety net. Uruguay has experienced a deepening of social exclusion during the crisis and the new Government is committed to addressing the problems associated with society's most vulnerable groups.

The proposed CAS aims to support the Government's efforts to meet Uruguay's development challenges in areas where the Bank has a comparative advantage. CAS preparation has benefited from extensive consultations and AAA work. This has included: (i) public discussion of a Sources of Growth study with the current Minister of Finance and his immediate predecessor, (ii) a two day Policy Notes seminar with the full Cabinet, (iii) a Client Survey conducted in July 2004 which highlighted widespread interest in maintaining or expanding Uruguay's relations with the multilateral financial institutions, (iv) consultations

with civil society, and (v) the lessons learned presented in the Completion Report on the 2000 CAS and the 2002 CAS Progress Report.

The proposed Bank assistance strategy is anchored around a series of programmatic development loans that are expected to be multi-sectoral in focus and support the Government in key policy areas including public sector management, financial sector reform, and reform of social programs. The investment lending pipeline will be rebuilt with new operations planned to support priority investments in infrastructure (transport, energy), social programs (reform of the national health insurance system, support to education), institution building (tax administration, expenditure management), and innovation, science and technology.

The CAS envisages a base case scenario of up to US\$800 million over the period through fiscal year 2010. The lending program will be modulated on the strength of the Government's program and its ability to implement it, as well as the country's creditworthiness and the Bank's exposure. Self-correcting mechanisms are built into the CAS to modulate Bank exposure in line with performance benchmarks.

If the macroeconomic framework, reform implementation, or improvement in debt sustainability were to fall below expectations, the Bank would revert to a low case scenario, with total lending commitments reduced by at least US\$300 million with respect to the base case envelope. Unsatisfactory portfolio implementation would also be grounds for slowing new investment lending. Were reform and investment program implementation to exceed expectations, allowing Uruguay to largely recover its investment grade status, this would open up the perspective of accelerated implementation of the lending program and a possibly enhanced level of Bank support to be discussed at the time of the CAS Progress Report planned for FY08.

Indicative outcomes and results indicators are presented in the CAS Results Matrix. Expected CAS outcomes will be further refined as required information becomes available. This will be reflected in the planned CAS Progress Report which will provide a preliminary stocktaking. A new Client Survey will also be carried out.

Effective collaboration with Uruguay's other multilateral partners – mainly the IMF and the IADB – as well as civil society will be instrumental in implementing the CAS. A new three year Stand-by arrangement has been agreed with IMF staff and is expected to be presented to the IMF Board in early June. The IADB is preparing a new Country Strategy for presentation to its Board of Directors later this year. In implementing the CAS, we have identified activities to assist the Government in strengthening relationships with civil society.

Notwithstanding the progress of Uruguay in consolidating its recovery, a number of important risks must be acknowledged. Most important is the risk associated with debt sustainability. Uncertainty about the new administration's ability to deliver on its program of reforms constitutes a political and social risk. There are also a number of other risks such as energy dependency, IBRD exposure, and the possibility of new regional shocks.

Executive Directors may wish to discuss, among others, the following issues:

- While the length of the CAS coincides with the political cycle, the outer years of the program have been broadly defined to ensure flexibility and the content of the policy lending remains under discussion with the Government. **Is the balance between specificity and flexibility in the CAS appropriate?**
- The substantial proposed lending program is intended to assist the new administration to achieve ambitious growth and social objectives. Program risks have been assessed and mitigation measures identified. **Does the composition and size of the program strike the right balance between opportunities and risks?**

Introduction



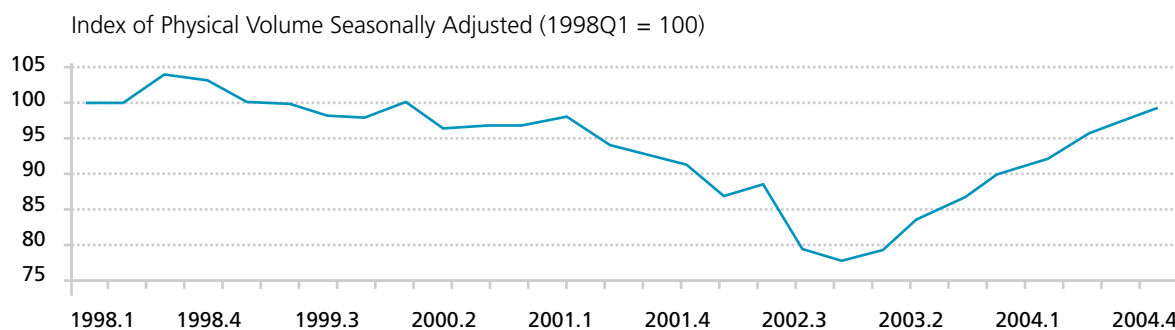
A. Overview

1. Uruguay is currently in the midst of a dual transition. First, there is an economic transition from the 2002 crisis towards a path of equitable and sustainable development. The Uruguayan economy has bounced back since mid-2003 and continues to enjoy a strong recovery. Real GDP growth in 2004 was 12.3 percent, and the forecast for 2005 is for further 6 percent growth. The success with which Uruguay was able to weather the economic crisis of 2001-02 owes much to its prompt and purposeful response to events as they unfolded. The economic crisis did not provoke a political crisis nor did it interrupt the normal procedures of government. Political continuity enabled the Government to manage proactively the economic situation and to mobilize long established elements of a social safety net to mitigate, but not prevent, the impact of the crisis on poverty.

Concerted support from the international financial community was also important in assisting the difficult adjustment. As a result of those combined efforts, Uruguay is on track to fully recover its pre-crisis level of income (Figure 1). The country is well positioned to service its sovereign debt and embark upon a path of sustained growth provided sound macroeconomic policies and the agenda of post-crisis structural reform continues to be implemented.

2. Second, there is a political transition. The victory of the *Frente Amplio – Encuentro Progresista – Nueva Mayoría* (FA-EP-NM) coalition in the October 2004 elections ended 170 years of dominance of Uruguayan politics by the two traditional parties, the *Partido Colorado* and the *Partido Nacional*. The new Government took office on March 1, 2005. Uruguay is an open society and the political transition period

FIGURE 1: URUGUAY: QUARTERLY GROSS DOMESTIC PRODUCT, 1998-2004



Source: Central Bank of Uruguay.

has been smooth. The *Frente Amplio* reached agreement with the two traditional parties as well as independents on an overall framework for the conduct of economic policy, foreign policy and education policies. The resulting "Inter-party Agreement" of February 16, 2005, specifically commits all parties to honor the outcome of the 2003 debt renegotiation. It also acknowledges the need for strict fiscal discipline to satisfy the urgent social needs of Uruguay while, at the same time, generating an adequate primary fiscal surplus. Although many specifics still remain to be determined, it augurs well for stability and continuity of the body politic that a multi-partisan agreement could be reached so early in the new administration.

3. To accompany Uruguay's economic and political transition, there is a need for continued support from the international financial community. The new administration has worked to establish a close relationship with multilateral lenders including the Bank, which plans to open an office in Montevideo in the coming months. The proposed country assistance strategy adopts a threefold focus:

- Analytical work to help the Government to articulate selected areas of its program.
- Rebuilding of the investment project pipeline in areas that would enhance growth, increase competitiveness, and reduce poverty and social exclusion.
- Continued development policy lending to support implementation of strategically important reforms to help the Government to reduce macroeconomic vulnerability, sustain growth and improve living standards.

4. The last CAS, discussed by the Board of Executive Directors on June 6, 2000¹, followed upon a decade of macroeconomic stability and growth in Uruguay. In view of the country's relatively high level of economic and social development at the time, the 2000 CAS contemplated a progressive reduction in Bank support and a transition to graduation. The relatively strong growth performance of Uruguay during the nineties was tempered by a sharp recession in 1999, which was in part a spillover from events in neighboring Argentina and Brazil. However, when the CAS was prepared, it was not foreseen that the recession would deepen and the economy would become seriously destabilized late in 2001 when neighboring

Argentina defaulted upon its public debt and devalued its currency to one third of its previous value. A CAS Progress Report² prepared in mid-2002 covered the truncated period FY03-04, in comparison to the FY01-05 program of the original CAS. The Progress Report was prepared at a time when the economic situation in Uruguay was deteriorating rapidly due, in part, to a run on bank deposits provoked by events in Argentina. The full dimensions of the crisis and its likely outcome could not be clearly discerned because events were still unfolding. Nevertheless, the 2002 Progress Report determined that the 2000 CAS lending scenario was no longer appropriate and concluded that additional support was needed to assist Uruguay to weather the crisis and to introduce specific reforms ranging from fiscal measures to increase revenues and curtail spending, to bank restructuring, promotion of efficiency and competition in infrastructure, maintaining investment in human capital and strengthening measures to protect vulnerable groups.

5. The rapid pace at which events were developing in 2002 required that the August 2002 Progress Report be supplemented with an Update³ which was discussed by the Board of Executive Directors together with the Progress Report on August 8, 2002. The Progress Report and its Update proposed adjustment lending as the preferred instrument for increased Bank support to Uruguay during the crisis period. Two Structural Adjustment Loans (SALs) and two Special Structural Adjustment Loans (SSALs) were envisaged over the period FY03-04 totaling US\$550 million (Box 1). Some operations in the pipeline of the original 2000 CAS were delayed, and a new project to help stem the outbreak of *aftosa* resulting in a substantial loss in competitiveness, was added.

6. The Bank's response was part of a concerted multilateral effort, which furnished a combined US\$4 billion of commitments, one of the largest such efforts as a percentage of GDP ever carried out (Table 1). In this context, the IMF took the lead in providing critical emergency support accounting for over 70 percent of commitments, with the Bank and the IADB providing the remainder. The coordinated effort by the international community and the determined policy response of the authorities, supported by all of the major parties, enabled Uruguay to achieve a recovery that compares favorably with other crisis countries of the past decade. Looking forward, the Bank will

1. Report No. 20355-UR.

2. Report No. R2002-0147.

3. Document No. R2002-0147/1.

BOX 1: SUPPORT FOR STRUCTURAL ADJUSTMENT IN RESPONSE TO CRISIS

- ▶ The CAS Progress Report of August 2002 proposed adjustment lending as the preferred instrument for Bank support to Uruguay during the crisis. As a result, the Bank extended structural adjustment loans to Uruguay in the course of FY03. The principal characteristics of these operations are outlined below. Their implementation is summarized in Annex 1.
- ▶ A SAL (SAL I, Report No. 24515-UR) in the amount of US\$151.5 million was approved in August 2002. The loan supported macroeconomic and fiscal actions centered on restraining public sector wages. In addition, the system of social protection was to be strengthened by improving management and by safeguarding budget allocations. Unemployment insurance was to be reformed and training for the unemployed was to be streamlined. A Special SAL (SSAL I, Report No. 24515-UR) in the amount of US\$151.5 million was also approved in August 2002. That loan focused specifically on support for restructuring of the National Mortgage Bank as part of a broader reform of the banking system which was also receiving support from the IMF. Both the SAL and the Special SAL have been fully disbursed.
- ▶ In addition, a Public Services and Social Sectors SAL (SAL II, Report No. 25012-UR) in the amount of US\$151.5 million was approved in April 2003. The overall objective of the loan was to boost competitiveness and economic growth through the better provision of public and social services and infrastructure. To that end, a broad range of structural and policy reforms were identified with respect to infrastructure and public services. A Public Services and Social Sectors Special SAL (SSAL II, Report No. 25012-UR) in the amount of US\$101 million was also approved in April 2003. That loan aimed at improving the equity and efficiency of public expenditures in health and education by supporting measures to improve management and give budgetary protection to priority programs. The first tranche of both the Public Services SAL and Special SAL was disbursed when the loans were approved in April 2003. Two tranches for the Public Services SAL (for a total amount of US\$100 million) still remain to be disbursed and two tranches for the Public Services Special SAL (for a total of US\$75 million) will be cancelled (para. 89).

TABLE 1: INTERNATIONAL SUPPORT FOR THE CRISIS (in US\$ Million)

	Commitments ¹	Disbursements ²	Current Exposure ³
World Bank	556	381	784
IMF	2,831 ⁴	2,645 ⁴	2,493 ⁵
IADB ⁶	700	580	2,220
Total	4,087	3,606	5,497

1 From June 2002 to February 2005.

2 From June 2002 to February 2005.

3 As of end February 2005.

4 Exchange rate as of commitment date (US\$/SDR = 1.33).

5 Exchange rate as of 2005 (US\$/SDR = 1.5).

6 Includes a US\$200 million policy loan for the Strengthening of the Banking Sector approved in November 2003.

Source: IMF, World Bank and IADB estimates.

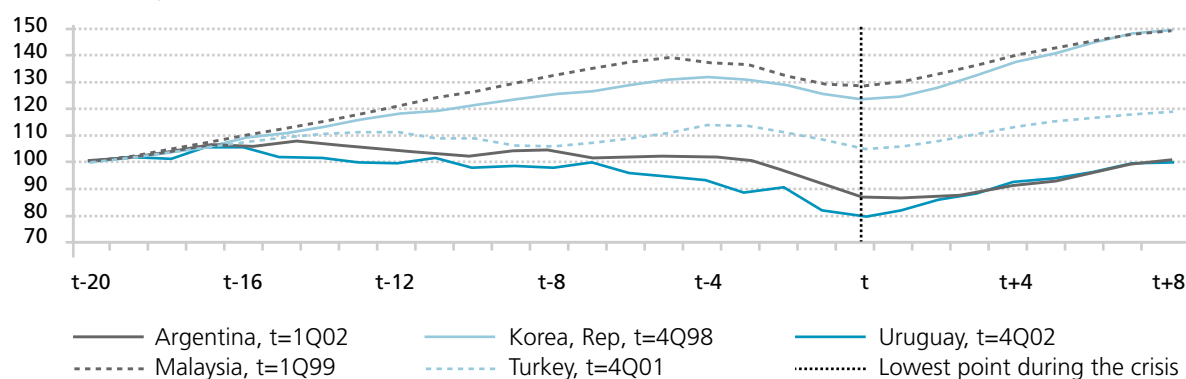
continue to work with the Vázquez Government to transform what was essentially a crisis response toward a balanced medium-term assistance program centered on key investments to sustain growth and promote social development.

7. In retrospect, it is clear that the crisis in Uruguay was particularly severe when compared with other countries that have experienced a crisis in the recent past. It can be seen from Figure 2 that the decline in

GDP from its pre-crisis peak was deeper in the case of Uruguay than for other countries including neighboring Argentina. It reflects well on its adjustment efforts that Uruguay has been able to recover so much lost ground relatively quickly. The depth of the crisis also provides clear justification for the Government's priority focus on social programs and the Bank's support for this objective under the proposed CAS.

FIGURE 2: CRISIS AND RECOVERY IN SELECTED COUNTRIES

Quarterly Gross Domestic Product, constant LCU, t-20=100



Notes: Four quarter moving averages for all countries, except for Argentina and Uruguay for which official seasonally adjusted data is available.

Sources: World Bank, IFS, and Central Banks of selected countries.

II. Country context and recent developments



A. Political Context

8. The first-round victory of the Frente Amplio party in Uruguay's presidential election on October 31, 2004 marked the first time in more than 170 years that the executive is not being controlled by either of the two traditional parties—Partido Colorado (PC) and Partido Nacional (PN). President Vázquez's victory after two previous attempts is interpreted, among other things, as a certain disenchantment of the electorate with the governance practices of the traditional parties. The recession starting in 1998, the financial crisis in 2002, the dissolution of the governing coalition in November of that same year, the limited scope for renewal in the ruling party, and poverty levels above 30 percent helped the Frente to win the elections in the first round with just over 50 percent of the vote.

9. Although the Frente has embraced an agenda for change, it has also signaled continuity in many of the policies that have enabled the economic rebound. The new Government's agenda for sustained growth abides by the recent referendums that have guaranteed a predominant role for the state in certain strategic economic sectors (i.e., water, petroleum, and telecommunications), while aiming to improve the climate for private sector investment. Initial indications are that the new administration will be seeking an increased professionalism and transparency of the state, maintain prudent macroeconomic policies, and improve rules of the game for the private sector as the catalysts for stimulating the private sector in a proactive and productive role. There appears to be broad consensus within the Frente Amplio on this strategy and the economic team enjoys a high degree of respect and broad support. The new administration

has proactively sought dialogue with the International Financial Institutions (IFIs) and the active support of these institutions in formulating and implementing its development agenda.

10. President Vázquez has begun his presidency with broad support both domestically and from the international community. The economic environment is also benign. Recovery from the crisis years has been robust, and growth should continue to be solid over the near-term. Unemployment has been cut significantly from the depths of the crisis and investment is picking up. Obstacles remain and some outstanding reforms will continue to be demanding politically. Nevertheless, the Government is well positioned to address Uruguay's development challenges.

B. Recent Economic Developments

11. Following upon a period of macroeconomic stability and steady growth during most of the nineties, Uruguay suffered a sharp reversal in 1998 with a recession that persisted for more than three years before collapsing into a deep economic crisis provoked, in large part, by events in neighboring Argentina. When Argentina defaulted on its public debt, abandoned the US dollar as a monetary anchor and devalued its currency to one third of its previous value, the effect upon Uruguay was disastrous. There was a rush to withdraw deposits from the banking system driven initially by the exposure of Uruguayan banks to Argentina's country risk and later for fear that the Government of Uruguay may follow the example of Argentina and restrict withdrawals. As a result, the important offshore banking sector and,

eventually, the domestic banking sector came under severe pressure and a number of banks collapsed, notwithstanding emergency government support. A ripple effect throughout the economy caused GDP to fall by some 11 percent in 2002 alone, while unemployment rose to almost 20 percent by end-2002.

12. It is likely that the outcome would have been much worse had it not been for an effective adjustment effort by the Uruguayan authorities, and the consensual nature of the country's political system. The success with which Uruguay was able to weather the economic crisis of 2001-02 owes much to its prompt and purposeful response to events. Negotiations with creditors led to the successful conclusion of a sovereign debt exchange in May 2003, raising the average maturity of bonds by over 5 years without increasing interest rates and without a reduction in principal (Box 2). Fiscal and monetary policy were well managed which resulted in a primary

surplus of the public sector (excluding sub-national administrations) of 3.8 percent of GDP in 2004 (a major turnaround given that there was a primary fiscal deficit of 1.5 percent of GDP in 2001). Following a modest pass-through to inflation from the 2002 devaluation (inflation peaked at 25.8 percent that year), inflation was brought down to single digit figures.

13. GDP growth in 2004 is estimated to have been 12.3 percent due in part to good economic management but also to favorable external developments, including high commodity prices for exports and strong economic growth in both Argentina and Brazil (Table 2). Consumption and in particular investment started to recover from 2003 onwards. Prospects for continued economic growth in 2005 are good. A modest strengthening of the peso and higher oil prices will not offset the greatly enhanced competitiveness of Uruguay which resulted from the 2002 devaluation. Rising employment and

BOX 2: URUGUAY DEBT RESTRUCTURING

- ▶ In April 2003, Uruguay proposed a sovereign debt exchange to all holders of government bonds denominated in foreign exchange and having an initial maturity of 12 months or more. The objective of the debt restructuring was to bring debt servicing obligations into line with the country's prospective post-crisis payment capacity. Cash-flow relief was to be obtained by extending maturities without reducing the principal due. The proposal applied to US\$3.8 billion of bonds that had been issued on the international markets and to US\$1.6 billion of bonds issued on the domestic market. It is estimated that approximately two thirds of all eligible bonds were held by residents of Uruguay.
- ▶ Two options were offered to bondholders. The first was to swap existing bonds for new bonds with an extended maturity but with principal and interest unchanged. A second option was to offer a choice of alternative benchmark bonds with different maturities and with cash incentives for bondholders who chose longer benchmark bond maturities. In the case of bonds that had been issued on the domestic market, the menu of options was more extensive, including progressive step-up interest rates. An important feature of the debt swap was that all new bonds were subject to collective action clauses that would facilitate future debt restructuring.
- ▶ Voluntary participation in the bond swap was 92.5 percent with most participants opting for alternative benchmark bonds rather than simple extended maturities. The high rate of participation may be attributed to two factors. First was prior consultation with creditors before the terms of the exchange were announced so that creditors were able to participate in the design of exchange options. Second was the strong IFI support for Uruguay's adjustment program.
- ▶ Figure 3 shows how, before the crisis, Uruguay was able to command a much lower spread than other countries of Latin America. At the time of the crisis, the spread for Uruguay rose sharply but, after the successful renegotiation of debt with bondholders, it declined quickly and is now slightly below the average for the Region. The current (Standard & Poors) credit rating is B (Figure 4).

FIGURE 3: URUGUAY RISK PREMIUM

Basis points, May 2001 - April 2005

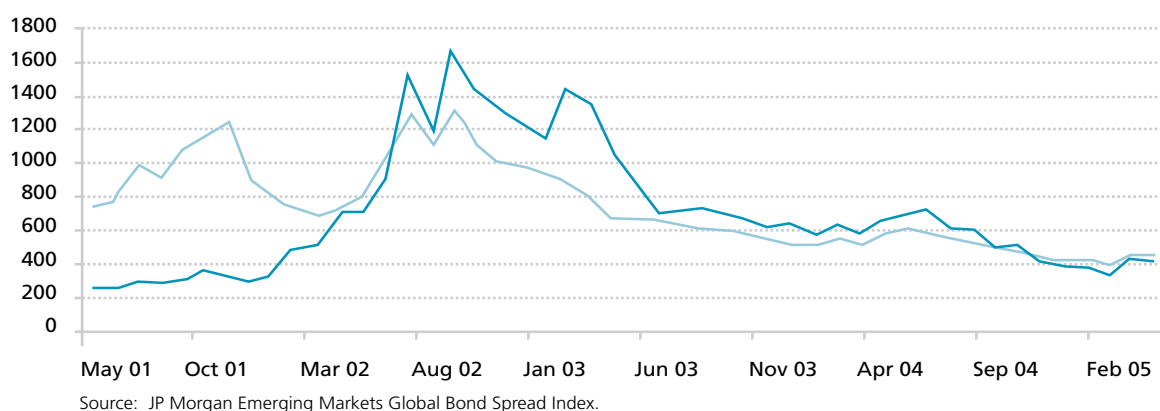


FIGURE 4: URUGUAY SOVEREIGN CREDIT RATING

Standard & Poors sovereign rating for foreign currency bonds, January 2001 – April 2005

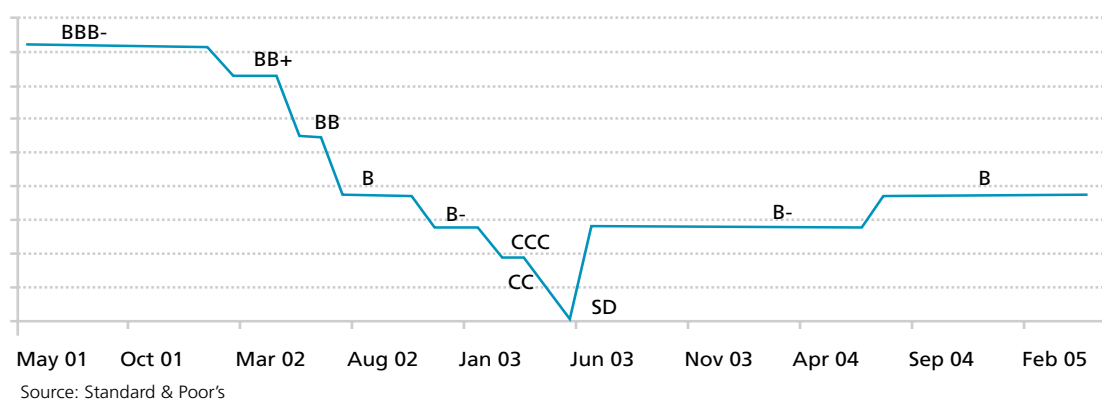


FIGURE 5: URUGUAY POVERTY AND UNEMPLOYMENT

In percentage, 1991 – 2004

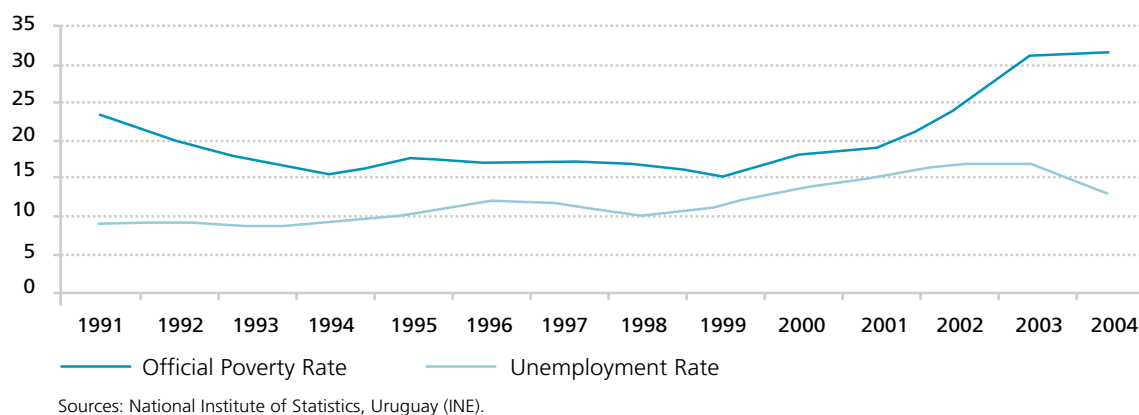


TABLE 2: URUGUAY KEY ECONOMIC INDICATORS
(In percentage, unless otherwise indicated, 2002-2005)

	2002	2003	2004e	2005 ¹
Real GDP Growth	-11.0	2.2	12.3	6.0
Gross Domestic Investment/GDP	11.5	12.6	13.3	14.7
CPI inflation, period average	14.0	19.4	9.2	5.0
Exports of Goods and Services/GDP	21.9	27.6	30.4	27.8
Imports of Goods and Services/GDP	20.3	24.4	27.8	26.8
Current Account Balance/GDP ²	3.1	-0.5	-0.8	-0.8
Public Sector Primary Balance ³	0.0	2.7	3.8	3.5
Public Sector Overall Balance ³	-4.6	-3.2	-2.2	-2.0
Public Sector Debt/GDP ³	83.5	101.5	92.2	77.5
GDP, USD billion	12.3	11.2	13.2	15.8

1. Indicators for 2005 are a projection.

2. Does not incorporate expected large foreign investments in the forestry sector which would be financed through foreign direct investment.

3. Excludes sub-national administrations.

Source: Uruguayan authorities and World Bank estimates.

some increase in real wages is likely to boost domestic demand. Real growth of 6 percent is projected in 2005 and that would raise per capita incomes close to pre-crisis levels. At the same time, a disciplined monetary policy together with a modest appreciation of the peso is likely to keep inflation within the 5.5-7.5 percent target range of the Central Bank. A primary surplus of 3.5 percent of GDP is targeted in 2005, slightly down from the 3.8 percent recorded in 2004 in order to accommodate the new Government's social emergency program.

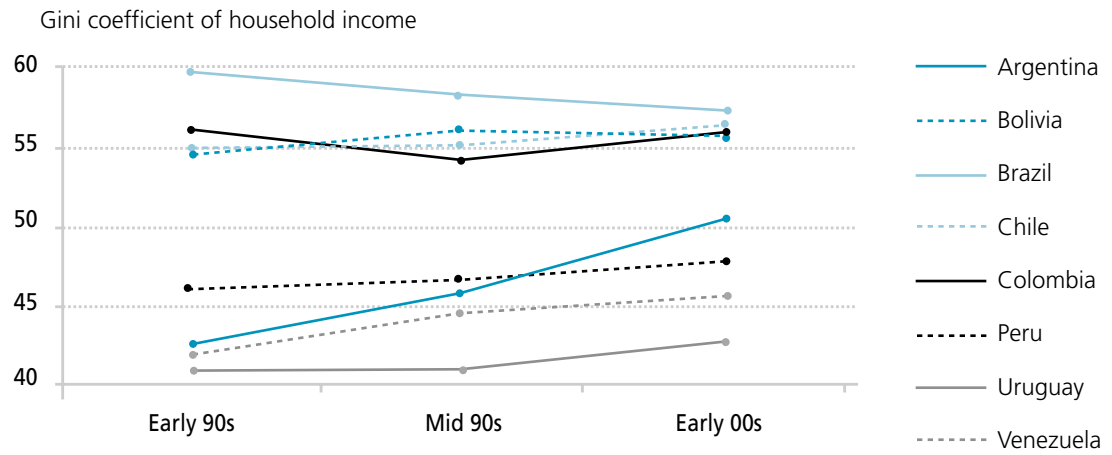
C. The Social Impact of the Crisis

14. The 1998 recession and the subsequent economic crisis had a severe social impact. Unemployment increased from about 10 percent in 1998 to 17 percent at the end of 2002 (Figure 5), albeit this figure declined to 13 percent by the end of 2004. During the period from 1998 to 2002, the proportion of self-employed and of those employed in the informal sector also grew and was accompanied by a reduction in real wages in the private sector. Household income also started to decline in 1998, and fell by more than a fifth in the period from 1998 to the end of 2002 as it was negatively impacted by poor performance of the labor market in terms of job creation and wage behavior. As a result, according to

data from the Instituto Nacional de Estadística (INE), poverty increased between 2000 and 2003 from 18 percent to 31 percent of the population, while extreme poverty also doubled to 2.8 percent of the population during the same period. Despite this increase, extreme poverty remained low in Uruguay with respect to the other Latin American countries. The strong economic recovery has yet to be reflected in an improvement the overall poverty rate. Income inequality has traditionally been low in Uruguay when compared to the rest of the region. However, inequality also increased during the period between 1998 and 2002 (Figure 6), and this exerted a significant negative effect on poverty.

15. While poverty and unemployment increased to record levels in the aftermath of the crisis, the Government response mitigated a potentially much stronger negative impact on both quantity and quality of service delivery. Repercussions on basic social indicators such as school enrollment and infant mortality were largely avoided and, in some cases, the indicators continued to improve (Annex B5).

FIGURE 6: URUGUAY COMPARATIVE INEQUALITY



III. The government's development agenda



16. The new Government's program as enunciated in Tabaré Vázquez's electoral document *El Gobierno de Cambio - La Transición Responsable* suggests a broad continuity of macroeconomic policies, which is in line with the traditional consensus style of government in Uruguay, but with increased emphasis on social programs and confirmation of a central role of the state. The document proposes a new national development strategy for the country articulated along six key complementary themes: enhancing productivity (**Uruguay Productivo**), fostering social development (**Uruguay Social**), promoting innovation (**Uruguay Innovador**), strengthening democracy (**Uruguay Democrático**), enhancing regional and global integration (**Uruguay Integrado**) and promoting policies which consolidate and promote Uruguayan culture (**Uruguay Cultural**).

17. In a nutshell, the program of the new administration aims at attaining economic development in manner which is at the same time productive, integrated, equitable, of good quality and sustainable. Development should be productive in that it should leave room for promoting areas as diverse as biotechnology, information and communication technology, tourism and culture-based on the premise that while no country can be competitive in all areas, it would be wrong to limit unnecessarily areas in which Uruguay might achieve regional and international competitiveness. Development should be trade-oriented and better integrated with both Mercosur partners and beyond. Development should also be equitable in a territorial sense, so as not to give way to disparities among areas which are labeled as successful and areas which are labeled as

depressed. Development should be of good quality in that it should maximize a national production which is competitive and qualified – which is based on good educational quality for all, leading to equal employment opportunities, especially for the youth. Development should finally be sustainable, not only in environmental but also in social terms – and poverty should therefore be fought with policies aimed at civil participation and social inclusion.

A. Uruguay Productivo

18. **Uruguay Productivo** places high and sustained growth as a top priority in the Government's agenda. This will be attained through the coherent implementation of structural changes and short-term economic policies. Structural changes will aim to establish clear rules of the game between the State and the market, to transform the financial sector, to develop capital markets and de-dollarize the economy. "*Uruguay Productivo*" also calls for state reforms, including improving professional and technical qualification of civil servants, enhancing transparency and accountability in the conduct of state functions, decentralizing management and eradicating all forms of clientelism. The Government plan further calls for promoting public investment through the use of both own resources and external credits and for including the private sector as a concessionary under certain conditions. An additional structural reform contemplated by the proposed program is tax reform, which should be guided by the principle of fairness and serve as a stimulus to productive investment. Tax reform will encompass introduction of a personal income tax. Another major change that the Government intends to introduce is that of seeking

stronger ties with Mercosur. The plan also calls for improvements in extra- regional commercial relations, thereby continuing to build on the dynamism of exports to these markets.

B. Uruguay Social

19. **Uruguay Social** underscores the need to transform the quality of life of Uruguayans with special emphasis on the most vulnerable, thereby fostering social inclusion. One of the first actions of the new Administration was the creation of a new Social Emergency Program called PANES (*Plan de Asistencia Nacional a la Emergencia Social*). The objective of the plan is to attend to the needs of individuals below the extreme poverty line or in high risk of falling below it – estimated to include some 200,000 individuals, or 6 percent of the population – through a set of eight, coordinated programs (basic food, health emergency, minimum income, education for critical areas, workfare, two housing programs, and homelessness). Several of these programs are not new, but in the past they have not been very effective in reaching the poor. The emergency plan seeks to overcome these obstacles and reach the neediest in society, using the structure of existing institutions (such as the BPS) and volunteers. Enrollment in the program began on April 1, and nearly 100,000 heads of household applied in the first month (they will be individually interviewed and assessed to identify targeted households). Payments of the minimum income scheme, for approximately US\$50 a month, are expected to start in May 2005. The implementing agency is the new Ministry of Social Development which is still being organized.

20. The incoming administration has also put education high on its agenda, including a promise to raise overall funding for the education sector to improve equity, improving achievements, and making school education more relevant for the labor market. This would require a legal reform which the incoming administration has announced as part of its Uruguay Social program. The new Government has indicated that its goal in the health sector is to create a more harmonized system through the introduction of a national health insurance that would ensure more equitable access to services and improved quality of care, while reducing the financial burden of the system. In that context, a key strategic need would be to improve the incentive framework for all actors in the system, primarily through reducing fragmentation and increasing the effectiveness of financial and regulatory incentives for efficiency and equity.

C. Uruguay Innovador

21. **Uruguay Innovador** focuses on the need to promote scientific and technological progress in order to reverse the current trend of stagnation and centers on a strategy of specialization and increased quality. Under Uruguay Innovador, the incoming administration lays out its goal to (i) revamp existing institutional relationships within the creation of a National System of Innovation; (ii) draft a strategic innovation plan for the country which would bring together priority sectors (including agro-industry, natural resource conservation, technology and communications, the health system, manufacturing and tourism); (iii) orientate the entire education system, most importantly the *Universidad de la República*, towards scientific and technological applied research with strong links to the productive sector; and (iv) support innovation in the small and medium enterprise sector.

D. Uruguay Democrático

22. **Uruguay Democrático** emphasizes among other the need for greater transparency and efficiency of government, including the decentralization of functions in government and the strengthening of the internal auditing, the promotion of greater transparency and social participation in the media, and the need for an agile judicial system which is perceived by civil society as an effective instrument to defend the rights of the citizens.

E. Uruguay Integrado

23. **Uruguay Integrado** points to need of strengthening relations between Uruguay and its neighbors, and particularly the need to strengthen ties within the Mercosur, especially during the second semester of 2005 when Uruguay will assume the rotating presidency of the union. It also calls for a better integration of Uruguay with the rest of the world economy.

F. Uruguay Cultural

24. **Uruguay Cultural** emphasizes the need to promote the cultural debate in the country in order to instill in the citizenship a sense of democratic dignity, of collective growth and learning, and of plurality. Most importantly, culture should promote diversity as the basis for social inclusion and the creation of a cultural identity.

IV. Uruguay's development challenges



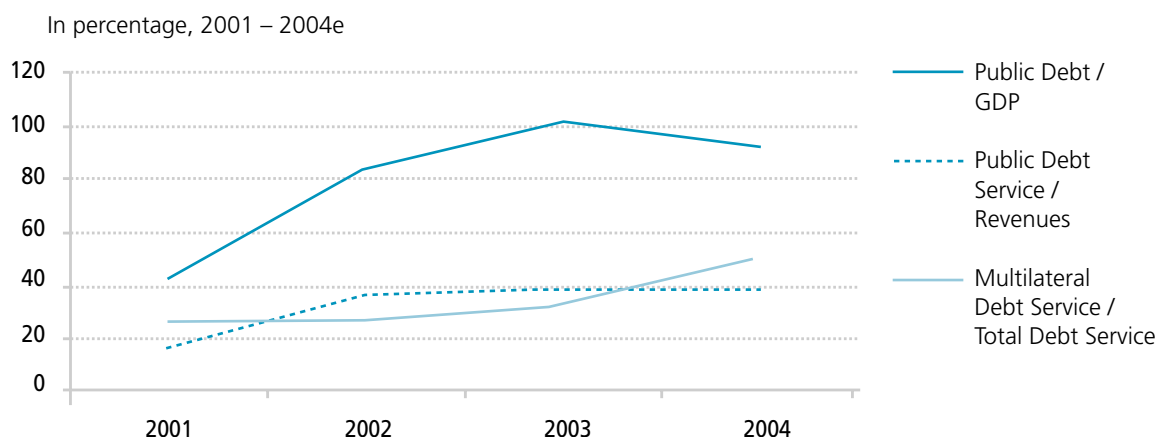
25. Uruguay is still struggling to recover from the social and economic consequences of the prolonged recession over 1999-2001 and the deep crisis of 2002. However, now that the economy is rebounding from the crisis, the Government's priorities have shifted from crisis response to the achievement of the longer-term objective of equitable and sustainable economic development. In addition, an overarching goal of the Government's program is that of fostering social participation and increasing inclusion. The following sections outline the main challenges the Government needs to address, both at the macroeconomic level and in key sectors of the economy, in order to attain its objective.

A. Reducing Vulnerability

26. **Debt sustainability** will continue to be a major development challenge in the medium term notwithstanding the successful debt restructuring of 2003 which provided relief from liquidity pressures in the bond market (accounting for about half of all sovereign debt) over the short and medium term. After restructuring, the ratio of public debt to GDP is estimated to have stood at nearly 90 percent at end-2004 (Figure 7). Heavy amortizations due in the period 2006-07, including payments to the IFIs, constitute a source of vulnerability.

27. Debt sustainability will depend critically upon generating a primary fiscal surplus sufficient to service

FIGURE 7: PUBLIC SECTOR DEBT INDICATORS



Source: IMF and World Bank estimates.

the debt and that issue will be examined in greater detail in the following section. Over and beyond fiscal considerations, however, debt sustainability will also depend upon managing the debt proactively to ensure that its size, its term-structure and its currency composition correspond to the needs and to the repayment capacity of Uruguay.

28. The currency composition of Uruguay's debt has become a major focus of public attention ever since the 2002 economic crisis revealed how readily a debt denominated in foreign currency can expose the economy to external vulnerabilities. A public debt denominated in foreign currency restricts the maneuverability of the central bank to manage monetary policy and an insufficiency of peso denominated instruments may also stifle the development of the domestic capital market by making it more vulnerable to the exchange rate. The prevailing sentiment in Uruguay favors issuing more peso denominated debt in both domestic and international markets (in particular, indexed peso debt), rather than debt denominated in foreign exchange, to the extent that the costs of borrowing in pesos are competitive.

29. A strong foreign exchange reserve position and a favorable debt composition are essential elements of sound integrated asset and liability management which can help the Government better manage the roll-over of debt as it falls due. As of March 2005, the international reserves of Uruguay were equivalent to 8.4 months of imports, sufficient to cover projected public debt service in 2005. To further strengthen its

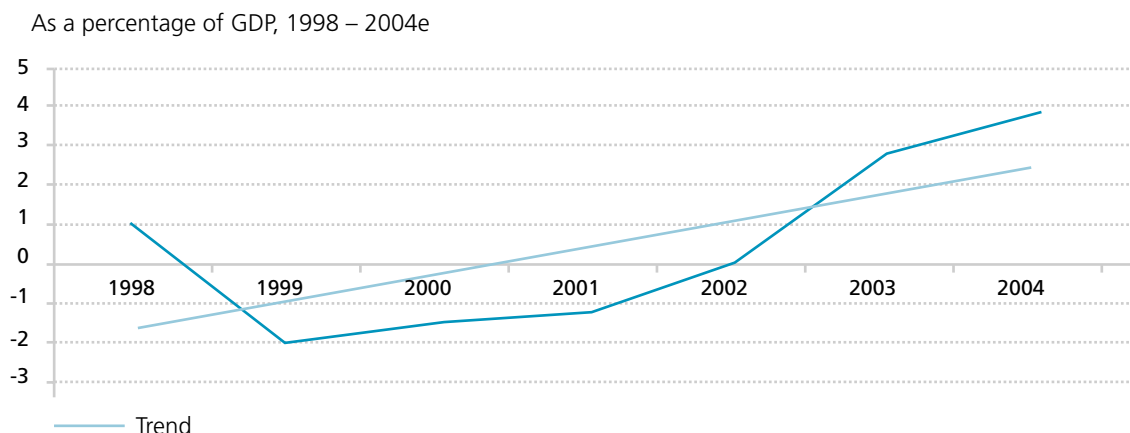
liquidity cushion, Uruguay could require financial institutions to carry liquidity reserves on foreign currency deposits that are higher for non-residents and inversely related to the maturity of the deposit.

30. **Fiscal management** is one of the principal instruments available to the Government in pursuing the objective of sustained growth with equity. The new administration has signaled its intention to maintain tight fiscal policy. In addition to issues of debt sustainability discussed in the previous section, strong fiscal management will be a sine qua non for macroeconomic stability and growth. Whereas, in many other areas of economic and social policy the Government may have an ample choice of options, there will be few degrees of freedom in conducting fiscal policy.

31. After restructuring the public debt in 2003, Uruguay continued to strengthen its fiscal position (Figure 8). This policy stance will need to be maintained in order to achieve primary surpluses compatible with debt sustainability. The primary surplus is expected to be maintained at 3.5 percent of GDP in 2005 and increase to 3.7 percent in 2006 and to 4 percent of GDP from 2007 onwards. Projections indicate that fiscal reforms will be required to achieve primary surpluses of this order (Annex 2). In addition to several new revenue initiatives and more efficient tax collection, by far the most effective way to increase fiscal revenues is to accelerate the rate of GDP growth.

32. Options for increasing fiscal revenues are few. The new administration has pledged to introduce a

FIGURE 8: PRIMARY FISCAL SURPLUS OF THE PUBLIC SECTOR



Source: Uruguayan authorities and World Bank staff estimates.

personal income tax and that could provide a significant new source of revenue in the longer-run. However, a personal income tax is administratively complex and it will need to be carefully planned and prepared if it is to be applied effectively and equitably. It will take time for procedures and administrative structures to be put in place. Meanwhile, the Government will need to rely upon already established sources of fiscal revenue. There are particularly good prospects for enhancing revenues from social security contributions which declined from 6.1 percent of GDP in 2000 to 3.7 percent of GDP in 2003. Better coordination between the Tax Administration Department (DGI) and the agency which administers the social security system (BPS) could, aided by the on-going economic recovery, result in a rebound of revenues from currently low levels.

33. The main challenges confronting the tax administration include: a high turnover of personnel; a lack of continuity in policies; an inadequate tax structure and, despite progress, administrative inefficiencies. There is an urgent need to simplify the tax structure, which would include a review of bank account secrecy provisions and greater accountability; public registry for the property tax; and a human resources policy that introduces modern management tools, including greater emphasis on training. Other important areas of concern include the design of a cross-data system and access to third party registration systems, such as public registries, notaries, etc; and the need to utilize improved communication systems to better link tax administration with Uruguayan society.

34. Expenditure control has been key to the fiscal stance over the last few years, with primary expenditure falling by five percentage points of GDP over 2002-04. Maintaining a policy of expenditure restraint will be at the center of fiscal management. The new Government intends to achieve this through a combination of expenditure switching policies to fund new initiatives and expenditure reducing measures. Pensions are by far the largest single item of public expenditures in Uruguay and they account for most of the growth in expenditures over the last ten years. Implementing reforms to control the growth in pension spending will be a major challenge (para. 64). Public sector employment was reduced by some 10 percent between 1995 and 2002, although there is still room for additional efficiency improvements which could imply *inter alia* further reduction in public employment over time, in particular through attrition and voluntary retirement

schemes. Changes in public employment would be linked to broader improvements in the civil service and public sector management (paras. 58-60). Increased private sector participation could help to increase fiscal space by reducing demand on the budget from infrastructure investment needs (paras. 49-54).

35. *The financial sector* remains a potential source of vulnerability for Uruguay and its contribution to growth needs to be strengthened. The 2002 crisis was devastating for the banking sector. Many private commercial banks collapsed, leaving the sector even more dominated by public banks than was the case before the crisis. The two traditional public banks (BROU and BHU) have now been joined by a third, the Nuevo Banco Comercial (NBC), established with assets salvaged from several private banks driven into bankruptcy by the crisis. Public banks now account for 60 percent of all banking assets. The crisis revealed deep structural and managerial weaknesses in BROU and BHU. The authorities have extended emergency assistance to both banks which are undergoing structural reform with support from the IMF and from the IBRD. It is important that these restructuring efforts continue to be diligently pursued. The NBC complicates the picture because, with branches throughout the country, it competes directly with BROU. The NBC (which operates under commercial law) is currently seeking a foreign strategic investor. However, it would better serve the long-term interests of the banking sector if the NBC were to be privatized. What remains of the private banking system after the 2002 crisis is a small network of foreign-owned banks and a few domestic banks offering short-maturity dollar-based products. The financial position of these banks is solid and many of them can draw upon support from large parent-banks abroad. They are well placed to take advantage of the vacuum left by liquidated domestic banks. In particular, there is scope for engaging more actively in the capital markets and for extending value-added services. The Government has recently introduced legislative reforms regarding anti-money laundering and combating the financing of terrorism, which now await implementation.

36. The principal challenge for the financial sector in Uruguay today is to reestablish a stable and efficient system of financial intermediation between depositors and borrowers that can channel capital to productive investments. The problem is not a lack of deposits. Deposits by residents have already surpassed the level of July 2002 when the bank moratorium was

imposed. Nevertheless, banks, both public and private, are highly liquid. There are a number of reasons for that:

- The vast majority of deposits in the system today are sight deposits which could be withdrawn at the slightest sign of trouble and banks must prepare themselves for that possibility by maintaining high levels of liquidity and lending with short-term maturity.
- Risk aversion and liquidity considerations encourage banks to lend predominantly within the financial sector so that 61 percent of the total loan portfolio is between financial institutions. Loans to the non-financial sector have decreased by almost 60 percent since December 2001, and access to credit has been squeezed, particularly for smaller businesses.
- Most deposits (90 percent as of end-June 2004) are foreign currency denominated and, as a result of the crisis, banks are acutely aware of the danger of extending foreign currency loans to borrowers whose income is exclusively peso-denominated. Hence lending is concentrated on the export sector.

37. The problems confronted by the banking sector stem in part from limited confidence, but also from structural challenges including:

- The lack of a significant market for peso-denominated financial products has greatly increased the vulnerability of the financial system to external shocks. The recent introduction of inflation-indexed (UI) deposits was an important step to encourage the development of peso-based financial services.
- A recently introduced deposit insurance program remains un-funded. If the scheme is funded and implemented selectively to peso and UI deposits in the first instance, this would increase confidence in the banking system as a whole and help foster a gradual “pesification” of the financial sector.
- Financial sector regulation and supervision will play an important role in the recovery and improved performance of financial sector institutions. Independence of the central bank is a goal that Uruguay may seek to attain. Short of that, the authorities could ensure the full technical independence of financial sector

supervisory and regulatory activities within the Central Bank.

- Off-shore banking merits special attention from the regulators. Given the distinct risks embedded by on- and off-shore activities and their sensitivities to different parameters, arrangements are needed for differentiating regulations of on- and off-shore banking activities in line with international experience.

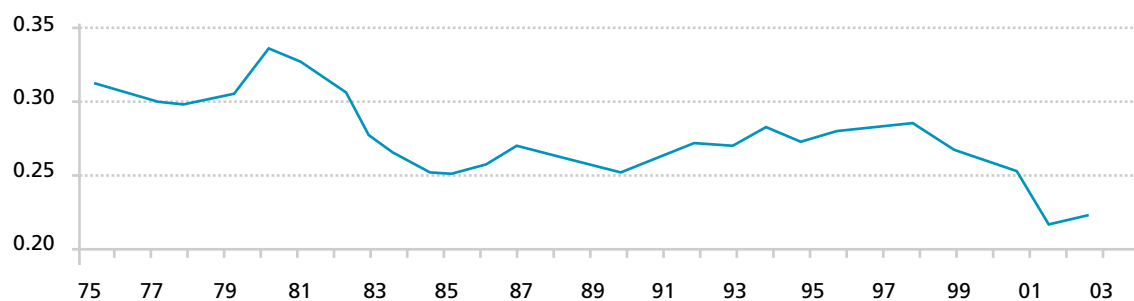
38. A broader financial sector strategy explicitly oriented to sustain growth would favor a deepening of financial markets and a progressive lengthening of the maturities of available financial assets in order to provide financial resources to long-term investments in fixed assets by the productive sector and to housing investments by the household sector. A strengthening of managed savings institutions such as life insurance and pension funds- whether public or private – would help to create a stronger and more stable domestic demand for long-term assets that could offer to long-term investment a domestic source of finance. The supply of long-term assets may be channeled, among other possibilities, through the banking sector by securitizing long-term loans to the corporate sector (for fixed investments) or to the household sector (for housing). A lengthening of the maturity of domestic currency denominated government debt would benefit from the presence of a more stable demand, provided that clear limits are put to the maximum portfolio share of investments in public assets. A stable demand for longer-term government issues would in turn provide an important support to a more ambitious reform of the government bond market and of its related segments (repos, derivatives) and would help the development and trading of some basic hedging tools.

B. Sustaining Growth

39. Over the past thirty years per capita income growth averaged little more than one percent a year. Relative to many countries, Uruguay has fallen steadily behind. Whereas, in 1980, the per capita income of Uruguay was about one third the level of the United States, it is now less than one quarter in purchasing power parity terms (Figure 9). Without sustained growth, fiscal stability and overall improvement in living standards will not be achievable.

40. Longer-run economic growth will depend upon structural and policy reforms aimed at increasing investment and enhancing competitiveness. The Bank recently completed a comprehensive study on sources

FIGURE 9: GDP PER CAPITA IN URUGUAY (PPP) AS PERCENT OF USA



Source: Central Bank of Uruguay.

TABLE 3: YEARS REQUIRED FOR URUGUAY TO EQUAL SPAIN IN INCOME PER CAPITA (PPP)

Annual GDP growth in Uruguay				
Annual GDP growth in Spain		3%	4%	5%
	0%	34	26	21
	1%	51	34	26
	2%	97	51	35

Source: World Bank.

of growth in Uruguay which examined in detail the issues that need to be addressed. The Sources of Growth study contains detailed recommendations for consolidating fiscal and financial reforms, improving the efficiency of factor markets, fostering integration through trade and investment, promoting competition in infrastructure and, in general, improving the business climate for private sector development (Annex 3). Even with stronger growth, however, it will take many years for Uruguay to catch up with the metropolitan countries of Europe and North America. Table 3 illustrates the size of the task using Spain as a comparator country. Were Uruguay to grow at 4 percent a year, it would take a minimum of 26 years to catch up with Spain and,

if Spain itself were to grow at a modest 2 percent, it would take Uruguay fully half a century to catch up.

41. **Trade.** MERCOSUR has been the most important vehicle of trade policy for Uruguay for many years past. The recent economic crisis has revealed weaknesses in the structure and the share of Uruguay's merchandise exports to its MERCOSUR partners fell from 55 percent in 1998 to an estimated 24 percent in 2004. A complicating factor is the persistence of significant non-tariff barriers within MERCOSUR.

42. MERCOSUR could best harness its potential for trade expansion by providing a context for member

countries to join forces and gain more leverage in trade negotiations with industrial countries which favor high agricultural protection. While striving to mobilize MERCOSUR to the fullest extent possible, within the context of its commitments to MERCOSUR, Uruguay could also pursue bilateral trade agreements with other countries wherever these hold a potential for trade gains. The bilateral agreement concluded with Mexico has led to an acceleration of trade and it illustrates well how such agreements can be advantageous for Uruguay. There have been on-going discussions about possible free trade agreements between MERCOSUR and the USA and between MERCOSUR and the European Union. Analysis has shown that a free trade agreement with the USA, and by extension the proposed FTAA, could bring substantial gains for Uruguay. Similar gains could come from a free trade agreement with the European Union. Trade agreements with industrial countries would also entail intangible advantages in terms of investment, quality and variety, standard and regulation.

43. Agriculture, natural resources and environment. Agriculture has been the principal source of growth for Uruguay in the past and the sector possesses considerable potential for further growth. The agriculture and agro-industry sectors represent approximately 23 percent of Uruguay's GDP; over half of agricultural output is exported and accounts for more than 60 percent of Uruguay's total export earnings. The currency devaluation of 2002 increased the competitiveness of Uruguayan agriculture in world markets. This is a temporary boost, however, and longer-term competitiveness will hinge on fundamental structural changes. A stronger, more competitive agriculture can be built on three main pillars: (i) the development and dissemination of new technologies, (ii) improved product quality based upon good production and processing practices and food safety and (iii) the establishment of a new institutional structure to enhance competitiveness.

44. Food safety is a major concern for the agricultural sector. It is estimated that losses from the recent foot and mouth disease epidemic amounted to US\$730 million during 2001-03, or almost 2 percent of GDP annually. To avert a repetition of the crisis, concrete measures should be developed together with all neighboring countries to guarantee food safety and avoid further disease outbreaks in the livestock population.

45. The longer-term success of agriculture in Uruguay will depend critically upon conserving the natural

resource endowment. Advances already made in stemming erosion, soil degradation and cultivating vulnerable land should continue to be pursued. In particular, increased livestock production will depend upon the improved management of natural pastures, and increased agricultural production will require stronger water resource management. As more and newer irrigation investments are made and generate more pressure on limited resources, the need for an improved water resources policy and regulatory framework will increase.

46. The substantial potential for forestry development in Uruguay is widely acknowledged and major foreign direct investments are currently being undertaken. New forest plantations have been located in "priority areas" which are relatively unsuitable for other agriculture. As these activities expand, it will be important to assess further the environmental sustainability of commercial forestry, especially with respect to surface water, soils and biodiversity. Sustainable industrial processing of forestry products calls for careful environmental assessment of proposed new investments, as well as ongoing pollution monitoring and control.

47. The above pillars could help to improve living conditions in the rural areas where poverty is relatively higher than in the urban areas. In 2000, the poverty rate in rural towns was 27 percent, a full ten percentage points higher than in urban areas. However, given the low labor intensity of many agricultural product lines, the agriculture sector alone is not sufficient to generate adequate productive employment to lift the rural poor out of poverty. Without growth in rural non-farm alternatives, rural wages are likely to remain low – i.e., often at or below the poverty line. In order to support growth in non-farm employment, particularly in the small rural towns, additional targeting of educational and productive services will be needed.

48. Pollution is a manageable challenge that can be kept under control through effective preventive measures. National environmental challenges include urban degradation (especially solid waste management and urban air pollution); coastal contamination (both in the degrading international waters of the Rio Plata and the Atlantic coast with its strong coastal tourism industry); and industrial pollution (including major new investments in industrial processing of forest products). The institutional and legal framework is considered to need improvement and this is on the list for action under the new Government.

49. **Infrastructure and public services.** In terms of coverage and quality, the provision of infrastructure and public services in Uruguay is good when compared with other Latin American countries and middle-income countries in other regions. However, there are shortcomings with respect to efficiency and, as a consequence, some services are relatively expensive compared to other countries in the region. This is particularly the case for water and hydrocarbons and, to a lesser extent, other energy sources. Inefficiencies in infrastructure and public services affect Uruguay's competitiveness and impact consumer welfare.

50. The transport sector is a good example where reforms have improved efficiency and quality. Uruguay boasts a relatively efficient road sector and an improving port sector. The primary road network is in better condition than in any other country in the region. Overall, the number of containers has increased by 160 percent since 1993, the year after port sector reform, and the absolute cost of moving a container is similar to that of other ports under concession in the region. The improving competitiveness of transport services is associated with progress achieved in sector reform which is still on-going and needs to be consolidated. The reform has identified institutional responsibilities within the Government for policy formulation, planning, and regulation of the sector and gradually introduced private-sector participation in varying forms into construction and maintenance operations. The increased private sector participation has helped improve management practices in both public and private sector, and generated additional investment.

51. The utilities and public services are almost exclusively in the hands of the public sector, and policy definition, regulation and operations are generally merged in the sector agencies and public enterprises. The efficiency shortcomings of the utilities sectors relative to the transport sector suggest that a significant margin for improvement exists. The experience of the transport sector shows that efficiency gains can be achieved through a combination of distinguishing the three separate functions of policy definition, regulation and operations on the one hand and promoting private participation on the other. In the utilities, progress has been made in separating these functions, but more can be done.

52. The redefinition and strengthening of the policy function at the ministry level is an essential challenge,

together with strengthening the legal and regulatory framework. In practice, the utilities continue to play a central role in defining tariffs which are then confirmed by the Government on the basis of fiscal rather than efficiency criteria. The responsible ministries lack strong policymaking units and there is an absence of publicly available analysis to support key government decisions. In the absence of strong policy leadership at the ministry level, public utility operators have frequently taken upon themselves policy issues by default.

53. Presently, sector laws exist in Uruguay only for power and communications. Sector laws for natural gas and for water supply and sanitation have been submitted to Congress but have yet to be approved. The need for a such a law is especially pressing in the case of water supply and sanitation where the institutional framework is particularly complex. In the case of petroleum products, a sector law was enacted but subsequently annulled following a referendum, leaving a legislative void to be filled. Regulatory bodies have been established for power, natural gas, petroleum products, water supply and sanitation (URSEA), telecommunications and postal services (URSEC). However, these bodies are not yet sufficiently well staffed and equipped and, in some cases, their mandate is not yet sufficiently well defined for them to discharge their functions properly. Early action to complete the legal frameworks in key sectors would set the stage for further improvements in efficiency, service quality and private investment. In the energy sector, for example, promotion of private investment could be achieved through public/private partnerships for expansion of power generation and transmission capacity. Another option for consideration would be to open the capital of state companies.

54. Infrastructure and public service sub-sectors all have their own individual challenges over and beyond the cross-cutting issues of regulation, governance and private sector participation.

- The challenges faced in the transport sector focus on completing and consolidating the sector reforms, particularly in the ports and railway sectors, but also in attaining higher levels of investment in order to: (i) ensure stable functionality and good condition of major transport infrastructure linking producers to markets for agricultural, livestock and forestry production; and (ii) arrest further deterioration of infrastructure resulting from

the maintenance backlog as a result of the economic crisis.

- The challenges in energy include; (i) adopting import parity prices for fuels; (ii) introducing yardstick competition or other incentives to increase supply efficiency; (iii) developing programs for reducing energy losses and increasing end-use efficiency; (iv) improving energy interconnections with Argentina and Brazil to tap their wholesale markets through long-term supply contracts; and (v) establishing an operational wholesale energy market (ADME).

- In addition to the need for yardstick competition and programs to reduce unaccounted-for water, the water supply and sanitation sector faces the challenge of achieving universal coverage. Only a very small percentage of the population lacks potable water (about 2 percent), but a large share of the population (35 percent by some measures) lacks household sewerage connections and sewerage treatment services. Universal coverage of water supply and sanitation services is a key factor for improving living standards in line with the Millennium Development Goals.

55. *Enabling environment for the private sector.*

In order to create a more conducive environment for the private sector, the Government faces challenges in three areas: (i) creating public-private partnerships; (ii) improving the legal framework for firm entry and exit; and (iii) fostering innovation. The Government sees the instrument of public-private partnerships as a “transversal” arrangement that may serve many public sectors in order to enhance efficiency and mobilize much needed additional (private) resources without resorting to (repeatedly rejected) privatization schemes. Specifically, Uruguay could benefit from public-private partnerships in sharing the risks involved in innovation systems, and in the development of adaptation technology, the formation of a market-information based culture, as well as change management and communication strategy.

56. One of the most serious problems affecting competition stems from regulations which limit the mobility of firms in the Uruguayan market. This is partially due to the legal framework on bankruptcy and receivership which is in need of modernization as it promotes negative incentives and increased costs due to time lags and ambiguous results from bankruptcy proceedings. SMEs rarely obtain bankruptcy insurance due to high costs and a lack of

accounting records which are required by regulation in order to file a petition for bankruptcy, thereby failing to take advantage of this important protection. A more comprehensive legal and judicial framework for declaring bankruptcy in Uruguay could be an important step for private sector development. To be effective, it would be important to accompany this with adequate capacity-building for the specialized bankruptcy courts and administrative agencies that have jurisdiction in this area.

57. Despite recent advancements, SME development and innovation policy need further strengthening. The system is characterized by a number of specific innovation and SME support programs which lack a strategic vision and adequate coordination among the different implementing institutions. This results in fragmentation, as well as duplication of efforts and resources. Recently some actions have been taken, such as the establishment of an SME network, with encouraging results. These measures provide greater strategic and operational consistency to the National Innovation Strategy and they help the planning, funding an execution of programs. To further promote innovation and to facilitate the implementation of the National Innovation Strategy, it is also important to promote linkages between research and business, and more generally between the public and private sector.

58. *State modernization.* The new administration recognizes that a broad-based reorganization of the public sector is required to realize its vision of a strategic government role in economic management. Key challenges include clarifying institutional responsibilities—including the functions of policy, regulation and operation discussed above, preempting potential conflicts of interest, enhancing transparency, strengthening accountability, and increasing operational efficiency. The scope of the challenge is enormous and success will depend not only on political will, but also on a well designed strategy that takes advantage of the window of opportunity facing the new Government. Priority action areas encompass tax administration, the regulatory reform agenda, management of state companies, as well as streamlining public services to respond more effectively to the needs of the population and offer an enabling environment for the private sector. Decentralization is a potentially important means to enhance the efficiency of the state and increasing civil society participation in public management. The new Government has identified the need for a single citizen registration process which will serve multiple purposes, including improving the efficiency of payroll

control, subsidy and other social policies, public utilities, tax administration, electoral processes and property rights registration.

59. Modernization of the state has a central role in efficient public expenditure management. While Uruguay has previously pursued a system of performance management in the public sector, specific targets and indicators reflecting efficiency and quality should be made public on a regular basis so that performance can be adequately evaluated. Policies to increase the professionalism of Uruguay's civil service could include linking performance evaluation, bonus and promotion to the achievement of targets. Full implementation of projects involving state purchasing and other procurement reforms would lead to greater transparency and increased competition among suppliers as well as a more efficient procurement process, particularly within Uruguay's Central Administration. Bringing the SICE (Sistema Integrado de Compras Estatales) into broader use within the public administration would allow for compliance with the procedural rules and ensure that payments by the State are recognized for purchasing. It would also permit a more wide-ranging control over calls for bids, an aspect that is currently difficult to control in Uruguay. Finally, it will be important to expand and strengthen substantially the country's public expenditure monitoring and evaluation (M&E) systems. The Government is well aware of the potential of a well-designed, carefully managed M&E system in supporting the creation of fiscal space and re-composition of public expenditure in line with its priorities.

60. A key challenge for the Government is to improve efficiency in the administration of state-owned companies, and the quality of their goods and services, by promoting a more competitive environment in corresponding markets. This involves redesigning the institutional framework, while aiming to define proper governance structures. It is important that state companies function as efficient enterprises acting under market conditions. Profit alone is not an adequate indicator of efficiency, since the rigidity of demand and the small number of actors (when there is more than one) allow pass through of inefficiencies to prices. Governing boards facing clear incentives linked to the achievement of qualitative and quantitative goals can promote efficiency. An institutional framework that provides working mechanisms of public oversight of performance, both at the market and political level, can underpin the drive for more efficient state companies.

C. Improving Living Standards

61. While Uruguay dedicates a large portion of its income to the social sectors, the bulk of the expenditures are concentrated in public pensions and health. High levels of expenditures in these two areas are largely driven by the demographic of an aging population. The level of public expenditure in other social services is similar or lower than the norm for Latin American countries (such as in the case of education). Overall, the distribution of social expenditures in Uruguay no longer favors human capital formation to the extent needed to compete globally. This situation needs to be addressed in the years ahead, and the new administration faces the challenge of bringing the escalating costs of public pensions and health care under control, in order to free up fiscal space for other essential social investments including an expanded social safety net.

62. Social protection and poverty alleviation.

While total spending on social protection (including both social insurance and social assistance expenditures) in Uruguay is high compared to the Region and even the OECD countries, the system is dominated by public pensions which have absorbed the equivalent of 18 percent of GDP on average during the past 5 years. There is ample evidence that the high cost of public pensions has crowded out public expenditures on other much needed programs of social protection such as unemployment benefits and transfers in kind and in cash to the poor. As a result, the coverage of these other programs is uneven and many urgent social needs remain unattended. Food transfer programs were called upon to expand their activities by as much as one third in the wake of the economic crisis. While it appears that these programs are well targeted towards the poor, it is not clear whether they are as effective as cash transfer programs in combating poverty.

63. Similarly, the recent economic crisis revealed serious shortcomings in the provision of unemployment benefit which is currently available only to workers who have contributed insurance premiums to the Banco de Previsión Social (BPS) during the 12 month period prior to job loss. Many workers do not contribute to the BPS so that, at the height of the crisis in 1999, unemployment benefits were provided to only 17 percent of the unemployed. The serious poverty impact of the crisis points to the need for a more effective structure of income protection for the unemployed.

64. **Public pensions.** As mentioned above, public pensions currently crowd out other important human

BOX 3: WHO IS VULNERABLE IN URUGUAY?

- ▶ While poverty and other social indicators in Uruguay are better than in much of Latin America, social conditions deteriorated substantially during the recession and crisis. Many categories saw increases of up to 100 percent, with unemployment increasing from 10 to 17 percent between 1998 and 2003, while poverty spiked from 18 to 31 percent and extreme poverty doubled to 2.8 percent over 2000-03.
- ▶ The 2003 Poverty Update (Report No. 26223-UR) provides useful insight into who in Uruguay was most vulnerable to the damaging effects of the crisis, and suggests where interventions to address the causes of the vulnerability can be most effective. The Poverty Update provides a breakdown of vulnerable groups into gender, spatial and minority. In general, those households in which the head is unemployed, employed in the informal sector or self-employed, i.e., not having social security benefits, were more likely to be poor. Crowded households, households headed by young men, workers in sectors sensitive to economic downturns such as construction, or individuals with low educational attainment were also particularly vulnerable. The young are overrepresented among the poor, and this situation has worsened during the recession.
- ▶ Finally, although small in absolute number, rural poverty rates exceed those of major urban areas, and non-agricultural wage-earners living in small towns are more likely to be poor than farmers and farm in the more dispersed areas. In 2000, the poverty headcount was 25.0 percent for small settlements of 900-5000 inhabitants, 28.2 percent for villages with less than 900 inhabitants, and 19.5 percent for dispersed rural areas; while the urban poverty headcount was 17.8 percent. More recent rural poverty data is not available. The relative high incidence of rural poverty is especially significant as over 40 percent of the rural poor are children, many of whom have left school and entered the labor market at a young age.

development investments. In concert with efforts to strengthen contribution enforcement, several measures could help bring the escalating cost of public pensions under control. First, there could be a closer link between the retirement age and increases in longevity. Second, consideration could be given to restructuring the relationship between retirement age and the replacement rate of pensions so as to reduce the financial pressure on the system. Third, a phased introduction of a different indexing scheme –which would protect the real value of pensions also in times of crisis – could be considered. The present practice of indexing pensions to wages (set under the Constitution), together with a progressively aging population, poses important constraints on containing the cost of the pension system. In other countries, a shift from pure wage towards an index based on a mixture of prices and wages has yielded substantial savings. Pension reforms would help in promoting economic efficiency and faster growth, while making the social protection system more responsive to the objectives of equity and poverty reduction.

65. **Health.** Notwithstanding recent improvements in several important health institutions in the country (including the Ministry of Health and the Fondo Nacional de Recursos, universal insurance for high complexity interventions), Uruguay faces a number of serious challenges in the health sector. There is an urgent need to contain the heavy financial cost of health care which continues to increase year by year and which threatens to become unsustainable. Uruguay invests about 11 percent of its GDP on health care, one of the highest ratios in the world. The high level of health expenditures is due to a constellation of factors including: technological change, an unduly complex institutional structure with overlapping responsibilities and inadequate incentives for efficiency, a highly regulated physician labor market that undermines the ability of health organizations to control their personal costs, and a delivery system that is not well matched to the health needs of the population. The fragmentation of the system not only results in high costs but also undermines the quality of care.

66. The main financial problems of the health sector are manifested in the long-term financial crisis of the IAMCs (Collective Mutual Care Institutions). Most of the IAMCs – especially those of Montevideo – have had steadily increasing levels of long-term debt and seven (15 percent of total) have gone bankrupt since 1999. The recent economic crisis added to the financial woes of the IAMCs, and revealed even more the institutional problems. Those include weaknesses of management, together with the functioning of a complicated physicians labor market and a regulatory framework that does not promote price competition or efficiency.

67. The new Government wants to work towards a harmonized system that will ensure a more equitable access to services, and improved quality of care and increased financial protection, while reducing the financial burden on the system. The Government intends to define its strategy towards a harmonized system through a consultative process.

68. **Education.** In terms of outcomes, Uruguay's education system stands out in Latin America, but compares less favorably with OECD countries (Table 4). As of 2003, 95 percent of primary school age Uruguayan children were enrolled and nearly all remained in school to complete the full primary cycle.

Enrollment in secondary and tertiary education has also increased, though at more moderate rates. National student assessment results indicate substantial improvements in achievement between 1996 and 2002.

69. Despite progress, the education system is facing challenges that need to be addressed. First, overall spending in education continues to be low. At 3.6 percent of GDP (2003), Uruguay invests considerably less on education than the average Latin American country (and even more so as compared to the OECD average). Second, although Uruguay's focus on full-time schools has been generally acclaimed to have reduced inequities, such inequities persist and their reduction is at the top of the agenda of the new administration. Inequities in learning outcomes between children of different socio-economic background continue to be high and manifest themselves in unequal pre-school attendance. In-depth analysis to determine the degree to which the current system of teacher and student assignments contributes to maintain inequities in the system would help prioritize appropriate policy measures. Third, the quality and relevance of secondary and technical schools could be improved. About half of those who enter secondary and technical education drop out before completion, with such drop-outs

TABLE 4: MEAN 2003 PISA SCORES

	Mathematics	Reading	Science
Hong Kong-China	550	510	539
Finland	544	543	548
Korea	542	534	538
Japan	534	498	548
New Zealand	523	522	521
OECD average	500	494	500
Poland	490	497	498
Spain	485	481	487
United States	483	495	491
Portugal	466	478	468
Greece	445	472	481
Turkey	423	441	434
Uruguay	422	434	438
Thailand	417	420	429
Mexico	385	400	405
Brazil	356	403	390

Source: OECD.

disproportionately representing students from poorer families. Fourth, the public university system displays similar challenges as in many countries, such as a considerable discrepancy between planned and actual length of matriculation and a bias in access towards students from higher income families. University reform, including introducing incentives for students to finish their studies on time, and reduction of the secondary school drop-out rate are key priorities for the country to improve its competitive edge in a globalized world economy. Lastly, administration of the education system could benefit from modernization and efficiency improvements. This would entail, *inter alia*, a streamlining of ANEP, the autonomous institution which currently leads the country's education system. The brain drain of educated youth from Uruguay poses an additional challenge to human capital formation, as according to the most recent estimates (2002) about 12 percent of the country's professionals and technicians have migrated to other countries.

70. *Social inclusion, gender and civil society.*

While Uruguay is considered an homogeneous society compared to other countries in the region, and has the most equal income distribution in South America, it has experienced a deepening of social exclusion during the last crisis, e.g. for Afro-descendants, youth, women and the rural poor. Uruguay has the largest Afro-descendants population in the Southern Cone. This group has historically experienced above-average poverty and unemployment rates, lower wages, and educational attainment rates that are consistently below the average for the general population. In the case of Uruguayan youth, those between the ages of 15 and 24 account for only 16 percent of the total population but 46 percent of total unemployment. Of the unemployed youth, only 2 percent receive some sort of training and only 4 percent obtain unemployment insurance. Half of the unemployed youth in Uruguay did not finish secondary school and are unprepared for skilled jobs, while those who are unemployed are frequently employed in unstable and precarious jobs, with scarce possibilities of social mobility. As risk factors increase for youth, including lack of opportunities for gainful employment, the attractiveness of alternative methods for gaining welfare through crime and violence increases, as does the incidence of drug and alcohol consumption, with consequent costs for society. The new Government is committed to addressing the problems associated with society's most vulnerable groups, and has created a new Ministry of Social Development in which to focus its

efforts. This young Ministry will need support in facing this broad set of challenges.

71. Despite Uruguay's reputation as a socially progressive society, recent research indicates that women continue to suffer from discrimination. The male-female wage gap, and labor participation gap closed significantly between 1990 and 2000, but there was no progress thereafter. There is a persistent wage differential of approximately 14 percent between male and female wages for similar work overall, and higher still for men and women with higher levels of education. Further, fewer women than men receive unemployment insurance, independently of the level of education. Clearly, more proactive labor market policies and intermediation services to foster a non-discriminatory labor market would help addressing this issue. In addition, domestic violence remains a serious problem in Uruguay, as a recent survey found that 46 percent of women married or living with a partner suffered from domestic violence in the previous year. Although considerable progress has been made in terms of legislation to address domestic violence, more remains to be done particularly in terms of improving access to justice for the most vulnerable groups.

72. **Millennium Development Goals.** Uruguay has made major progress towards reaching the Millennium Development Goals (MDGs). As indicated in Annex 4, Uruguay is making good strides towards attaining the goals related to education, gender, child and maternal mortality rates, especially in view of the crisis which the country has undergone in the recent years. The goal to reach the poverty reduction target, formulated as reducing by half the percentage of the population living on less than US\$1 per day, suffered a set-back during the crisis years in line with the large increase in the official poverty rate. Although poverty is expected to decline with continued economic growth, it is likely to take years of sustained growth and improved social policies to bring poverty down to pre-crisis levels and below. Finally, the MDG related to environmental sustainability shows good progress for water, but somewhat less so for sanitation. More than one third of urban households still lack proper sanitation services, and this rate would have to be reduced to about one fifth by 2015 to meet the target.

V. Macroeconomic outlook



73. The macroeconomic framework projected for Uruguay under the base case envisages steady state GDP growth of 3 percent in the medium term. This projection assumes: (i) continued macroeconomic stability and improved creditworthiness underpinned by strong fiscal performance and reduced financial sector vulnerability, and (ii) higher investment and productivity underpinned by broad-based improvements in the investment climate. Sustained progress on the structural reform agenda to address the development challenges facing Uruguay is assumed to contribute to the strong fiscal fundamentals and improved investment climate supporting the base case scenario. The investment to GDP ratio is projected to rise steadily towards 18 percent, some 2-3 percentage points above historical levels. The projected 3 percent growth rate is higher than the historical average of 2.0 percent (1965-2004), but not unprecedented in Uruguay. For example, the economy recorded average growth of 4.4 percent during 1991-97, that is, the period prior to the recession and the crisis.

74. Strong fiscal performance is critical to realizing higher levels of growth. Sustaining a primary surplus at or above the 3.8 percent of GDP recorded in 2004 is an achievable challenge for Uruguay. A sustained primary surplus of this order is an important factor to generating a “virtuous circle” whereby improving public creditworthiness lowers vulnerability and supports macroeconomic stability which in turn promotes economic growth which then contributes to fiscal performance and a falling public debt to GDP ratio. The Government’s program includes reforms to strengthen revenues (such as a new personal income

tax, reducing evasion in social security contributions, increases in the VAT base, elimination of low yield distortionary taxes) and also a commitment to keep expenditures under control.

75. Price stability is another important element of the projected macroeconomic framework. Keeping inflation under control can be important to avoid a spiral of inflation and wage increases that could jeopardize fiscal performance and undermine the investment climate. The base case scenario assumes that inflation remains low under continued tight macroeconomic policies and gradually converges to international levels, that is, to 3.5 percent per year starting in 2007. Consumer inflation is projected at 5 percent in 2005-06. The real exchange rate (RER) is projected to move on a modestly appreciating trend through 2007 and then remain constant thereafter, thereby stabilizing in an intermediate range between the depreciated level of the 1980s and the more appreciated level of the 1990s.

76. Reforms in the financial sector that are underway are a core element in the growth strategy. These reforms aim to reduce financial sector vulnerability and improve financial intermediation. The new Government has committed to continue the reform process. Key priorities include: (i) strengthened bank supervision with greater efforts to comply with international standards and greater independence from possible political interference; (ii) upgraded prudential regulation to manage risks arising from non-resident deposits and currency mis-matches; (iii) improved bank exit procedures; and (iv) continuation of the state bank restructuring program including

TABLE 5: MACROECONOMIC SCENARIO BASELINE PROJECTIONS
(In percentage, unless otherwise indicated, 2004-2010)

	2004e	2005	2006	2007	2008	2009	2010
Real GDP Growth	12.3	6.0	4.0	3.5	3.0	3.0	3.0
Gross Domestic Investment/GDP	13.3	14.7	16.0	16.9	17.7	18.2	18.3
CPI inflation, period average	9.2	5.0	5.0	4.5	3.5	3.5	3.5
Exports of Goods and Services/GDP	30.4	27.8	28.3	28.4	28.8	29.0	29.3
Imports of Goods and Services/GDP	27.8	26.8	28.0	28.0	28.3	28.3	28.3
Current Account Balance/GDP ¹	-0.8	-0.8	-0.9	-0.6	-0.6	-0.5	-0.5
Public Sector Primary Balance ²	3.8	3.5	3.7	4.0	4.0	4.0	4.0
Public Sector Overall Balance ²	-2.2	-2.0	-0.5	-0.1	-0.1	0.1	0.2
Public Sector Debt/GDP	92.2	77.5	72.3	68.0	65.3	62.6	59.8
GDP, USD billion	13.2	15.8	16.7	17.4	18.0	18.5	19.1

1. Does not incorporate expected large foreign investments in the forestry sector which would be financed through foreign direct investment.

2. Excludes sub-national administrations.

Source: Uruguayan authorities and World Bank staff.

measures to improve efficiency, reduce costs, and improve corporate management.

77. Other reforms incorporated into the base case projections include measures to improve the business climate such as simplification of procedures and regulations for new businesses, improvement of commercial justice procedures, measures to promote research and development in small and medium enterprises and to facilitate their access to international markets. The base case scenario is also predicated on steady progress to reduce costs of public services and maintain Uruguay's infrastructure. This encompasses improvements in regulation and measures to improve efficiency in their utilization. The scenario further envisages a comprehensive program of social policies (including health, education, social protection) to enhance Uruguay's human capital and promote social inclusion.

78. Under the base case macroeconomic framework, public sector creditworthiness indicators are projected to improve steadily over time. Public debt as a share of GDP is projected to decline gradually from an estimated 92 percent as of end-2004 to about 60 percent by 2010 (Table 6). Debt service as a share of total government revenues is also projected to decline over time after a peak in 2006 of 49 percent, to about 35 percent by 2010. Multilateral debt service is

projected to decline as a share of total debt service, from about 50 percent in 2005 to about 44 percent in 2010. A strong policy framework, supported by the IFIs, and projected improvement in creditworthiness are expected to enhance Uruguay's access to financial markets at reasonable spreads. It is assumed that spreads remain at 400 basis points over the medium term. This spread is at the level observed in March 2005.

79. The public sector financing plan under the base case is predicated on issuance of about US\$450 million in bonds per year on average. Table 7 shows gross financing needs (interest plus amortization obligations) estimated for the coming years. Interest payments are estimated to remain at about US\$0.7 billion per year through 2005-10. Amortization payments are estimated at about US\$1.2 billion per year, except during 2006 and 2007, with amortization peaks of US\$1.7 and US\$1.4 billion, respectively. These peaks are associated with repayments to the IMF of US\$0.7 and US\$0.9 billion, and also to maturing bonds in 2006 of US\$0.6 billion.

80. Sensitivity analysis (Annex 2) shows that limited deviations from the base case scenario are unlikely to reverse the downward projected public debt path, but that larger slippages in performance could increase vulnerability significantly. For example, a primary

TABLE 6: PROJECTED PUBLIC SECTOR DEBT INDICATORS (In percentage, 2004-2010)

	2004e	2005	2006	2007	2008	2009	2010
Public Debt/GDP	92.2	77.5	72.3	68.0	65.3	62.6	59.8
Public Debt Service/GDP	11.7	13.1	15.3	13.1	10.8	10.1	11.0
Public Debt Service/Revenues	39.0	43.9	49.2	41.1	33.4	31.5	34.3
Multilateral Debt Service/Total Debt Service	50.2	53.3	56.7	69.3	52.4	52.1	44.2

Note: the indicators exclude sub-national administrations.
Source: Uruguayan authorities and World Bank staff.

TABLE 7: PUBLIC SECTOR FINANCING (In US\$ million, 2005-2010)

	2005	2006	2007	Average 2008-10
Gross Financing Needs	2086	2572	2308	1971
Interest	864	714	724	733
Amortization	1018	1713	1423	1062
Bonds	217	584	114	325
Multilateral Organizations	801	1129	1309	737
o.w. IBRD	104	154	111	87
Other ¹	203	145	162	176
Gross Financing Sources	2086	2572	2308	1971
Primary surplus	555	624	702	746
Bonds	297	478	304	445
Multilateral Organizations	668	974	846	409
o.w. IBRD	176	187	145	96
Other ²	565	496	456	371

1. Includes deposits, bilateral loans, other international loans and assistance to the financial sector.

2. Includes deposits, central bank financing, asset recovery from the Bank's Stability Fund and bilateral lending.

Includes Central Government, public sector enterprises, sub-national administrations and IMF obligations. Source: World Bank staff estimates.

surplus of 3 percent of GDP, with all other base case assumptions unchanged, would result in a projected debt to GDP ratio of 67 percent in 2010, 7 percentage points higher than the 60 percent projected under the base case but still a significant decline from current levels. If, on the other hand, medium-term growth were to converge to the historical average of 2 percent, then the projected debt ratio in 2010 would be 64 percent. This implies a certain cushion with regard to the base case in terms of debt sustainability. However, the margin for error is limited and the risks increase commensurately with

the extent of the deviations. If, for example, fiscal performance and growth were to slip simultaneously, leading to downward pressure on the exchange rate and higher risk premiums on sovereign debt, then Uruguay's creditworthiness would remain quite vulnerable to shocks. The combination of 2 percent GDP growth, 3 percent primary surplus, no real exchange rate appreciation and higher interest rates would result in a projected medium-term public debt ratio in the range of 84 percent in 2010.

VI. The Bank's Assistance Program



A. CAS Objectives

81. The Bank Group's assistance over the period covered by the CAS (FY05-10) proposes a strategic program of lending and non-lending services to support the main objective of the new administration's development plan "*El Gobierno de Cambio – La Transición Responsable*", which is the **attainment of equitable and sustainable economic development**. To attain this longer-term goal, the Government needs to meet challenges in three broad areas:

- reducing vulnerability;
- sustaining growth; and
- improving living standards.

82. The proposed Bank program responds to specific requests for support made by the new administration to help address some of the key aspects of the broad development challenges facing Uruguay. Requests for Bank support include **tax reform**, as well as **financial sector and capital markets development**, mainly through technical assistance and development policy lending; **the health sector**, where Uruguay needs assistance in reforming the national health system, mainly through an investment operation; **education**, where the Government is looking for continued support to expand full-time schools in marginal areas as well as management reforms in the education administration; in the **area of innovation**, where mainly technical assistance is required to reform the existing institutional set up and to design a national system of innovation which would provide the basis for generating the required decision making capacity

in the country; **the infrastructure and public services sector**, both in the form of technical assistance to revise the current institutional set up as well as investment in the areas of transport, energy and water supply and sanitation, with a view to strengthen regulation and promote private sector participation; **in agriculture and natural resources management**, mainly through investment to promote the use of integrated systems for natural resources management which are viable both from the environmental as well as the economic standpoint, and which should provide a basis for the improvement of competitiveness in agricultural productivity; **state modernization**, with a view to redefining the role of the state in order to enhance transparency, strengthen accountability and increase its operations efficiency. In the area of private sector development, the Government seeks assistance in defining the role of state financial institutions in the development of capital markets, as well as the development of a business environment which is in line with the country's current requirements for productive investment. In the context of the proposed technical assistance in this area, the Government is also seeking Bank support for conducting studies on the needed improvements in bankruptcy mechanisms.

83. An overarching goal of the Bank's program is to support the Government's objective to increase social inclusion and reduce inequality. To this end, we will: (i) support institutional strengthening for social inclusion, particularly the newly established Ministry of Social Development, the Institute of Women's Affairs (IWA) and by creating mechanisms for NGO outreach; (ii)

strengthen the analytical underpinning by building upon previous analytical work, such as the recently completed study on social tariffs, and through regular poverty monitoring, inequality monitoring, and social analysis; and (iii) mainstream social inclusion and stakeholders analysis into project design and implementation. Finally, we will mainstream throughout various thematic interventions mentioned above the commitment to strengthen outreach to civil society to better engage stakeholders in the various reform and governance initiatives that will both require public support and invite public accountability in order to be successful. With regard to reducing inequality, tax reform may prove to be an important instrument. The new Government plans to re-introduce a personal income tax from all sources – currently only wages and pensions are taxed. Depending on deductions and exemptions, progressivity of tax rates and effective compliance, the

new tax has the potential of improving equity through taxation. This may be supported through the DPLs. In addition, the Government is interested in reducing inequality in education and has asked the Bank for analytical support.

84. In selecting specific areas to be supported, the Bank drew upon:

- The outcome of an extensive CAS consultations process, which included a dissemination seminar for the Sources of Growth report, a seminar to discuss the Policy Notes, several technical missions to review sectoral issues, the preparation of a client survey (Box 4, Annex 5 and Section B), and consultations with civil society.
- The findings of core analytical work undertaken in recent years, especially the Poverty Update

BOX 4: FINDINGS OF THE CLIENT SURVEY

- ▶ To better understand the overall situation in Uruguay and how the Bank is perceived by its key interlocutors and other stakeholders, the Bank commissioned a comprehensive client survey of key actors and opinion makers from across the spectrum of government, private sector, civil society and academia. The Survey was conducted in June and July 2004. A total of 256 people were asked to respond to the survey, of which 205, or 80 percent, participated.
- ▶ It is important to note two aspects of the respondent group. First, respondents had a good understanding of the Bank, with more than half indicating that they have been involved with or a close observer of World Bank activities for more than three years. Second, with respect to how respondents viewed events in Uruguay, more than 60 percent registered optimism about the direction in which the country was headed.
- ▶ Salient findings emerged from the survey. The first relates to the country's participation in the multilateral financial community. Some 97 percent indicated that the country should receive at the least same as or more assistance from external sources to address key challenges—with more than 50 percent indicating that more was needed.
- ▶ With respect to the Bank in particular, the findings provided extremely useful information. First, nearly three-quarters of respondents indicated that the World Bank should be “more involved in Uruguay's development strategies” with only 1 percent of all respondents calling for less involvement. In terms of where the Bank could make the greatest contribution, the strongest responses centered around supporting economic growth, and helping to reduce poverty. From the Bank's perspective, of course, these are encouraging responses. At the same time, however, the data indicate a clear challenge. The Bank was seen as more effective in areas considered important but of relatively less urgency (basic services and infrastructure, governance) than in the areas of poverty reduction and social protection where the Bank's involvement is considered by respondents to be most critical. Perhaps this should not be surprising given the complexity of poverty reduction in normal times, let alone when the impact of severe crisis is still evident and far reaching. Nevertheless, it provides a useful guide for the Bank as it seeks to move forward in transforming its support from crisis response to long term development.

(FY04), the Sources of Growth (FY05) and the Policy Notes (FY05), which were discussed extensively with the previous Government and the new administration and which informed the consultation process.

- A careful review of past successes and failures as identified by the CAS Completion Report which formed part of the dialogue with Government on the design of this CAS.

B. CAS Preparation Process and Lessons Learned

85. Several activities, engaging both the previous and the new administration in an active dialogue with the Bank, preceded the preparation of the CAS and formed the basis for its recommendations and proposed program.

86. **Consultations.** In late 2004 several participatory workshops were held for the preparation of the Sources of Growth report. In early December 2004,

BOX 5: CAS CONSULTATIONS WITH CIVIL SOCIETY

- ▶ An important round of CAS consultations was organized by the Bank in partnership with the Government of Uruguay, Foro Consultivo Económico Social del MERCOSUR, Sección Uruguaya (FCES). Half day-long meetings were held on April 19-21, 2005 in three areas of the country with different characteristics: Montevideo, Paysandú and Tacuarembó (Annex 8).
- ▶ **Participants:** All meetings attracted a high number of participants (more than 200 in total), with broad participation from the entire spectrum of civil society, including NGOs and representatives from unions, faith groups, academia, workers' organizations, producers' associations, media and Government official at the national, departmental and local level.
- ▶ **Meetings' Organization:** All meetings were structured around a presentation on the role of the Bank and the main objectives of the CAS being discussed with the authorities. Following the presentation, participants were divided into break-up working groups with a broad representation from various segments of civil society, and headed by a group leader, who reported the findings of each group in a plenary session.
- ▶ **Main Themes:** There was a high level of coincidence between the challenges facing Uruguay which were identified in the CAS and those being singled out by the break-up groups. Main themes that emerged from the discussion were the need to deal with fiscal constraints and to strengthen the public sector. Participants emphasized the cost of the crisis in terms of loss of employment, particularly for women, youth and other vulnerable groups, and noted that the crisis had a severely negative impact on the country's values, both at the family and at the individual level.
- ▶ **Perceptions of the World Bank:** Overall, participants had very limited information about the role of the Bank in the past. To this end, participants welcomed the forthcoming opening of a Bank's resident mission in Montevideo. A number of perceptions about the Bank emerged forcefully throughout the consultations with civil society representatives, including a concern with the impact of the Bank's assistance. However, there was a very positive attitude towards developing a constructive dialogue with the Bank in the future and towards an increase in Bank's involvement.
- ▶ **Proposals for Bank Engagement:** Civil society welcomed the opportunity to collaborate with Government and the Bank in the reconstruction of those values that were lost as a result of the crisis, and in ensuring that the needs of the most vulnerable groups are addressed. The need for broader reforms in the education sector, with the active involvement of the teachers, was also identified. With respect to the productive sector, the scope for wide participation of the civil society in the design and implementation of programs targeted at small and medium enterprises, micro-enterprises and cooperatives was also highlighted. In the area of state reforms, civil society would welcome a future involvement in the monitoring of results obtained by the public sector.

these events were followed by a workshop in Montevideo where the Bank presented the findings of the Sources of Growth report to representatives of both the outgoing and the new administration. The workshop was hosted by the Central Bank Governor and included participation and comments by both the previous and the current Ministers of Finance. This event was followed by a two-day seminar in late January 2005 to discuss the findings of the Policy Notes with the new Cabinet. The seminar was highly participatory, and included several sessions dedicated to specific sectoral issues. The outcome of the Policy Notes⁴ seminar was instrumental in establishing a close dialogue with the new authorities on key aspects of the new Government's program and in defining the framework for ensuing Bank support. In addition, over the last couple of months, a number of technical missions visited Montevideo to assist the Government in better defining sectoral priorities and the needed actions for reforms in key areas of the economy. In close cooperation with the authorities, the Bank intends to ensure that the preparation of new operations, including the proposed DPLs, is based on a participatory and consultative process.

87. CAS Completion Report. The CAS Completion Report (Annex 1) notes that the economic crisis of 2002 was anticipated as a possible, albeit not highly likely, risk scenario. The 2000 CAS explicitly acknowledged downside risks of *"a recession (or even more severe economic crisis) in either Argentina or Brazil"* which might cause Argentine residents to withdraw their deposits from Uruguayan banks. Yet, while acknowledging the risk, the CAS did not propose any contingency plan to deal with the likely dire consequences for Uruguay. In the absence of a country-specific contingency plan the Bank resorted to a standard emergency lending instrument, the Special SAL, to satisfy the urgent financial needs of Uruguay. A combination of SALs and Special SALs effectively enabled the Bank to contribute its share of a US\$3.8 billion package of support from the IMF, the IADB and the Bank. However, the compressed repayment schedule of the Special SAL will create by itself and contribute, more generally, to a hump in debt service in 2006 and 2007 which may complicate the financing challenges for Uruguay and which might have been avoided if alternative contingency plans had been prepared ahead of time. The Government has requested cancellation of the remaining tranches of the second SSAL (para. 89). A

lesson to be learned, therefore, is that, whenever serious downside risks are present, advance consideration should be given to contingency planning and, ideally, financing terms should be compatible and conducive to advancing a robust debt sustainability position.

88. The CAS Completion Report also notes how the Bank was able to respond promptly and effectively to the crisis as it unfolded. In part that was possible because the Bank had already assembled a broad body of country experience through a diverse operational program and through its analytic work. The country knowledge and experience gained from an active and long-standing country program could be mobilized quickly to assemble an emergency program of support for crisis management. At the same time, a broad and deep country dialogue over many years, not only with the Government, but also with the private sector, academia and civil society was instrumental in fostering an effective partnership with the client. Another lesson to be learned, therefore, is that a strong corpus of country knowledge and a strong client relationship should be pursued as a prerequisite for the effective delivery of emergency Bank assistance. Similarly, a close cooperation with other multilateral and bilateral partners enhances the effectiveness of the Bank's country program.

C. Development Policy Lending

89. On-going adjustment loans. With regard to the ongoing adjustment operations, the Bank has consulted with the Government on a future course of action.

- **SAL II.** A letter of understanding for the continuation of SAL II has been presented by the authorities (Annex 6). All outstanding conditions under the second and third tranche are expected to be met, with the exception of two conditions which, as a result of two referenda, will need to be modified. These two conditions relate to (i) the issuing of a decree establishing the regulatory framework for the importation, production and commercialization of petroleum products, and (ii) the issuing of an offer to award a performance-based contract to a private operator for the management of the unaccounted-for-water reduction program in Montevideo⁵. It is expected that adequate progress will be achieved to

4. Report No. 31338-UY, dated March 31, 2005.

5. In December 2003, a referendum resulted in a vote in favor of repealing a law, passed in 2001, that allowed ANCAP, the state oil company, to set up joint ventures with foreign partners. Simultaneously with the Presidential election, another referendum resulted in favor of a Constitutional amendment making water and sanitation services exclusively the domain of the public sector.

BOX 6: POTENTIAL REFORMS TO BE SUPPORTED BY DPLS

► **Public Sector Management**

Tax Administration and Tax Policy
Expenditure Management
Institutional Reform

► **Financial Sector Reform**

Continuation of the Public Banks Restructuring Program
Capital Markets Development
Financial Sector Regulation and Supervision
Implementation of Deposit Insurance

► **Reform of Social Programs**

Health Sector Reform
Public Pension System Reforms

recommend release of the second tranche of SAL II (in the amount of US\$50 million) later in 2005 and the third tranche (also in the amount of US\$50 million) in 2006.

- **SSAL II.** With the immediate crisis over and a new CAS period beginning, the Government has requested cancellation of the outstanding second and third tranches of SSAL II in an equivalent amount of US\$75 million. The social reform agenda that was pending under SSAL II has been achieved and will be supported by new development policy lending under the CAS.

90. **New development policy lending.** A first DPL, in an amount of US\$75 million, is being prepared to support the social reform objectives of improving equity and efficiency of public expenditures in the social sectors by supporting measures to improve management and give budgetary protection to priority programs. The program to be supported by DPL1 will incorporate reform progress in social policies over the last two years (based on SSAL II tranche conditions that have all been met), and early but important measures the new Government has taken with respect to health, education and social protection. The DPL 1 also recognizes the result achieved by Uruguay of protecting basic social indicators despite the severe impact of the crisis on poverty and employment.

91. The proposed lending program comprises three additional programmatic Development Policy Loans in FY06-08. These operations are expected to be multi-

sectoral in focus and provide support to the Government in implementing reforms in the three key areas mentioned above, namely public sector management, financial sector reform, and reform of social programs. Potential programs within these three broad areas which could be supported by the DPLs are presented in Box 6. The specifics of these programs would be geared to respond to the corresponding development challenges pre-sented in Section IV above.

92. Within the public sector management area, the DPLs may focus on tax reforms and elements of the authorities' expenditure management agenda such as public procurement and social transfers. On the tax front, the aim will be essentially to improve equity of the tax system, while on the administrative side the focus will be on improving tax collection, which is essential to maintain the primary surplus. Regarding expenditure management, reform of social transfers are likely to play a leading role. It is also possible that the DPLs may support some broader institutional reforms within the public sector. In the financial sector, it is expected that emphasis will be on strengthening the institutional framework for supervision, on continuing state bank restructuring, particularly of the BHU, and on policies to promote the deepening of capital markets. Within the social context, the focus is expected to be on health and pension reforms where efficiency improvements can improve overall social welfare while contributing to fiscal stability and expenditure switching policies. The poverty and social impacts of the reforms would be

assessed (paras. 101-104) and, as noted above, mainstreamed throughout the thematic areas. The preparation process for the DPLs would be designed to engage stakeholders and invite public accountability.

D. Investment Lending Priorities and Entry Points

93. Rebuilding of the investment pipeline starts with two projects designed to improve transport access under the Transport Maintenance and Rural Access Project and support investment in the strategically important agriculture sector under the Integrated Natural Resources Project. These two projects are being presented to the Board with the CAS and represent a strong beginning to a renewed partnership with Uruguay in supporting critical public investments. The two operations were largely prepared during the outgoing administration, but could not be negotiated and delivered as the allocations under the previous CAS Progress Report were exhausted. The new administration has confirmed that these two operations are also consistent with its development priorities.

94. To support more efficient and accessible infrastructure systems, the Bank plans to assist the authorities with: (i) an Infrastructure Investment project that would address energy, security and additional transport investments; and (ii) a second phase of the OSE Modernization and Systems Rehabilitation Program (APL II). The infrastructure investment project would address energy security and additional transport investments to enhance regional integration, competitiveness and urban transport that would complement the Transport Infrastructure Maintenance and Rural Access Project. The APL II project would build upon the efforts of the ongoing first phase of the Program to consolidate the institutional renewal of OSE, particularly the reforms aimed at improving governance and management of the utility, complete and consolidate the implementation of public information and benchmarking system and unaccounted-for water control program, universalize the provision of potable water and increase coverage of sanitation services.

95. As agreed with the Government, the Bank plans to prepare an Institution Building operation (FY07) which is expected to assist in the design and implementation of institutional reforms in the core fiscal, financial and social areas. The design of this operation is expected to accommodate demands for institutional reforms which may emerge during the execution of the Government's program. In the spirit

of clustering and enhanced multi-sectoral focus, the Institution Building operation will replace potential smaller operations to address the institutional building needs of the various sectors.

96. To support improved living standards, the Bank is working with the authorities on investments to support the Government's reform of the national health insurance system through: (i) overhaul of the regulatory framework to make it more effective in providing consumer protection, to improve incentives for efficiency in purchasing services from providers, to allocate public subsidies in a more equitable mode, and to ensure access to health services for the whole population; (ii) definition of a mandated, explicit and guaranteed coverage for all beneficiaries subject to public financing, including primary and secondary health prevention; (iii) deepening initiated reforms of the provider payment mechanism in ASSE and the link of the payment system to actual provision of services to Ministry of Health (MOH) beneficiaries; (iv) providing financing for necessary investment to expand the primary health care network of the public system as it would require significant modernization in the move towards a national health insurance and (v) definition and implementation of a health service delivery system that caters to the health needs of the population, specifically improving the quality of primary and secondary health prevention. As regards support to social security, the Bank is prepared to assist the Government in considering options for pension reform, including linking the replacement rate to the retirement age. As regards support for education, the Bank is prepared to assist the Government in improving the quality and equity of the education system through a new lending operation which could focus on continuing the Bank's current support for the expansion of full-time schools in impoverished areas. Further, the Government might also seek support from the Bank in its efforts to reform and modernize the administrative structure of education administration. A further entry point may be reforms and changes of the unemployment insurance and the family allowance program.

97. Support for innovation, science and technology is a high priority for the Bank program. The objective is to help the authorities address the broad issue of innovation as a driver for growth, thereby linking innovation to growing sectors in the economy. Efforts to strengthen of the national innovation system are likely to include support for the formulation of an efficient policy framework with strong incentives. Priority would be given to strengthening the

Government's capacity to formulate a long-term policy vision supported by concrete policy measures which would also include drafting a strategic innovation plan. The process is expected to involve stakeholders from several Ministries (including Finance, Education, Agriculture, and Industry) as well as representatives from industry. A related action area may involve fostering public-private linkages in the education sector. Grants and scholarships could be provided to support: (i) cooperative research (support to research groups from universities, government laboratories, and private industry undertaking collaborative research and development, and research training in areas of importance to industry); (ii) advanced graduate programs in priority fields; and (iii) promoting 'researcher in industry' programs (expansion of the stock of high-quality personnel in Uruguayan industry by awarding scholarships to doctoral students who undertake a substantial part of their thesis work in industry). A third action area would aim at enhancing agricultural competitiveness and trade by linking the fundamental structural issues of innovation, sanitation, and integration. This work could build upon the Integrated Natural Resources Project. Additional action areas could cover infrastructure and private sector development.

98. **Grant activities.** The above lending program will be supplemented by an active program in environmental management which will seek to leverage GEF and Carbon Fund resources to: (a) support regional grassland management (in a regional GEF-financed medium sized project shared with Brazil, Paraguay and Argentina); (b) improve solid waste management, methane capture, and electricity generation, using carbon finance, building on a successful pilot program nearing completion in Maldonado and potentially expandable into Montevideo; (c) sequester carbon and reduce methane emissions using a combination of planted forests and efficient livestock production systems; (d) and support to urban transport operational efficiency gains and emissions reduction to help reduce transport-related carbon emissions. The above mentioned assistance through GEF and Carbon Finance funds will be additional to the assistance provided under the GEF-financed Integrated Ecosystem Management project, which is blended with the Integrated Natural Resources Project which will be presented to the Board together with the CAS.

99. In addition, support will be given, possibly through trust funds, to the implementation of

national environmental priorities by National Directorate of Natural Resources of the Ministry of Agriculture and National Directorate of Environment of the Ministry of Housing, Land Use and Environment in their shared and even overlapping capacities. A Statistics Support Grant has been requested to provide support to the National Institute of Statistics (INE).

100. The program will further be complemented by institutional strengthening initiatives and grass-root capacity building activities financed from the IDF and other grant facilities. The proposed priorities are to use IDF capacity-building resources to support (a) the new Ministry of Social Development, which has the broad mandate of fostering inclusion and lobbying to reduce inequality across a wide range of government programs and policies, and (b) NGOs and NGO networks actively supporting youth, afro-descendants, women and other socially excluded vulnerable groups. Both IDF and project funding (such as through the proposed Institution Building Project) could be specifically targeted to support the Government's strategy of making social services more accountable and responsive to end-users by financing activities that promote voice and client power mechanisms. Specifically, support could be given in such areas as (a) drafting and implementing the *Ley Básica de Participación Institucional* and (b) designing the *Consejo ciudadano de seguimiento de los compromisos de gobierno*.

E. AAA and ESW

101. The Bank's non-lending program (Table 8) aims to assist the Government in translating selected development priorities into action agendas, underpin lending operations, and provide policy advice as requested. The proposed ESW program seeks to respond to evolving Government priorities in a flexible and agile manner so as to effectively contribute to the policy debate on key development issues. We will identify together with the authorities additional areas where the Bank is well placed to provide the Government with the needed analytical support. Furthermore, the Bank expects to increase its involvement in outreach activities which will foster civil society participation and to mainstream the use of PSAs as part of its ESW program.

102. A Public Expenditure Review (PER) and a Health Strategy are ongoing and will be discussed with the authorities in the near future. These studies have a fiscal dimension, but also focus on the issue of equity in access. The health and education chapter of the

PER include an incidence analysis, while the social protection chapter of the PER and the recently concluded Policy Notes include the coverage rates of major social programs among the poor.

103. It is expected that trade will be an area where the Bank could be potentially involved in providing the Government with the needed policy advice, and additional areas will be discussed with the authorities in the coming months. The Bank would also consider providing advice to the Government in the implementation of the newly approved legislation on anti-money laundering and combating the financing of terrorism, upon request by the authorities. Clustering of areas/topics under a single piece of ESW will be one of the guiding principles in the further development of the program. The ESW program currently includes in FY06, the completion of the Update to the 2000 Country Procurement Assessment Report (CPAR), which will assess the impact of procurement modernization actions since 2000 and will identify possible future initiatives. The FY06 program will also include the completion of an Investment Climate Assessment, two Reports on the Observance of Standards and Codes (ROSCs) on insolvency and governance and a Financial Sector Assessment. The latter will provide the new administration with a menu of options for continuing the ongoing reforms of the financial sector and the development of capital markets. The Equity and Quality of Education Economic and Sector Work (ESW), also planned for FY06, will analyze the degree to which the current system of assignment of teachers and students contributes to maintaining inequities in the education system and will explore options for increasing equality in education.

104. Starting in FY06 and continuing on throughout the CAS period, the ESW program will be articulated around programmatic multisectoral development policy reviews (DPRs). Each of the DPRs will first have a topical focus. A social sector DPR is planned to start in FY06 with particular focus on poverty and employment. A sectoral DPR in FY07 will focus on infrastructure. In FY08, the planned DPRs will focus on agriculture and the environment. In addition to focusing on a specific topic, the DPRs will cover cross-cutting issues including fiscal, growth, social inclusion, social accountability and environmental management. In this way, the DPRs are expected to provide the core analytical and safeguard framework for the DPLs, including Poverty and Social Impact Analysis (PSIAs). The PSIAs are expected to provide an analysis of the distributional impact of key reforms supported by the

DPLs. The DPRs are further expected to provide a framework for poverty and inequality monitoring. This could include support for new survey work on rural poverty. In addition to formal ESW, some sector studies will be conducted by the Government and the Bank in the context of project preparation or implementation.

F. Indicative Program

105. Table 8 below summarizes the Bank's proposed lending and ESW program for the CAS period. The specific investment projects to be supported and the studies under the ESW program may change as the Government fine tunes its priorities for Bank support.

G. Portfolio Management

106. Uruguay's current portfolio reflects commitments for a total of US\$542 million of which roughly half correspond to investment projects and the balance to two of the policy based operations approved in 2003 (Public Services & Social Sectors SAL and SSAL). About 80 percent of the investment portfolio commitments correspond to projects in the infrastructure sector, while maintaining some modest investments in the education and agricultural sectors. No new investment operations have been approved since April 2002 as the lending envelope under the 2000 CAS was exhausted with the policy based loans approved in the midst of the crisis.

107. Portfolio performance during the period 2002-2003 was seriously affected by the crisis as the fiscal restrictions limited the possibility for execution of some of the key investment programs, particularly in the areas of energy and roads. In addition, two projects were facing some endogenous difficulties that led to their downgrading to unsatisfactory status after the crisis. Investment portfolio performance reached its lowest level in FY03 when total disbursements reached only US\$16.3 million, equivalent to 11 percent of total undisbursed funds of an aged portfolio expected to be disbursing at a rate close to triple that amount.

108. A major joint effort has been launched since then to improve portfolio performance. There have been semi annual portfolio performance reviews involving the Government and all project entities aimed at probing the cross cutting and project specific issues affecting portfolio performance. The project teams have intensified the supervision efforts and there has been increased responsiveness by the Government to ensure that projects have adequate budgetary allocations. Special efforts were made to

TABLE 8: IBRD PROGRAM SUMMARY (BASE CASE)

LENDING			ECONOMIC & SECTOR WORK
Fiscal Year	Project	US\$ Million	
2005	Transport Infrastructure Maintenance and Rural Access	US\$70	Sources of Growth (Completed) Policy Notes (Completed) Public Expenditure Review Health Strategy
	Integrated Natural Resources	US\$30	
	DPL I	US\$75	
	Total FY05	US\$175	
2006	National Health Insurance & Social Security Support	US\$20	CPAR Investment Climate Assessment ROSC (Insolvency) ROSC (Governance) Equity and Quality of Education Financial Sector Assessment Country Gender Assessment
	DPL II	US\$75	
	Infrastructure (energy)	US\$70	
	Total FY06	US\$165	
2007	Innovation/Science & Technology	US\$35	Programmatic DPR Social Sector (Poverty and Employment) Programmatic DPR Infrastructure
	DPL III	US\$75	
	Water Sector APL II	US\$30	
	Institution Building	US\$15	
	Total FY07	US\$155	
2008	Education	US\$25	Programmatic DPR Agriculture and Environment
	Coastal and Marine Resources	US\$30	
	DPL IV	US\$50	
	Total FY08	US\$105	
Sub-Total		US\$600	
2009	Investments in Social, Institutional and Infrastructure Areas	US\$100	Programmatic DPR (topic to be determined)
2010	Investments in Social, Institutional and Infrastructure Areas	US\$100	Programmatic DPR (topic to be determined)
Total		US\$800	

ensure increased responsiveness of projects to the country's post crisis investment requirements and actions were undertaken to address project implementation difficulties. The results have been positive. Project execution levels more than doubled during the course of FY04 to US\$35.8 million -

representing 21 percent of total undisbursed funds - and disbursements during the current FY are expected to remain at similar levels. The problem projects have overcome their implementation difficulties and currently all the projects in the portfolio are rated satisfactory.

109. The main challenges ahead in terms of portfolio management will be the orderly closure of five of the six projects currently in implementation and ensuring that the new operations approved will begin implementation swiftly, breaking with the past experience of slow execution. Achieving faster implementation rates will continue to be an important challenge for both the Bank and the Government. The Bank will maintain a proactive dialogue with the Government on portfolio management to ensure that new projects will be undertaken in an environment that is conducive to a more efficient project execution to ensure the projects are effectively contributing to their expected results.

H. The Role of IFC, MIGA and WBI

110. **IFC.** IFC's strategy for Uruguay for the last few years has been focused on the management of its existing portfolio, which was negatively affected in the aftermath of the Argentine crisis. As stabilization and reform efforts advanced, IFC focused on pursuing opportunities to support the private sector, particularly in activities that would help reactivate growth and increase exports. During this period, a project of US\$30 million in the agrobusiness sector has been committed. The project is for Conaprole, the National Cooperative of Milk Producers and one of the country's main exporters. The project aims at enhancing the efficiency of Conaprole's operations and at helping it to remain competitive in the world markets. The current portfolio includes projects in the agrobusiness, education, infrastructure and finance sectors.

111. Going forward, IFC's strategy will focus on supporting the expansion of the private sector in areas where Uruguay is internationally competitive and on selectively supporting private infrastructure and projects that facilitate access to financing for second tier enterprises. Given the State relative strong presence in the infrastructure sector, IFC could consider exploring opportunities under PPP schemes for sectors under which the regulatory framework is conducive and provides opportunities for IFC to add value to these projects. It would also explore opportunities that may arise through regional projects, either at the Mercosur level or at the broader level. IFC's pipeline currently includes projects in the export-oriented manufacturing sector.

112. **MIGA.** MIGA's activities in Uruguay have been concentrated in the financial sector until FY02. At that time, with the expiry of existing contracts of guarantee in the country. MIGA's exposure to Uruguay

risk disappeared from the Agency's portfolio. During FY05, MIGA has experienced a growing interest for guarantees for investments in Uruguay. This has resulted, thus far, in one contract of guarantee covering the equity investments in the solid waste management concession awarded to a private operator in the city of Montevideo. In addition, MIGA is currently examining other requests for guarantees, and expects to see an important increase in its exposure to Uruguay over the next couple of calendar years.

113. **WBI.** During the previous CAS period, approximately 300 representatives from Uruguayan government agencies, civil society organizations, academia and the private sector participated in courses, conferences, GDLN (Global Development Learning Network) dialogues and other learning programs offered by the World Bank Institute (WBI). Much of this participation was through global and regional programs. Training programs delivered in Uruguay included courses in infrastructure regulation and education reform. WBI will support the new CAS objectives by continuing to include Uruguay in its various learning and capacity development programs to be offered over the duration of the CAS and will attempt, wherever possible, to link these learning programs to ongoing and planned operational activities. In addition to the delivery of learning activities, WBI will provide support to the GDLN Center in Uruguay through its GDLN Services Unit.

VII. Lending scenarios and performance indicators



A. Base Case Lending

114. The CAS envisages a base case scenario of up to US\$800 million over the period through FY10. The program for the initial years of the CAS period (end-FY05-08) would provide for a total of up to US\$600 million in commitments (Table 8). The program for the last two years of the program will be formulated as the CAS progresses and presented to the Board in a CAS Progress Report in FY08.

115. The CAS lending program will be modulated on the strength of the Government's program and its ability to implement it, as well as the country's creditworthiness and the Bank's exposure. Creditworthiness will improve to the extent that Uruguay maintains credible macroeconomic policies and makes concrete progress in implementing

structural reforms in key areas related to fiscal sustainability, reduced financial vulnerability, improved regulatory framework for infrastructure investment and public services, and enhanced social protection. Improved creditworthiness will be reflected in improved debt sustainability indicators. New development policy lending early on in the program period is expected to support selected structural reforms in the three key areas (public sector management, financial sector reform and reform of social programs), while improved regulation will be supported through the restructured SAL II. The expectation is that up-front reform implementation will support improvements in creditworthiness which will allow for a substantial rebuilding of the investment pipeline.

TABLE 9: IBRD PORTFOLIO PROJECTIONS (in US\$ Million)

	CY04	CY05	CY06	CY07	CY08	CY09	CY10
Commitments	0	225	162	140	104	100	70
Disbursements	144	176	187	145	100	104	86
Principal Repayments	80	104	154	111	80	83	97
Net Flows	64	72	33	34	20	20	-11
Memo							
Total Debt Service	102	153	212	167	132	132	149
Debt Disbursed & Outstanding	785	858	891	925	945	965	954

Source: World Bank estimates.

116. As indicated in Table 9, the proposed base case lending will have implications for Bank exposure. Broadly, exposure would gradually increase from US\$785 million in CY04 to reach US\$965 million in CY09. However, policy-based lending will depend upon the progress made in actually implementing reforms. Slower than expected execution of reforms and/or the investment program would delay new Bank operations and reduce the amount of actual commitments under the new CAS below the US\$800 million envelope. In this regard, self-correcting mechanisms are built into the CAS to modulate Bank exposure in line with performance benchmarks.

117. The linkage between country performance and new Bank lending will be made on the basis of a focused set of base case triggers (Box 7). If the macroeconomic framework, reform implementation, or improvement in debt sustainability were to fall significantly below expectations during the first three years of CAS implementation, the Bank would refrain from further development policy lending and slow

new investment lending. Under this low case scenario, total lending commitments would be reduced by at least US\$300 million with respect to the base case envelope. Parameters for determining lending plans for the remainder of the CAS period would then be reassessed in the CAS Progress Report planned to be presented to the Board in FY08. A change in the status of portfolio implementation to unsatisfactory would also be grounds for slowing down new investment lending until satisfactory status were restored. Were reform and investment program implementation to exceed expectations, allowing Uruguay to largely recover its investment grade status, this would open up the perspective of accelerated implementation of the lending program and a possibly enhanced level of Bank support to be discussed at the time of the Progress Report. Finally, were Uruguay to be hit by a new external shock large enough to impact growth and debt sustainability, the lending program would be reassessed based on the Government's policy response and, if judged appropriate, a revised strategy would be presented to the Board in the months following the shock.

BOX 7: CAS BASE CASE TRIGGERS

- ▶ Maintenance of a satisfactory macroeconomic framework as evidenced by, for example, an active IMF program.
- ▶ Continued improvement in public debt sustainability in line with the indicators presented in the medium-term Debt Sustainability Analysis in Table 6.
- ▶ Implementation of structural reforms in the public sector management, financial sector and social programs endorsed by the Bank (Box 6). These reforms will encompass tax policy and administration, financial sector regulation and supervision, and reform of the health care system.
- ▶ Satisfactory implementation of the Bank's investment project portfolio as determined by twice annual portfolio reviews.

VIII. Implementing the CAS



A. Expected Results of the CAS

118. Indicative outcomes and results indicators are presented in the annexed CAS Results Matrix. Expected CAS outcomes as outlined in the Results Matrix will be further refined as the required information becomes available and could be subject to change. This will be reflected in the CAS Progress Report which will be prepared at the end of the third year of CAS implementation. The CAS Progress Report will provide a preliminary stocktaking of the program and the revised indicators will reflect the status of program implementation at that stage. A Client Survey will also be carried out during the third year of program implementation.

B. Decentralization

119. With the decentralization of the Southern Cone Department and reactivation of the Bank program in response to the crisis, there has been a marked increase in visits of the Country Director and other Bank staff to Montevideo. In addition, and with the strong increased demands for Bank assistance, the Bank will open a liaison office in Montevideo, effective mid-2005, which will further enhance the dialogue and implementation of the Bank's program.

C. Partnerships

120. **International Monetary Fund.** Since liquidity problems were at the center of the crisis in Uruguay, the IMF appropriately took a lead role in providing support from the international financial community. In March 2002, the IMF approved a Stand-by arrangement which, together with a supplement in June of that year, amounted to US\$2.8 billion. Financing was used to restructure the banking system,

strengthen fiscal performance to assure medium-term debt sustainability and to foster private sector participation in basic services with a view to improving productivity and efficiency. All of the reviews of the Stand-by arrangement proceeded well, albeit with some delays. Bank restructuring has been the most difficult issue to resolve, particularly the liquidation of banks that had no prospect of regaining financial viability. In February 2005, the IMF Board approved the seventh and final review. The ex-post assessment of the program was discussed by the IMF Board on March 18, 2005.

121. A new program with the IMF will be crucial to ensure sustained macroeconomic stability. The Government has reached agreement with IMF staff on a new three year Stand-by arrangement through mid-2008 which is expected to be presented to the IMF Board in early June. IMF staff are proposing access under the new program to cover 60 percent of repayments due over the program period which amount to approximately US\$1.9 billion at current exchange rates.

122. **Inter-American Development Bank.** Since the 1990s, the IADB has become the largest multilateral development partner to Uruguay and has played a prominent role in helping the country overcome the crisis in 2002. The strategic framework for IADB's assistance was articulated in a Country Paper covering the period 2000-2004. The Country Paper provided financing for a program of US\$1 billion over the five-year period. An alternative scenario involving credits of over US\$1.2 billion was also foreseen in case the implementation of structural reforms aimed at

sustained export-led growth within a framework of macroeconomic stability and improved social equity required additional funds. That program was accelerated as a result of the 2002 crisis and, with the approval of a US\$500 million loan for Social Protection and Sustainability in August 2002, overall lending exceeded the basic loan scenario. In 2003, the IADB approved additional commitments in the order of US\$260 million, and in 2004 it approved an additional US\$77 million for a Highway Infrastructure loan.

123. A new Country Strategy for Uruguay is currently under preparation for presentation to IADB Management's Programming Committee in June 2005 and presentation to the Board of Directors in the fourth quarter of the calendar year. Lending under the new program is expected to be commensurate with Uruguay's public financing needs which include large repayments to IADB.

124. **Civil society.** In implementing the CAS, we will identify areas that will assist the Government in building relationships with civil society. During the CAS consultations process, a number of areas have been discussed. In the area of social inclusion, civil society could play a major role in ensuring that the needs of the most vulnerable are addressed, and in education the active involvement of teachers could contribute to future reform efforts. In addition, civil society could assist the Government in designing and implementing programs for small and medium enterprises, micro-enterprises and cooperatives. In the area of state reforms, civil society could play a key role in monitoring the results obtained by the public sector.

D. Fiduciary Assessment

125. The recently completed economic and sector work in financial management and accounting indicates that the fiduciary environment in Uruguay does not present major issues, and that overall the country presents a low level of fiduciary risk. However, more remains to be done in terms of improving some of the procedural, institutional and legal aspects relating to both procurement and financial management. With the completion of a Country Financial Accountability Assessment (CFAA) jointly with the Inter American Development Bank (IADB) in 2003, and the planned completion of an Update to the 2000 Country Procurement Assessment Report (CPAR) in early FY06, there are no gaps in core diagnostic ESW. Looking forward, we will address fiduciary issues systematically by more effectively

integrating the recommendations of the fiduciary work into the lending program.

126. **Procurement.** A CPAR for Uruguay carried out in 2000 found no serious systemic problems affecting public procurement, and corruption was found not to be an issue. However, the report identified a number of legal, institutional and procedural aspects that needed improvement. From the Bank's perspective, procurement has been singled out in the past as one of the areas of delay and contention in portfolio management. The major shortcoming in the procurement area is that the country lacks a national procurement law. The public procurement legal framework is provided by the Code of Accounting and Financial Management (*Texto Ordenado de Contabilidad y Administración Financiera* or TOCAF), which is a compilation of provisions found in budgetary and financial laws. The procurement provisions in the TOCAF are very general and provide considerable latitude for interpretation. Consequently, harmonized procedures and documentation is lacking.

127. In addition, the Court of Audits (*Tribunal de Cuentas*) is frequently a source of delay for the procurement process. The Court does not have an ex-ante responsibility, but is required to issue opinions on procurement documents and decisions. Such opinions are not mandatory, but are generally respected by the Executive Branch. The Court is required to issue its opinions within a specific and relatively short time frame, although through bureaucratic maneuvering which often take a long time, thereby disrupting the procurement process with limited value added.

128. As a follow-up to the 2000 CPAR, an IDF Grant completed in FY04 aimed at assisting Uruguay to improve the legal procurement framework, establishing an e-procurement system and conducting staff training, concurrently with complementary efforts supported by an IADB's State Modernization project. Considerable progress has been made since the year 2000 on enhancing the institutional framework, establishing e-procurement information and standard documentation for procurement of goods, and staff training. The Office of Planning and Budget (OPP) has been assigned the lead role in public procurement. In addition, centralized systems for procurement of medicines and food were established in the Ministry of Economy and Finance (MEF) in 2003. Despite this progress, a national procurement law stalled in the National Congress.

129. The Uruguayan Congress is currently considering

a bill to modify procurement legislation, including new procedures which seek to increase the reduction in costs that the central administration has already experienced as a result of previous reform efforts. Congress has made compliance with procurement laws a requirement for all public entities, which provides a significant legal mechanism for those outside the central administration. Some of the noteworthy aspects of this proposed law are as follows: (a) to promote e-procurement and the publication of information not only with regard to specific procedures on the Government's website, but also framework contracts. This permits a centralized procurement of some goods, the delivery of which depends on the needs of each executive unit; (b) a differentiation in procurement procedures both regarding the amounts involved as well as for the specific types of product that will be purchased. This will allow for economies of scale, however, it should be borne in mind that competition may also be reduced; and (c) the introduction price lists for procurement which are continually updated by the authorities. This would allow the traditional mechanism of direct procurement to be partially replaced, and still provide a system of permanent bidding for prices, or at least generate a maximum reference price for purchases by the public sector.

130. A CPAR Update currently under preparation and scheduled for completion in FY06 is intended to assess the impact of procurement modernization actions since 2000 and to review with the new administration the possibility to proceed with other initiatives, including the enactment of a national public procurement law, further strengthening of the institutional capacity, the harmonization of procurement practices in the central government institutions, the municipalities and state owned public utilities, and reviewing the role of the private sector.

131. In particular, the Bank could support Uruguay through technical assistance to more fully implement the modernization of state purchasing. For example, the SICE integrated purchasing system could be brought into a more general use among the executive units, or at least those within the Central Administration. This would facilitate the standardization of procurement procedures and compliance with the country's legal framework. Bringing SICE into general use also would provide a guarantee of compliance with procedural rules, such as the obligation to publish on the website and ensure payments by the State are recognized for purchasing. It would also allow for a more wide-

ranging control of the calls for bids and the "extension" of such calls, an aspect that is currently difficult to control in Uruguay. Generalized implementation of the system would also be useful for keeping suppliers up to date with their tax payments.

132. **Financial management.** The latest CFAA prepared jointly with the IADB in 2003 indicates that there are no major concerns on financial management and accountability, and that in general public sector financial management in Uruguay continues to be transparent, albeit bureaucratic. Further, bank financed projects usually receive unqualified opinions from external auditors and they are received by the Bank in a timely manner. With respect to the 2000 CAS objective to establish more transparent accounting and budget processes, progress is being made toward improving the transparency of fiscal policy setting, budget management and accounting. The quality of fiscal data has substantially improved, performance of the operational units of the public sector are more closely monitored. However more proactive dissemination of data on budget performance is desirable.

133. Several areas of good practice were observed and included: (i) an adequate legal framework for financial accountability; (ii) clear division of the roles of the Executive and Legislative Branches in terms of financial administration; (iii) complete and systematic revenue and expenditure classifications; (iv) budget execution and control at a decentralized level; (v) a mandate for the adoption of internationally accepted accounting standards for the public sector by end of 2005; and (vi) timely submission to the Legislature of the Annual Consolidated Report of Budget Execution.

134. Notwithstanding the current economic climate and institutional arrangements governing public expenditures, the CFAA concluded that the efficiency and transparency of public expenditures and financial management operations could be improved even further and the CFAA recommended a mix of short term and medium term actions to support the further reform and modernization of the state and improve governance.

135. Overlaps in duties performed by the Internal Audit Office, the Delegated Accountants, the Court of Accounts, and the General Accounting Office and the onerous ex-ante controls performed by the Court of Accounts reduce the efficiency of these control functions and increase bureaucracy. During the CAS

period, efforts will be undertaken to mobilize World Bank Technical Assistance and Institutional Development grants as appropriate instruments to support the rationalization of the duties of the various control functions.

E. Country Financing Parameters

136. The new Country Financing Parameters agreed with the Government are presented in Annex 7. The Government has welcomed the increased flexibility that the new Bank policy provides with regard to eligible expenditures. However, the degree to which the Government would like to use the increased flexibility depends largely on its strategy for funding development needs. The degree to which the Bank will use the increased flexibility will in turn depend on the Bank's overall exposure, as well as the impact on the Bank's ability to fund other projects under the CAS and the potential to reduce transaction costs.

137. In terms of cost sharing, the new parameters propose flexibility for the Bank to finance up to 100 percent of total project costs, when this would result in substantially reduced transaction costs and in a substantial impact on poverty alleviation. In other cases, flexibility in cost sharing will depend upon the Bank's overall lending envelope, and subject to satisfactory ownership of the overall program and at the sector level. The Bank's financing share of individual projects is however expected to continue at current levels.

138. With regard to Bank financing of recurrent costs, the new parameters propose no country-level limit. From an economic perspective, sound fiscal management and the fact that Bank financing is fully integrated in the budget and taken into account in fiscal and debt targets indicate that financing of recurrent costs would not jeopardize overall fiscal or debt sustainability. Therefore, no country-level limit on recurrent cost financing is proposed. From a project perspective, financing of recurrent costs under Bank projects is likely to continue to take place only in exceptional cases, although in the future increased flexibility may be applied when there are special emergency and project-related circumstances.

139. In terms of local cost financing, the requirements for Bank financing of local expenditures are met, and the new parameters allow financing of local costs in the proportion needed in individual projects. The change in policy is not expected to represent a major deviation from the prevailing practice in local cost financing in Uruguay, since the Bank has been

financing substantial local costs in the past. With respect to taxes and duties, the new financing parameters allow the Bank to finance all taxes and duties associated with project expenditures with the exception of import tariffs above 28 percent, which is the average of the Mercosur common external tariff. At the project-level, the Bank would also consider whether taxes and duties constitute an excessively high share of project costs.

F. IBRD Financial Products

140. IBRD financing and risk management products could provide some needed flexibility to Uruguay to manage its debt. This includes flexible repayment terms to smooth the debt repayment profile in order to reduce rollover risk and the possibility to change the financial characteristics of IBRD loans to better manage financial risks relating to currency, interest rate and commodity price volatility caused by external factors. For its new IBRD loans, Uruguay has moved to the Fixed Spread Loan (FSL) but has not taken advantage of the embedded risk management tools included in the FSLs that the Government could use to manage currency, interest rate and rollover risks. Furthermore, Uruguay might want to consider signing a Master Derivatives Agreement with IBRD, which would give Uruguay access to a range of IBRD financial products that could help the Government manage the interest rate and currency risks of its overall debt portfolio. The Country Management Unit (CMU) is actively exploring with the authorities their interest in having a Bank team visit Uruguay in the near future to better illustrate to the authorities the available IBRD financing and risk management products.

141. The choice of IBRD loans, guarantees and hedging products might help manage/reduce Uruguay's vulnerability to external shocks, and could be applied to both the portfolio and at the level of individual projects, both ongoing and in the pipeline. At the portfolio level, well structured IBRD financial products could support Uruguay to better manage risks inherent in its debt. This could be achieved through the use of: (i) traditional IBRD lending as needed; (ii) guarantees; and (iii) IBRD intermediation for long dated risk management tools. At the individual project level, the Government will be able to use flexible features embedded in IBRD loans along with IBRD risk management products and guarantees to maximize developmental impacts of certain programs by achieving the desired cost/risk structure of certain existing projects or structuring more adequate financing for new ones.

G. Risks

142. Notwithstanding the satisfactory progress of Uruguay in consolidating its economic recovery, a number of important risks must be acknowledged. Most important is the risk associated with debt sustainability which, in turn, is closely related to the dependency of Uruguay upon events in neighboring countries, particularly Argentina. Uncertainty about the new administration's ability to deliver on its program of reforms constitutes a political and social risk. There are also a number of other risks of lesser importance such as energy dependency.

143. **Political transition.** For the first time in 40 years, the FA-EP-NM ruling coalition will have an absolute majority in parliament. However, its majorities in both houses are small and the FA-EP-NM is a broad coalition of parties and movements ranging from the center left to the radical left. The President may therefore have difficulty maintaining discipline within the coalition, especially when voting on controversial legislation. The opposition may also seek to exploit political differences within the Frente Amplio and might trumpet any inconsistencies between the coalition's policies while in opposition and those in government. Lack of cohesiveness within the coalition may also result in political indecision. However, the President has been the undisputed leader of the coalition for almost a decade and has proved to be capable of exercising his power to settle internal differences and mediating between the coalition's factions in the past. In addition, as President he will use his power of appointment to secure the support of the different factions, and is reaching out to all elements of Uruguayan civil society. This augurs well for keeping the Government's program on track and reducing risks of policy slippage. This risk is assessed as low.

144. **Social risk.** The risk associated with the political transition also has a social dimension. The population has paid a high social price for the crisis, including unemployment and a reduction in real wages. The political transition has generated high expectations among the population that urgent social needs will be met. High popular expectations have increased pressure on the Government to deliver quickly on its program. There is therefore a social risk associated with the fact that the authorities may not be able to deliver on their program as quickly as the public expects, or in a manner that meets popular expectations. Particularly important, employment and real wages could lag behind economic growth. The result could engender social discontent. As was the

case with the December 2004 referendums, popular sentiments could drive the Government's decisions in key areas of the reform program. This risk is assessed as moderate.

145. **Debt sustainability.** Debt sustainability will continue to be a major issue for economic management in the medium term notwithstanding the successful debt restructuring of 2003 which provided relief from liquidity pressures over the short and medium term. The ratio of public debt to GDP is estimated to stand at about 90 percent at end-2004 and heavy amortizations due in the period 2006-07 constitute a potential threat to liquidity. Most of those obligations are due to multilateral financial institutions, particularly the IMF. Uruguay will need to rely upon continued support from the international financial institutions and access to financial markets at interest rates commensurate with its economic growth prospects. The debt sustainability risk is currently assessed as high, but expected to decline over time provided the Government can sustain strong macroeconomic and structural policies.

146. Three factors that heavily influence debt sustainability are economic growth, fiscal policy, and the real exchange rate (Annex 2). Growth improves debt sustainability by increasing resources available to finance the public debt. Sustained growth of at least 3 percent is targeted under the base case. There is a risk that slippage in the structural reform agenda or additional external shocks could jeopardize growth and thereby undermine debt sustainability. Fiscal policy, in particular a significant primary surplus, contributes directly to debt sustainability by reducing the Government's borrowing requirement. Under the base case, a sustained primary surplus at or above the level achieved in 2004 is targeted. Maintaining the primary surplus at this level will require disciplined expenditure control which may prove difficult. The post-crisis fiscal adjustment has largely depended upon restraining nominal wages and wage-indexed pensions which will now be subject to upward pressure. Achieving the primary surplus target will hinge on structural reforms in tax, pensions, health, and state modernization, as well as in infrastructure and public services to support private sector participation—thereby reducing pressure on the public investment budget. Experience indicates that these reforms are not easy to implement in any country. Finally, debt sustainability in Uruguay is sensitive to the path of the real exchange rate given the large share of public debt denominated in foreign currency. As demonstrated by the crisis, a sharp drop in the

value of the peso can dramatically increase the domestic currency value of Uruguay's external debt. Under the base case, the peso is projected to appreciate moderately in concert with sustained economic recovery. However, this will depend not only on credible macroeconomic policies but also on structural reforms to improve the investment climate, thereby sustaining growth and attracting capital inflows.

147. **IBRD exposure.** The total of IBRD debt outstanding and disbursed stood at US\$785 million at end December 2004, and Uruguay's share of the total Bank portfolio was 0.7 percent. That compares with an average of 0.5 percent throughout the nineties. While a small share of the portfolio in relative terms, Uruguay's per capita exposure is the third highest in the Bank. This justifies close monitoring. Recent lending included two special SALs in 2002 and 2003 in the amounts of US\$151.5 million and US\$101 million respectively, under which a total of US\$177.5 million has been disbursed. The shorter amortization of those special SALs will cause a bunching of payments that will need to be carefully managed. With good macroeconomic management and reform, this risk is assessed as moderate; under deteriorating macroeconomic conditions this risk would be assessed as high.

148. **Regional shocks.** Uruguay is exceptionally vulnerable to shocks emanating from neighboring Brazil and Argentina – particularly the latter. It was the crisis in Argentina that triggered events in Uruguay during 2001-02. Generally speaking the economic performance of Uruguay tracks that of Argentina quite closely. If there were to be a serious setback to the recovery currently under way in Argentina, there is likely to be a parallel setback in Uruguay, although not necessarily of the same magnitude. In the last couple of years, Uruguay has diversified its export markets and that will reduce its vulnerability. Whereas Brazil and Argentina used to account for 50 percent of Uruguay's exports they now amount to only 30 percent. In addition, the United States became Uruguay's largest export market in 2004, accounting for one fifth of export sales. Furthermore, Uruguay has already effectively adjusted to accommodate many of the new post-crisis realities and that will further reduce its dependence upon neighboring countries which have yet to make the adjustment. Under conditions of regional growth, this risk is assessed as moderate, but would increase to high were growth in Argentina to falter.

149. **Energy security.** Uruguay is dependent upon Argentina for its supply of energy, particularly electric power and natural gas. In early 2004, Argentina, confronted with a domestic energy shortage, reduced the supply of electricity and natural gas to neighboring countries including Uruguay. That experience underscored the vulnerability of Uruguay. The Batlle Government responded by seeking to diversify the sources of supply, and there is currently an agreement in place to import energy from Brazil, although this appears to be temporary. Therefore, energy dependency is a potential source of risk which could threaten economic recovery if supplies were to be interrupted. The new Government is aware of this risk and is working toward more secure energy supply. This risk is currently assessed to be high.



CAS Result Matrix

PART I REDUCING VULNERABILITY

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing	FY05-10	International Partners
1. Debt Sustainability					
<ul style="list-style-type: none"> ▶ Reduce debt burden to a level commensurate with sustained macroeconomic stability. ▶ Achieve improved sovereign credit ratings. 	<ul style="list-style-type: none"> ▶ High public debt to GDP ratio, estimated at about 90 percent at end-2004. ▶ Structure of debt is heavily denominated in foreign currency. 	<ul style="list-style-type: none"> ▶ Quality dialogue on debt sustainability supports government decision making on debt policy. 	LEN: SAL I1 SSAL I1 AAA: -Sources of Growth -Policy Notes	LEN: -DPL AAA: -Sources of Growth -Policy Notes	<ul style="list-style-type: none"> ▶ IMF -new SBA negotiated ▶ IDB -additional adjustment lending expected
2. Fiscal Management					
<ul style="list-style-type: none"> ▶ Achieve a sustained primary surplus commensurate with the targeted reduction in debt/GDP ratio. 	<ul style="list-style-type: none"> ▶ Primary fiscal surplus has increased in response to the crisis, but sustaining a large primary surplus requires structural fiscal measures. ▶ Tax system is high (23 percent) relying on VAT rate and more than 30 distinct taxes. ▶ Public spending is dominated by pensions and control systems are underdeveloped. 	<ul style="list-style-type: none"> ▶ Primary surplus is sustained at the level of 2004 or somewhat higher . ▶ Tax revenues as a share of GDP are maintained at levels required to meet primary surplus target while protecting essential social expenditure. ▶ Personal income tax is introduced. ▶ Number of taxes is reduced. ▶ Social expenditure reforms are introduced. 	AAA: -Sources of Growth -Public Expenditure Review -IDF Procurement Capacity -CFAA	LEN: -DPL -Institution Building AAA: -CPAR	<ul style="list-style-type: none"> ▶ IMF -new SBA negotiated

1. Outcomes to which the Bank CAS will contribute, but for which other factors are also important.

2. Major projects under implementation, recently completed and future Analytical and Advisory Assistance (AAA) and Lending (LEN).

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing	FY05-10	International Partners
3. Financial Sector					
<ul style="list-style-type: none"> ▶ Reduce financial sector vulnerability and improve the efficiency of financial intermediation. ▶ Develop capital markets and de-dollarize the economy 	<ul style="list-style-type: none"> ▶ Banking sector dominated by three large public banks holding 60 percent of assets. ▶ BROU and BHU have deep structural and managerial weaknesses. ▶ High liquidity in the banking sector due to restrictive lending policies. ▶ Most deposits are foreign currency denominated. 	<ul style="list-style-type: none"> ▶ Restructuring program for BHU is completed. ▶ Framework for bank regulation and supervision is strengthened. ▶ Deposit insurance program is funded. ▶ Measures introduced to promote capital markets and development of peso-based financial services. 	AAA: -Sources of Growth -Policy Notes	LEN: -DPL -Institution Building AAA: -Investment Climate Assessment -Financial Sector Assessment	<ul style="list-style-type: none"> ▶ IMF -new SBA negotiated

PART II SUSTAINING GROWTH

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing	FY05-10	International Partners
1. Trade Policies					
<ul style="list-style-type: none"> ▶ Promote exports and diversify export markets. 	<ul style="list-style-type: none"> ▶ Trade expansion volume and trade diversification are key to continued economic recovery. 	<ul style="list-style-type: none"> ▶ Government seeks new trade opportunities both within Mercosur and bilaterally. ▶ Exports expand in line with the medium-term macro framework and the structure of exports continues to diversify. 	LEN: -Forest Product Transport AAA: -Sources of Growth -Policy Notes	LEN: -Innovation/ Science & Technology -Coastal and Marine Resources -Road Maintenance and Rural Access AAA: -Investment Climate Assessment	<ul style="list-style-type: none"> ▶ WTO
2. Agriculture, Natural Resources and Environmental Management					
<ul style="list-style-type: none"> ▶ Increase production, value added and exports of agricultural products. ▶ Promote regional coordination to address food safety and quality. 	<ul style="list-style-type: none"> ▶ Weaknesses include: (i) outdated innovation policies and institutions; (ii) indebtedness in the agro-industrial sector and poor access to agricultural credit; and (iii) limited extension services for small farmers. 	<ul style="list-style-type: none"> ▶ Regional agreement signed on Foot & Mouth disease control. ▶ Reformed extension services for small farmers. ▶ Implementation of an integrated water resources management framework. 	LEN: -Forest Product Transport -Foot and Mouth Disease ERL AAA: -Policy Notes	LEN: -Integrated Natural Resources -Innovation/ Science & Technology -Coastal and Marine Resources -Transport Infrastructure Maintenance and Rural Access	<ul style="list-style-type: none"> ▶ GTZ ▶ EU ▶ IADB ▶ FAO ▶ IICA

1. Outcomes to which the Bank CAS will contribute, but for which other factors are also important.

2. Major projects under implementation, recently completed and future Analytical and Advisory Assistance (AAA) and Lending (LEN).

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing	FY05-10	International Partners
2. Agriculture, Natural Resources and Environmental Management					
<ul style="list-style-type: none"> ▶ Ensure sustainable and efficient use of natural resources including ecosystems and native species. 	<ul style="list-style-type: none"> ▶ Estimated losses due to Foot & Mouth epidemic of 2 percent of GDP for 2001-2003. ▶ Weak coordination among Mercosur to address regional problems. ▶ Natural pasture degradation due to loss of species and ecosystems. ▶ Risk of water resource depletion due to increasing irrigation. ▶ Need for carbon emission reduction and offsets. 	<ul style="list-style-type: none"> ▶ Attainment of national targets on carbon finance. 		<p>AAA:</p> <ul style="list-style-type: none"> -Programmatic DPR Agriculture and Environment -Regional coordination in phyto-sanitary standards and food safety <p>GEF/Carbon</p> <p>Finance:</p> <ul style="list-style-type: none"> -Integrated Biodiversity Mgt Project -Regional Grassland -Intensification of Livestock Production and Aforestation -Montevideo Solid Waste Mgt -Urban Transport Carbon Emission Reduction 	
3. Infrastructure					
<ul style="list-style-type: none"> ▶ Ensure universal access to infrastructure and public services at sustainable cost. ▶ Reduce by half the poor without access to basic water services. ▶ Better alignment of water, energy and telecom performance indicators and prices with international benchmarks. ▶ Policy definition, regulation and operation functions better delimited and policy making capacity within ministries and regulators strengthened. 	<ul style="list-style-type: none"> ▶ Investments are below level needed to sustain growth. ▶ Fragile regulatory frameworks and absence of sector laws in gas and water. ▶ Policy formulation in water, energy and communications insufficiently focused on efficiency, longer-term sustainability, and synergy effects with private sector. ▶ Lack of effective corporate governance. ▶ Inadequate public information. ▶ Deterioration of major interurban transport affects logistics and transport costs. 	<ul style="list-style-type: none"> ▶ Improved mobility of the poor in urban centers and lower cost of transport. ▶ Introduce yardstick competition in water and energy. ▶ Programs implemented for reducing losses and unaccounted-for water. ▶ Construction of sewage treatment plants in Salto and Pasyandu. ▶ Separate functions for policy definition, regulation and operations. ▶ Strengthened policy-making capacity within line ministries and autonomy of regulators. ▶ Vertical disintegration of public monopolies. ▶ Strengthened competition authority of URSEA and URSEC. ▶ Introduction of regulatory accounting. 	<p>LEN:</p> <ul style="list-style-type: none"> -SALII -APL OSE Modernization & Rehabilitation -Public Services Modernization TA -Power Transmission and Distribution -Forest Products Transport <p>AAA:</p> <ul style="list-style-type: none"> - Sources of Growth -Policy Notes 	<p>LEN:</p> <ul style="list-style-type: none"> - Road Maintenance and Rural Access -Institution Building - APL2 Water Sector -Infrastructure (Energy and Transport) <p>AAA:</p> <ul style="list-style-type: none"> - Investment Climate Assessment\ -DPR infrastructure 	<ul style="list-style-type: none"> ▶ IADB WHO-PAHO UNDP

1. Outcomes to which the Bank CAS will contribute, but for which other factors are also important.

2. Major projects under implementation, recently completed and future Analytical and Advisory Assistance (AAA) and Lending (LEN).

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing FY05-10	International Partners
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3. Infrastructure

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|---|---|
| <ul style="list-style-type: none"> ▶ Inefficient urban transport, high cost to urban poor. | <ul style="list-style-type: none"> ▶ URSEA performs efficiently its regulatory tasks (as per monitoring methodology and targets to be established). ▶ Further de-politicization of Board of Directors. ▶ Petroleum prices are maintained at import parity levels and electricity prices are maintained to reflect cost of service. ▶ UTE distribution losses decrease from 22% in 2004 to 15% in 2009. ▶ At least 200 MW of additional interconnection capacity is under construction by 2009 and long-term contracts are passed with Argentina and Brazil for supply of electricity and gas. ▶ Further deepening of wholesale market by 2009. ▶ Natural gas law is enacted. |
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4. Enabling Environment for the Private Sector

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|--|--|---|--|--|
| <ul style="list-style-type: none"> ▶ Improve framework for participation in public services and infrastructure. ▶ Increase protection for contract and property rights. ▶ Stimulating innovation for competitiveness and employment creation. | <ul style="list-style-type: none"> ▶ Over-regulation of firm entry, high cost of contract enforcement, and inefficient exit procedures. ▶ Unfocused strategy for SME promotion. ▶ Ill-defined innovation policy framework and low innovation outcomes. ▶ Insufficient articulation of public (university) and private R&D. | <ul style="list-style-type: none"> ▶ Approval by ADME of a first set of PPAs (Power Purchase Agreements) and request proposals for three ongoing energy contracts to be replaced by PPAs. ▶ 15% reduction in administrative and judicial appeals of contract cases. ▶ Enactment of new bankruptcy legislation and 50% of cases resolved under new law. | <p>AAA:</p> <ul style="list-style-type: none"> - Sources of Growth - Policy Notes | <p>LEN:</p> <ul style="list-style-type: none"> -Innovation/ Science & Technology - Water Sector APL 2 - Transport Infrastructure Maintenance and Rural Access -Infrastructure (Energy and Transport) <p>AAA:</p> <ul style="list-style-type: none"> - Programmatic DPR Infrastructure - Investment Climate Assessment -ICR ROSC Study |
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1. Outcomes to which the Bank CAS will contribute, but for which other factors are also important.

2. Major projects under implementation, recently completed and future Analytical and Advisory Assistance (AAA) and Lending (LEN).

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing	Group Instruments ² FY05-10	International Partners
4. Enabling Environment for the Private Sector					
		<ul style="list-style-type: none"> ▶ National Innovation Policy established. ▶ Increased private sector R&D investments. ▶ More researchers in industry and agribusiness. ▶ Increased number of patents. ▶ New business lines established. 			
5. Modernization of the State					
<ul style="list-style-type: none"> ▶ Reorganize public sector functions to enhance efficiency, transparency and accountability. ▶ Foster citizen participation in collaboration with civil society. ▶ Enhance de-centralization and improve local service delivery. 	<ul style="list-style-type: none"> ▶ Limited use of results-based budgeting and performance auditing. ▶ Incomplete procurement reforms. ▶ Inefficient organization of public sector functions. ▶ Public services in are highly centralized, and local governance is not highly developed, particularly in rural areas. 	<ul style="list-style-type: none"> ▶ 100% use by executive units in the central administration of SICE (Sistema Integrado de Compras Estatales) within the public administration. ▶ Passage of TOCAF (Texto Ordenado de Contabilidad y Administracion Financiera). ▶ Expanded and more effective use of results-based budgeting and performance audits. ▶ 25% cost reduction for central administration from purchase of goods as a result of competitive bids. ▶ Increased percentage of users satisfied by government performance and public service delivery as evidenced by the regular survey data. 	AAA: <ul style="list-style-type: none"> - Sources of Growth - Policy Notes 	LEN: <ul style="list-style-type: none"> - Institution Building - DPL 	<ul style="list-style-type: none"> ▶ DFID ▶ IADB ▶ UNDP ▶ Transparency International ▶ GTZ ▶ JICA ▶ EU

1. Outcomes to which the Bank CAS will contribute, but for which other factors are also important.

2. Major projects under implementation, recently completed and future Analytical and Advisory Assistance (AAA) and Lending (LEN).

PART III IMPROVING LIVING STANDARDS

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing	FY05-10	International Partners
1. Social Protection and Poverty Alleviation					
<ul style="list-style-type: none"> ▶ Reduce urban poverty from 31 % (2003/04) to 20 % (2009). Albeit baseline missing, reduce rural poverty in tandem with urban poverty reduction till 2009. ▶ Increase pension coverage of people in old age from 87% to at least 90% by 2009 while spending on pensions declines from 18.3% of GDP (avg. 2000-2003) to below 17% by 2009. 	<ul style="list-style-type: none"> ▶ Social Protection system does not reach all of the most vulnerable groups. Also, some programs lack both clear nutritional and distribution/poverty objectives, and are not evaluated. ▶ Insufficient unemployment coverage, partly due to structure of system. ▶ Large fiscal deficit of public pension system, with trend to decreasing coverage rates. ▶ Rural poverty is higher than urban poverty in relative terms. ▶ Agricultural job creation insufficient to reduce poverty. ▶ Out migration from rural areas is a critical problem. ▶ No updated information on the rural sector. 	<ul style="list-style-type: none"> ▶ Social emergency program (PANES) implemented, reaches 200,000 beneficiaries by 2006, and is largely phased out by 2009. ▶ Family allowance program has at least 60 percent of take-up among the poor by 2009. ▶ Pension system becomes more sustainable financially with more flexibility to include workers. Pension spending not to exceed 17% of GDP by 2009. ▶ Pension coverage of people in old age increases to at least 90%. ▶ More regular poverty monitoring in place. 	<p>AAA:</p> <ul style="list-style-type: none"> - Sources of Growth - Public Expenditure Review 	<p>LEN:</p> <ul style="list-style-type: none"> - DPL - National Health Insurance and Social Security Support <p>AAA:</p> <ul style="list-style-type: none"> - Programmatic DPR Social Sector - Programmatic DPR Agriculture and Environment - Adequate safeguard analysis, and/or PSIAs <p>TFs:</p> <ul style="list-style-type: none"> IDF on improving social service delivery to vulnerable populations 	<ul style="list-style-type: none"> ▶ IADB - support for emergency social safety net ▶ UNDP/ UNICEF - provision of technical assistance ▶ ILO/CEPAL - provision of technical assistance
2. Health					
<ul style="list-style-type: none"> ▶ Create integrated and fiscally sustainable health system that safeguards the health outcomes already achieved. 	<ul style="list-style-type: none"> ▶ Health system highly fragmented and lacking effective and enforced regulatory framework. ▶ Over-investment in tertiary care over primary and preventive care. ▶ Large fiscal subsidies for BPS health insurance and large contingent liabilities for cooperative health insurance sectors. ▶ Definition of basic packet of health services that would promote primary and preventive care necessary. 	<ul style="list-style-type: none"> ▶ National Health insurance regulation completed and implemented. ▶ Share of health sector expenditure directed towards primary and ▶ National Health insurance regulation completed and implemented. ▶ Share of health sector expenditure directed towards primary and preventative care increases from 0.4 % in 2003 to 4% in 2009. ▶ Fiscal transfers to BPS reduced in line with medium-term macro framework. 	<p>AAA:</p> <ul style="list-style-type: none"> - Policy Notes - Public Expenditure Review - Health Sector Review 	<p>LEN:</p> <ul style="list-style-type: none"> - DPL - National Health Insurance and Social Security Support <p>AAA:</p> <ul style="list-style-type: none"> - Programmatic DPR Social Sector 	

1. Outcomes to which the Bank CAS will contribute, but for which other factors are also important.

2. Major projects under implementation, recently completed and future Analytical and Advisory Assistance (AAA) and Lending (LEN).

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing	FY05-10	International Partners
3. Education					
<ul style="list-style-type: none"> ▶ Improved quality and equity in primary school: full-time primary school model reaches 20% of all primary students, representing 40% of all poor students by 2009. ▶ Improved quality in secondary school: dropout rates decrease to 35-40% by 2009. ▶ Improved equity in higher education: share of enrollment in higher education for students from bottom two income quintiles increased from 17% in 2003 to about 25% in 2009. 	<ul style="list-style-type: none"> ▶ Full-time school model appears to benefit the poor; expansion should further benefit poorer students while being continuously evaluated. ▶ Compartmentalized administration of the sector leads to little coordination between levels and limits efficient management. ▶ High secondary school drop-out rate, especially for poorer children, at greater than 50%. ▶ Unequal access to tertiary education. 	<ul style="list-style-type: none"> ▶ Full time primary school model reaches 20% of all students, representing 40% of poor students. ▶ School enrollment rate of 4 year olds reaches at least 95% by June 2010. ▶ First grade repetition rates fall to less than 10% by June 2010. ▶ Percentage of students achieving proficiency levels in math and language increases by 15 percentage points by June 2010. ▶ Achievement gap between students from low and high income backgrounds is reduced. ▶ Performance of 15 year old students in PISA 2006 is higher than in PISA 2003. ▶ Secondary school dropout rates decrease to 25% by June 2010. 	<p>LEN:</p> <ul style="list-style-type: none"> - Basic Education 3 <p>AAA:</p> <ul style="list-style-type: none"> - Policy Notes - Public Expenditure Review 	<p>LEN:</p> <ul style="list-style-type: none"> - Education Quality and Equity <p>AAA:</p> <ul style="list-style-type: none"> -Equity in Education 	<ul style="list-style-type: none"> ▶ IADB - support to secondary schools ▶ UNESCO - support to education component of emergency program ▶ UNICEF - support to preschool

1. Outcomes to which the Bank CAS will contribute, but for which other factors are also important.

2. Major projects under implementation, recently completed and future Analytical and Advisory Assistance (AAA) and Lending (LEN).

Development Objectives and Outcomes	Issues and Obstacles	CAS Outcomes ¹ and Milestones	World Bank Group Instruments ² Ongoing	FY05-10	International Partners
4. Social Inclusion, Gender and Civil Society					
<ul style="list-style-type: none"> ▶ Empower civil society-- including youth, women, and afro-descendants-- to access increased social and economic opportunities. ▶ Implementation of the Equality of Opportunities and Rights Plan through strengthening IWA, and partnership with relevant sectors. ▶ Gender mainstreaming in Government policies and launching anti-discriminatory initiatives. ▶ Full implementation of national plan against domestic violence at central and regional levels. 	<ul style="list-style-type: none"> ▶ Youth, women and afro-descendants are among the most socially excluded groups, measurable in terms of education, employment, and service access. ▶ Risk that civil society will become disillusioned with the difficult reform process announced by the new Government, such as in pensions, social security and public service delivery. ▶ Public policy lacks a strategy for gender equality. ▶ The Institute for Women's Affairs (IWA) lacks technical and budgetary resources. ▶ Domestic violence remains a serious issue. 	<ul style="list-style-type: none"> ▶ Civil society outreach efforts increase. ▶ Framework for social impact evaluation is strengthened across all Bank-supported reforms. ▶ Social consensus on economic program is maintained. ▶ Decreased unemployment and poverty rates among socially excluded groups. ▶ Reduced levels of domestic violence. 	<p>AAA:</p> <ul style="list-style-type: none"> - Policy Notes <p>Tfs:</p> <ul style="list-style-type: none"> -IDF for strengthening Uruguay's Justice institutions for equitable development 	<p>AAA:</p> <ul style="list-style-type: none"> - Country gender assessment - Programmatic DPR Social Sector - PSIA's 	<ul style="list-style-type: none"> ▶ UNDP

1. Outcomes to which the Bank CAS will contribute, but for which other factors are also important.

2. Major projects under implementation, recently completed and future Analytical and Advisory Assistance (AAA) and Lending (LEN).

URUGUAY: CAS COMPLETION REPORT

Date of CAS:	May 5, 2000	Report No. 20355-UR
Date of Progress Report:	July 25, 2002	Report No. 24410-UR
Date of Progress Report Update:	August 7, 2002	Memorandum of President

Summary

This document contains an evaluation of country developments in Uruguay and the respective contributions of the government and the Bank during the period of the previous CAS (FY00-FY05).

The 2000 CAS was written at a time when, after a decade of steady growth, it appeared that Uruguay would soon be eligible for graduation from Bank lending. As a first step towards graduation, the 2000 CAS proposed a level of Bank lending that was about half of the previous CAS period program. The proposed lending program was to be based on three pillars:

- Poverty reduction and social equity
- Environmental and natural resource management
- The role of the state as an engine of growth

At end-2001, less than half way through the CAS period, neighboring Argentina was thrown into a deep crisis and defaulted on its public debt after a devaluation of its currency to one third of its previous value. The crisis quickly spread to Uruguay where, in 2002, GDP fell by 11 percent, unemployment rose to a peak of almost 19 percent – the highest level in twenty years – and poverty peaked at 31 percent in the last quarter of 2002.

The response of the government was prompt and purposeful. It took the initiative to renegotiate the terms of the public debt with creditors and reached an accommodation that provided Uruguay with

medium-term debt relief. It took decisive measures to establish fiscal discipline, to restructure the financial sector and to take other measures to stabilize the situation.

A CAS Update Report of 2002 proposed an increase in financial support from the Bank as part of a combined program of support along with the IMF and the IDB to help Uruguay overcome the crisis. Structural Adjustment Lending and Special SALs were proposed as the preferred vehicle for Bank support. Although the medium term vision continued to follow that outlined in the 2000 CAS, priorities and lending instruments were to be changed to better reflect the immediate needs of the country.

This CAS completion report concludes that the government was successful in stabilizing the situation and that the Bank, together with other international financial institutions, contributed to that success by adapting their country assistance programs appropriately. Hence, changes in the country assistance strategy proposed in the 2002 CAS Update Report were successful in helping Uruguay recover from the economic crisis and position itself better for sustained growth and poverty reduction. As the result of an augmented Bank engagement both at the operational level and at the level of analytic and advisory services, the government was better able to keep sight of longer-term development issues notwithstanding its preoccupation with crisis management.

PART A: LONG-TERM STRATEGIC GOALS

The government's perspective

When president Batlle assumed office on March 1, 2000, his address to the national General Assembly outlined clearly the main strategic goals for his forthcoming five-year administration -- a period with which the 2000 CAS was designed to coincide closely (FY2001-FY2005). He voiced particular concern that protectionism and a lack of competition in both public and private sectors, were adding unnecessarily to the cost of production and eroding the competitiveness of Uruguayan products in the world market. To remedy the situation and to reduce the excessive “costo Uruguayo” he proposed a program of reform that was to focus on seven issues of particular concern:

1. Public expenditures would be prioritized with a view to eliminating waste.
2. Public enterprises would be reformed to improve the quality of service provided and to reduce prices to the consumer.
3. The relationship between the central government and the local government authorities (intendencias) would be restructured to better foster decentralization.
4. Publicly accessible information systems would be established to make more transparent the system of government procurement and the granting of concessions for public works and services.
5. Private sector development would be encouraged by eliminating unnecessary bureaucracy and by simplifying the procedures for market entry and exit.
6. With respect to state-owned enterprises, a clear separation would be made between the provision of infrastructure and public services on the one hand, and the regulation of those enterprises on the other.
7. Social security contributions would no longer simply be invested in government bonds but would be mobilized to finance productive investments in such basic services as water supply, sanitation and infrastructure.

In addition to those seven cross-cutting issues which affect efficiency and productivity across the board, president Batlle also focused on a number of sector-specific issues in his address to the General Assembly

and indicated how he intended to deal with them in his forthcoming administration.

Acknowledging that agriculture is a major source of export revenues for Uruguay, the president called for better management of the country's water resources and for improvements in animal husbandry such as would enable Uruguay to achieve a level of productivity comparable to that of New Zealand within the space of ten years.

The president also confirmed the commitment of Uruguay to Mercosur and expressed the desire that it may be broadened to include other nations with the long-term objective of creating a trade bloc that would encompass the entire western hemisphere from Alaska to Ushuaia in the Tierra del Fuego.

On social issues, the president expressed concern that many low-income families were congregating in squatter settlements for lack of alternative housing opportunities and he proposed that the government supply them with housing sites furnished with basic services of water, sanitation and electric power upon which they may build more better quality housing within a secure legal framework. He also made special mention of the need to expand pre-school educational facilities, particularly for low-income groups.

The Bank's program of support

Bank support for the long-term development goals of the government was constrained by strategic considerations of program size and structure. First, the Bank perceived Uruguay as a country that was approaching the eligibility threshold for graduation from Bank lending. Although, at the time of preparing the 2000 CAS, Uruguay was already experiencing a recession, the recession was perceived to be a temporary interruption that did not appear to threaten the very real gains of steady growth during the preceding decade. The Executive Summary of the 2000 CAS noted that the country's per capita income was already 20 percent above the Bank's indicative threshold for initiating graduation and concluded that “Given Uruguay's relatively high level of social and economic development, the time has come to consider a gradual reduction in support, reflecting the evolving nature of Uruguay's development challenges and the Bank's role”. Second, the CAS document noted that the Inter-American Development Bank had

1. See Press Release Cambio de Mando: Texto íntegro de las palabras pronunciadas por Batlle ante la Asamblea General

been and still remained the main source of external finance for Uruguay and, hence, the Bank did not have a lead role in external assistance. As a result of those two considerations, the 2000 CAS proposed a 50 percent reduction in lending to Uruguay, on a commitments basis, compared with the previous 1997 CAS. That proposal was also broadly consistent with the findings of an International Financial Institutional Advisory Commission which had been established by the US Congress under the chairmanship of Alan Meltzer. The report of the Commission, issued in March 2000, recommended that the World Bank and other similar development banks should lend less to countries that have access to the international financial markets and focus more on low-income countries with little capital-market access.

Subject, as it was, to a strategic constraint of program size, the CAS had to be much more selective in its support for the government's development agenda as compared with the past. It was decided that the base-case lending program of US\$150-200 million for FY01-05 should include *"selected investment lending in areas where there is an important social or environmental dimension, and the Bank's international knowledge would be crucial to project success". In addition, "advisory and analytic services (would) be used to guide the selectivity of the lending pipeline, and to maintain an open policy dialogue with the government. It would also serve as background preparation in the eventuality that a high case lending scenario is triggered."* A high case scenario would have boosted lending to US\$200 million and would have included adjustment lending for financial sector or other critical reform areas.

Mindful of the development objectives established by the Batlle administration and seeking to support them within a constrained resource envelope for Bank lending, the assistance strategy of the 2000 CAS was established on three pillars as follows:

1. **Poverty reduction and social equity** were to be fostered with investments in education, health, community development and social infrastructure such as water supply and sanitation. In parallel, an ambitious program of analytic and advisory work was envisaged including a multi-phased poverty assessment, a health policy note and an assessment of social expenditures.

2. **Environmental and natural resource management** were to be enhanced with investments in maritime management and rural development together with analytic work relating

to an assessment of rural conditions.

3. **The role of the state as an engine of growth** and its relationship to private sector development was to be examined in the context of a substantial program of analytic and advisory work in issues of trade and competitiveness as well as financial sector structures. Efficiency was to be enhanced and, at the same time, the prospects for graduation from Bank lending were to be advanced with investments in public enterprise reform.

The main differences between the government's development strategy and the Bank's selective program of support probably lay in a lower level of Bank lending for basic infrastructure as compared with the past. Whereas the government clearly desired to improve the efficiency of infrastructure and public services across-the-board, only water supply and sanitation figured in the proposed base-case lending program – probably because of their more immediately apparent social and environmental dimensions. Other infrastructure, such as power supply and transport which had figured prominently in previous Bank lending were notably absent from the much reduced 2000 CAS program. Instead, environmental initiatives such as maritime management together with social sector investments in education, health and community development constituted the core of the program, consistent with the government's own objectives in those areas.

The Onset of Crisis and the Management of Crisis

Half way through the period covered by the 2000 CAS, there was a radical and unexpected reversal in the situation of Uruguay which caused both the government and the Bank to fundamentally reassess the entire program of country assistance. Following upon a decade of macroeconomic stability and steady growth during the nineties, Uruguay suffered a recession in 1999 and then collapsed into a deep economic crisis in 2002 when neighboring Argentina defaulted on its public debt and devalued its currency to one third of its previous value.

The relative success with which Uruguay was able to weather the economic crisis of 2001/2 owes much to the government's prompt and purposeful response to events as they unfolded. Unlike neighboring Argentina, the economic crisis did not provoke a political crisis nor did it interrupt the normal procedures of government. Political continuity enabled the government to manage proactively the economic situation and to mobilize an already long-

established social safety net to cushion poverty. Concerted support from the international financial community was also an important factor in assisting the government to cope with a difficult adjustment.

Among the strong adjustment measures undertaken by the government in response to the crisis, the following were especially important in stabilizing the economy:

- Fiscal adjustment was at the center of Uruguay's response to crisis management. Public utility prices were quickly adjusted to reflect new financial realities even though the scale of the adjustment needed was substantial. In 2003, the post-crisis year, the government achieved a primary fiscal surplus equivalent to 2.7 percent of GDP. That represented an improvement of 3.9 percentage points when compared with a 1.2 percent primary fiscal deficit in 2001, the pre-crisis year.
- The 2002 crisis had a profound effect upon the monetary and exchange rate policy of Uruguay. The first response of the Central Bank was to accelerate the depreciation of the Uruguayan peso within the framework of the same crawling peg mechanism that had prevailed in previous years. However, as pressure mounted on the Uruguayan peso the Central Bank abandoned the crawling peg altogether and allowed the currency to float in June 2002. The result was a further sharp fall in the real effective exchange rate before it stabilized later in the year.
- Devaluation made it fiscally impossible to service the public debt most of which was dollar-denominated. The government took a bold initiative to negotiate with bondholders a refinancing of sovereign debt. Bondholders recognized that Uruguay's banking and debt problems were largely due to contagion from the crisis in Argentina. They were receptive to refinancing to avoid the government being pushed into a situation where default may be the only alternative. The perception that the government was implementing a sound fiscal and structural reform program was also an important consideration for creditors. The outcome of the negotiations was a debt swap that permitted Uruguay to lengthen the maturity of its sovereign debt over five years without raising interest rates and with no reduction in principal. The international financial markets were reassured by the successful outcome and the country risk premium for Uruguay fell from 1800 basis points

to its current level of 600 basis points.

- The decision of neighboring Argentina, in December 2001, to freeze bank deposits and restrict capital outflows prompted a run on Uruguayan banks for fear that Uruguay may take similar action. Total deposits of the non-financial private sector in the banking system fell by 50 percent in the course of 2002. The government then sought assistance from the IMF, the World Bank and the IDB for a program of structural reform aimed at safeguarding the financial system without channeling unnecessary support to institutions that had become insolvent and had little prospect of regaining financial viability. Four insolvent commercial banks were closed and their residual portfolios of performing assets were transferred to a newly created commercial bank which operates as a private entity even though the state is the sole shareholder at this point in time. Nearly all other private commercial banks reported losses in 2002 but they continued in business and their situation improved in 2003 as confidence returned and new deposits entered the system.
- The dramatic increase in poverty provoked by the economic crisis revealed serious shortcomings in the social safety net. Government action to address those shortcomings and their attendant fiscal cost, was reviewed in the preceding section above.
- The crisis also underscored structural weaknesses in the provision and management of infrastructure and public services which the government sought to address with assistance from the Bank.

The depth of the economic crisis in Uruguay and the seriousness of the government's response elicited strong support from both multilateral and bilateral sources. In a joint statement, issued on August 4, 2002, the IMF the IDB and the Bank pledged as follows:

"The Managing Director of the International Monetary Fund, the President of the World Bank, and the President of Inter-American Development Bank announced today that they will recommend to their respective boards that financing be increased by amounts that would bring total financing for Uruguay to US\$3.8 billion from the three institutions. They also announced that they would recommend accelerating disbursements to Uruguay in order to make about US\$1.5 billion available from the three institutions next week when authorized by their respective boards.

In order to provide immediate financing to the Uruguayan government in support of the banking

system, the United States government has agreed to provide up to US\$1.5 billion in bridge financing to Uruguay's central bank until international financial institution loans are disbursed."

The Bank's support for crisis management

A CAS Progress Report was prepared in July 2002. It is to be interpreted within the context of a broader effort by the international financial community to assist Uruguay at a time when the economic situation was deteriorating rapidly. The full dimensions of the crisis and its likely outcome could not be clearly discerned because events were still unfolding. Nevertheless, the Progress Report determined that the 2000 CAS lending scenario was no longer appropriate and concluded: *"The situation now calls for additional support to assist Uruguay to weather the current crisis and to continue the program of reforms critical to a more competitive economy while maintaining investment in human capital and reinforcing measures to protect vulnerable groups".*

Events were developing so fast in 2002 that the July Progress Report had to be supplemented with an Update issued on August 7. The Progress Report and its Update proposed adjustment lending as the preferred instrument for increased Bank support to Uruguay during the crisis period. The revised program outlined in the 2002 CAS progress report covered a truncated period FY03-04 compared with the FY00-05 program of the original CAS. The shortening of the program horizon to two years is significant because it indicates how the Bank perceived the situation in Uruguay to be fluid. The revised objectives of the 2002 CAS update report were characterized as follows:

"The updated Bank strategy focuses on pursuing the 2000 CAS agenda, but within a crisis environment. The revised program targets three broad objectives corresponding to the main challenges facing Uruguay, namely: (i) fiscal sustainability and adjustment, (ii) increasing competitiveness; and, (iii) social protection. In each area the Bank program offers financial and technical support, in concert with our major partners, the IMF and the IDB." (para. 47)

Although the 2002 CAS Progress Report sought to preserve the threefold long term objectives of the 2000 CAS, both the government and the Bank were preoccupied with managing an economic crisis of major proportions during the remaining years of the program. The threefold organizational framework of the 2000 country assistance strategy remained in

place but priorities were radically changed and alternative lending instruments were chosen to better reflect the requirements of a crisis environment. The updated program and the revised country assistance strategy can be presented along the following lines:

1. **Poverty alleviation** was to focus on measures for cushioning the impact of increasing poverty induced by unemployment and by other effects of the economic crisis. Quick disbursing finance was to be provided through structural adjustment loans with conditionality explicitly protecting budgetary support for important social programs at a time of exceptional fiscal constraint. At the same time, the Bank's ongoing operational presence in the health and education sectors became even more relevant in dealing with the broader social consequences of the crisis. Progress secured by those operations was to be protected with support from a Special SAL.

2. **Environment and natural resource management** became an issue of urgent concern when Uruguay was afflicted with an outbreak of foot and mouth disease which threatened the national herd and resulted in a suspension of beef exports, thereby further deepening the economic crisis. The Bank response was to put together a Foot and Mouth Disease Emergency Recovery Loan in support of a containment and recovery plan that would reinstate the sanitary status of the national herd on a sustainable basis and thereby enable Uruguay to regain access to export markets and re-activate livestock production. Previously envisaged longer-term plans such as improving the management of maritime and coastal resources were put on the back-burner pending a resolution of the prevailing economic crisis.

3. **The role of the state** became an even more pressing issue as a result of the crisis. In that context, however, the priority objectives were to stabilize the economy and recover the levels of production that had been lost. At the same time, it was recognized that structural weaknesses, particularly in the financial sector, the public enterprise sectors and in fiscal management would need to be remedied in order for the economic recovery to remain securely in place and serve as an effective foundation for sustained growth in the future. Structural adjustment lending was the instrument of choice for pursuing those objectives and the strong program of analytic work envisaged under the

2000 CAS facilitated the task of putting together a total of two SALs and two Special SALs.

In summary, the period covered by the 2000 CAS encompassed two quite separate and distinct country assistance strategies in response to a radical change of country circumstances. The first strategy was predicated upon a measured disengagement of the Bank in preparation for the eventual graduation of Uruguay. The second strategy was based upon full re-engagement in concert with other donors to rescue Uruguay from an unforeseen crisis. At the same time, it was apparent that the crisis had revealed fundamental weaknesses and vulnerabilities in the Uruguayan economy such that graduation from Bank lending would need to be postponed for the foreseeable future.

PART B – CAS OUTCOMES

Neither the 2000 CAS nor the 2002 Progress Report were “results-based”. That is to say, no quantifiable targets were specified as reference points against which actual outcomes can be measured. Nevertheless, the country context and the text of the documents themselves provide a sufficiently clear indication of anticipated outcomes. This section assesses country progress and the Bank contribution to attaining the CAS objectives.

Pillar 1: Poverty Alleviation

When the 2000 CAS was under preparation the Bank had an active operational presence in both the health and education sectors. The ongoing investment operations had been appraised at an earlier date before there was any sign of a recession but the effectiveness of their outcome was enhanced when the economic environment deteriorated. That was particularly true of the Second Basic Education Quality Improvement Project, the implementation of which coincided closely with the economic crisis. The implementation completion report for that operation noted that *“in this context of deteriorating economic conditions and increasing poverty, the objectives and focus of (the project) became even more relevant”*.² It would appear that the Uruguayan authorities shared the same viewpoint because, notwithstanding exceptional fiscal constraints, counterpart funding for the project was not seriously interrupted and the

project was brought to a successful conclusion in February 2004. The fundamental objectives of the operation, (a) to expand the coverage and improve the quality of preschool and elementary education and (b) to achieve greater social equality by targeting the expansion of the new full-time school model for preschool and elementary education to socio-economically disadvantaged children, were both fully achieved and the sustainability of the outcome was judged to be likely.

Likewise, a Bank supported Health Sector Development Project successfully achieved its objectives although it was substantially completed before the full crisis struck and therefore did not have to contend with the difficult implementation environment experienced by the education project.³ The achievements of the operation in helping the government to rationalize health sector spending and to improve sector management undoubtedly helped to cushion the social impact of the economic crisis.

Even at the time of the 2000 CAS, Uruguay was already experiencing increasing unemployment and poverty as a result of the 1999 recession. The poverty count had already risen from 15.3 percent in 1999 to 17.8 percent in 2000. The initial response of the government was to rely upon already established programs of social assistance and to strengthen them where necessary. Those programs included a child development program for children less than four years old living in poor households. There was also a housing program targeted to poor households in rural areas which, in 2000, the government complemented with a similar program targeted to urban slum dwellers. The overall effectiveness of programs for poverty alleviation was eroded, however, by growing fiscal constraints which caused social spending to respond pro-cyclically during the period 1998-2001.

The severity of the ensuing economic crisis was such that a significant increase in poverty was unavoidable in Uruguay notwithstanding the existence of a long-established social safety net. Following upon three years of recession, GDP fell by 11 percent in 2002. Unemployment rose to a peak of almost 19 percent – the highest level in twenty years – and poverty peaked at 31 percent in the last quarter of 2002.

The government responded promptly and decisively to

2. See Implementation Completion Report for a Second Basic Education Quality Improvement Project. Report No. 29878 dated July 30, 2004; Section 3.1 para.3.

3. See Implementation Completion Report for a Health Sector Development Project. Report No. 24995 dated December 12, 2002.

events as they unfolded with substantial support from the international financial community. In August 2002 the IMF, the Bank and the IDB announced that the three institutions would pledge a total of US\$3.8 billion in support of Uruguay. Within that envelope, the Bank was proactive in assisting the government to adapt its policies and programs of social protection. Bank analytic work, including a report entitled “maintaining Social Equity in a Changing Economy”, provided valuable insights and pointers for structuring government action more effectively and efficiently. In July 2002, based in part upon that analysis, the Bank approved a Special SAL in support of a broad range of government action including the following:

- Budget allocations for protected social programs in 2003 were to be no lower than the 2002 budget allocation. Thereby, an end was put to the pro-cyclical trend of social expenditures from 1998-2001 and the social safety net was made more effective. As a result of this provision, the overall budget allocation for protected social programs was completely protected although budget execution at the individual program level was uneven. Food programs substantially exceeded the amounts originally protected, in some cases by a very large amount. Other programs, such as those focusing on child and family centers fell slightly short of target. The only program that was significantly under-executed was a work-training program that appears to have been poorly designed. However, the government introduced a program of cash transfers in exchange for community based work which went a long way to achieving similar results. Further details on this and other provisions of the Special SAL can be found in a Memorandum of the President recommending release of the second tranche⁴.
- An evaluation was to be made of national and local social protection programs with a view to assessing their effectiveness, the targeting of their benefits, and the efficiency of their procurement procedures. The evaluation of the school food program revealed that it covered 40 percent of all school children and that the coverage was concentrated at the lower levels of family income. Results of the evaluation were disseminated on a government website. An evaluation was also made of the 2000-01 Program for Work Training. It revealed that the

training program did not effectively help participants to find work or increase their pay and it provided a basis for restructuring government efforts in that direction.

- All social spending on social protection programs at the national level and at the departmental and municipal level was to be consolidated and a report issued for the years 2000 through 2002. As a result of this provision, reports were issued for 2000 through 2002 and the Office of Planning and Budget (OPP) seized the opportunity to continue the practice on a permanent basis. The breadth of the analysis has now been amplified beyond the scope originally envisaged and results are posted on a government website.
- An interconnected database of beneficiaries was to be established so that information could be cross-checked between different programs of social protection. The data base was effectively established and the OPP now administers it using national identity cards to identify individual beneficiaries.
- A new unemployment insurance law was to be enacted to limit the period of eligibility for unemployment benefits and to restrict eligibility to workers who had not received generous severance payments. In the event, however, there was insufficient Congressional support to change unemployment legislation in an election year. Nevertheless, the government took steps to better enforce existing restrictions and it thereby reduced the average length of time that workers were eligible for unemployment benefit. With the onset of a strong economic recovery, the need for unemployment insurance reform has abated somewhat. The Board agreed to a waiver on this condition for purposes of releasing a second tranche of the Special SAL.
- Training for the unemployed was to be restricted to workers who receive severance payments less than one hundred minimum wages. After further research, however, it was discovered that virtually all trainees had received severance payments below the threshold and there was no need to refocus the program. Recently-introduced community and neighborhood work programs have been effective in reaching heads of poor households as intended.

In 2003 the government took additional measures to protect and consolidate the advances already

4. Memorandum of the President “Uruguay – Structural Adjustment Loan - Special Structural Adjustment Loan - Loans Nos. 7137-UY and 7138-UY – Proposed Waiver of Two Conditions and Release of the Second Tranche” dated September 29, 2004.

achieved in education and health and received financial support for those efforts from the Bank in the context of a second Special SAL that was to be disbursed in three tranches. To better reflect its scope and content, the operation was given the more expansive formal title of a “Public Services and Social Sectors Special SAL”. As far as education was concerned, the second Special SAL was supportive of a government undertaking to provide adequate and agreed levels of budgetary support for (a) basic school supplies and maintenance, (b) the bilingual education program and (c) textbooks for primary schools. Thereby, the ongoing Second Basic Education Quality Improvement Project would be assured of sufficient funding to fulfill its objectives. Supervision of the Public Services and Social Sectors Special SAL in December 2004 found that “budget expenditures in the agreed programs proceeded during 2003 as expected. The executed budget for schools operation and management was more than twice the agreed figure, while the executed budget for bilingual educations and schools didactic material was in line with the agreed figures.”⁵

In the health sector, where the Health Sector Development Project had been closed the previous year, the second Special SAL supported government efforts to press forward with its reform agenda. Specific reforms supported by the second Special SAL focused upon improving the financial situation of public hospitals by establishing information systems and administrative procedures that would enable them to obtain payments due from medical insurance companies. In addition, the financial situation of the FNR, a national fund that finances complex medical procedures, was to be better secured by defining more clearly the scope of its responsibilities and by estimating more accurately the cost of medical procedures. Loan supervision indicates that “there has been an impressive improvement of the FRN”. Beneficiary identification from the uninsured population reached 50 percent in June 2004 compared with a target of 40 percent.⁶

Progress with respect to the education sector and health sector reforms supported by the second Special SAL was very good and, on that basis, the second and third tranches were ready for release in 2004. However, when the second Special SAL was approved in 2003, a decision was made to cross-link the release of the second and third tranches with the

corresponding tranches of a second SAL that had received Board approval on the same date. Progress with the second SAL was much slower than had been anticipated and, because of the cross-linkage, release of the second and third tranches of the second Special SAL was held-up. By 2005, it became clear that Uruguay had already emerged from the economic crisis and further financial assistance on Special SAL terms was no longer appropriate. That prompted the government to request cancellation of the undisbursed tranches of the Special SAL. Following the cancellation, a new CAS would propose other more appropriate modalities for supporting the government’s program of social development.

In conclusion it is clear that, at the depth of the economic crisis, poverty outcomes were much worse than had been envisaged at the time of the 2000 CAS or even at the time of the 2002 CAS Update. However, in the case of a small country such as Uruguay, which is heavily dependent upon its two large neighbors, it is reasonable to attribute the negative outcome to force majeure. Notwithstanding the much vaunted reputation of Uruguay’s social safety net, it was insufficient to handle effectively the huge increase in poverty provoked by the crisis. At best, it was able to cushion the impact of poverty at the margin.

Nevertheless, the response of the authorities was prompt and purposeful. That owes much to the stability of the political system and to a well-established tradition of government by consensus. It was clearly understood that the most effective way of reducing poverty was to get the economy back on its feet again. Macroeconomic policy was, therefore, at the forefront of the fight against poverty and it was strikingly successful in reversing the economic decline and fostering a rapid recovery. GDP grew at 11 percent in 2004. At the same time, measures were taken to strengthen programs of social protection and to ensure that other social programs in health and education were shielded from fiscal retrenchment to the extent possible. The Bank, in conjunction with its partners the IMF and the IDB effectively supported the government’s program for economic recovery and poverty reduction and quickly saw the need to re-engage with an accelerated program of lending together with analytic and advisory work.

5. See Implementation Status Report (ISR) 04 dated 12/01/2004

6. Ibid.

Pillar 2: Environmental and natural resource management was the pillar most deeply affected by the crisis for two reasons. First, the government's attention was focused sharply upon managing short term issues of stabilization and poverty relief. Acute fiscal constraints stood in the way of funding longer-term projects such as the maritime management project that had been contemplated in the 2000 CAS program and it was shelved mid-way through project preparation. Ongoing projects continued to be implemented but were delayed by the crisis.

A Natural Resources Management and Irrigation Development Project, begun in 1994 was already well on the way to completion by the time of the 2000 CAS but the final two years of project implementation prior to the end-2002 closing date were important for the sustainability of the principal project objective which was to develop and implement a soil and water management strategy focused on the development of irrigation with the intention of increasing, diversifying and sustaining agricultural output and exports. The project overall was successful, and substantial progress was made towards achieving the principal and subsidiary development objectives.⁷

A second event which radically changed the focus of the environmental and natural resource management CAS pillar was the outbreak of a virulent epidemic of foot and mouth disease (aftosa) which threatened the production and export of beef. Given the importance of beef exports for Uruguay, the epidemic was a calamity that required an urgent response. Bank support for the government's efforts at short-term epidemiological containment and at longer-term monitoring, surveillance and control took the form of an EPL in the amount of US\$18.5 million which is still ongoing. Epidemiological containment through vaccination was thorough and successful and the operation is now focusing upon monitoring, surveillance and control systems.⁸

The Bank has also been active in broader efforts to improve the environment by administering GEF grants aimed at fostering alternative energy initiatives. An initial operation to capture methane that would otherwise be emitted from landfill waste and to harness it for the production of electric power has been successfully implemented and has

excited the interest of municipal authorities throughout the country.

Pillar 3: The role of the state as an engine of growth was an important focus of government action and of Bank support for structural and policy reform throughout the entire five year period of the CAS. However, the onset of a deep economic crisis in 2002 caused both the government and the Bank to reassess both the priorities and the modalities.

At the beginning of the CAS period and prior to the crisis, the Bank lending program was designed along lines that reflected continuity. A single tranche financial sector adjustment loan in support of already completed government reforms to increase efficiency and competitiveness in the financial sector was disbursed a few weeks after the incoming Batlle administration took office in March 2000. Shortly afterwards, the Bank submitted to the government analytic work which contained a broad range of recommendations for follow-up reforms to further strengthen the financial sector.

Infrastructure and public services, which are largely in the hands of the state, also received Bank support. In June 2000, building upon a long-standing operational presence on the part of the Bank, an Adaptable Program Loan was approved in support of a program of modernization and systems rehabilitation in water and sewerage. The progress of this operation was set back by the economic crisis of 2002 which negatively affected the financial position of OSE, the water and sewerage authority. Since then, however, the situation has since improved and the operation is progressing well. It is likely that all the original objectives will be met by the time the loan closes in June, 2006 and it is anticipated that subsequent APLs will build upon the results achieved.⁹

Transport had been a major focus of Bank support for infrastructure development in Uruguay and it continued to receive attention during the 2000 CAS period. The implementation of a Second Transport Project, approved in 1998, was made increasingly difficult by the recession of 1999 and the crisis of 2002 because the road sector budget was cut back severely. Nevertheless, the Implementation Completion Report was able to record a satisfactory outcome despite delays provoked by budget constraints. The operation increased efficiency in

7. See Implementation Completion Report No. 26167-UY dated June 17, 2003.

8. See Implementation Status Report (ISR) dated 03/10/2005

9. See Implementation Status Report (ISR) dated 09/07/2004

transport service and road maintenance and “thereby contributed to the rationalization of transport sector expenditures. It also removed some of the bottlenecks to international transport and contributed to the preservation of the road network, thus providing some of the necessary conditions for the competitiveness of Uruguay’s products to increase, especially within Mercosur”.¹⁰

Bank analytic work indicated that all infrastructure and public services, including water supply and sanitation, power, natural gas, petroleum products, railways, telecommunications and postal services, confronted similar issues of organization, management, regulation, tariff structures and information systems. The resolution of those issues frequently depended upon the outcome of surveys and analytic studies which sometimes could be complex. Technical assistance for that endeavor was furnished with Bank support under a Public Services Modernization Technical Assistance Project that was approved in March 2001. The project is progressing well and it has already helped the government achieve significant improvements in the efficiency of state-owned infrastructure and public services.¹¹

“Business as usual” was abruptly interrupted at the end of 2001 when neighboring Argentina devalued the Argentine peso to one third of its previous value and defaulted on its public debt. The ensuing crisis in Argentina quickly spilled over into Uruguay with Argentine nationals withdrawing their deposits from Uruguayan banks en masse.

As already discussed in the sections above, the Bank chose structural adjustment lending as the preferred vehicle for Bank support. Already, on August 8, 2002, prior to the joint statement, the Board had approved a SAL in the amount of US\$151.5 million and a Special SAL in the amount of US\$101 million. Those two loans were to be followed by a second SAL and a second Special SAL in the same amounts and approved in April 2003.

Both the SAL and the Special SAL of 2002 were fully disbursed in two tranches upon the satisfactory completion of the agreed action programs. The SAL supported macroeconomic and fiscal actions centered on restraining public sector wages. In addition, the

system of social protection was to be strengthened and protected along the lines already discussed above in the section on Pillar 1. The Special SAL focused more specifically on support for restructuring the National Mortgage Bank (BHU) as part of a broader banking system reform that was also receiving support from the IMF. Compliance with the conditions of the Special SAL was satisfactory overall.¹² Legislation was successfully enacted to restructure the BHU and the BHU adopted and implemented a restructuring plan. Changes were made in the powers of the Central Bank to remove the special privileges of the BHU with respect to prudential regulation. Deposits from the general public unrelated to the housing programs of the BHU were phased out on schedule. A due diligence valuation and appraisal of BNH portfolio assets was carried out. A plan for divesting BNH of its non-performing portfolio was prepared and approved by the Board of Directors. The Board of Directors likewise approved a new credit manual for BHN.

A second SAL, approved in 2003, was entitled a “Public Services and Social Sectors SAL” to reflect its content. The overall objective of the loan was to boost competitiveness and economic growth through the better provision of public and social services and infrastructure. To that end, a broad range of structural and policy reforms were identified with respect to infrastructure and public services. In the run-up to national elections in 2004 the main focus of attention was in the political arena and the incentive to press ahead with structural reforms was diminished.

The second SAL has been much slower to move forward. Two incidents, in particular, caused the government to hesitate. The first related to OSE, the state-owned company for water and sewerage which has had a long-standing problem of unaccounted-for water. A condition of the second SAL was that OSE should contract consultants to study the problem and recommend ways to resolve it. Labor unions opposed that proposal and lobbied successfully for a constitutional amendment to forbid private participation in the water supply and sanitation sector.

A second setback for the government related to ANCAP, the state-owned petroleum company. The second SAL supported the enactment of a sector law

10. See Implementation Completion Report No. 28235 dated May 10, 2004

11. See Project Status Report #08 dated September 7, 2004

12. Memorandum of the President “Uruguay – Structural Adjustment Loan - Special Structural Adjustment Loan - Loans Nos. 7137-UY and 7138-UY – Proposed Waiver of Two Conditions and Release of the Second Tranche” dated September 29, 2004.

defining a broad range of governance and regulatory issues with respect to the petroleum sector. One provision of the law enabled ANCAP to join with private sector entities in partnership arrangements. Again, labor unions registered their disapproval and lobbied successfully for a referendum which repealed the law in its entirety. That was a particularly serious setback because it has made it difficult for the government to address the whole issue of market liberalization and improved competitiveness within the petroleum sector for fear of being perceived as flouting the popular will.

As far as other conditions of the second SAL are concerned, prospects are mixed that they will be fulfilled and it may take time for the new administration to get parliamentary approval where that is needed.¹³ As of February 2005, only one of the eleven conditions for release of the second tranche had been fulfilled but discussions with the incoming administration give cause for optimism that progress will be resumed when the new administration settles in. However, it appears that the government and the Bank may need to agree on other strategies for increased competitiveness that do not directly involve private sector participation in the petroleum and water supply sectors as originally envisaged under the second SAL.

Over and beyond the operational context of structural adjustment lending, the Bank has recently completed a study on the Sources of Growth which has reinforced its economic dialogue with the government of Uruguay. The government has received the study with interest. It is anticipated that the study will establish a solid foundation for further discussions concerning policy and structural reforms for sustained growth and poverty reduction.

The Bank Contribution

In Attachment 1 the results of the 2000 CAS and the 2002 CAS Progress Report are summarized in a matrix format for each of the three pillars of Bank assistance. A comparison of programmed and actual AAA, and programmed and actual lending is set out in Attachments 2 and 3 respectively.

Although the Bank was not the principal source of multilateral assistance for Uruguay during the period covered by the 2000 CAS, it nevertheless made a significant contribution to advancing the government's program both with respect to long-term development

objectives and with respect to shorter-term issues of stabilization and crisis management. In terms of the longer-term development effort, the 2002 crisis caused interruptions and delays in the progress of Bank supported investment operations but it did not de-rail the program. Project implementation and analytic work continued to move forward as indicated in the preceding sections on each of the three pillars. In addition, the conditionality attached to quick disbursing adjustment lending at the time of the crisis was designed to be supportive of longer term-development goals, particularly in the areas of social protection, public enterprise reform and governance. Hence, as a result of the Bank presence, the government did not lose sight of the longer-term perspective, notwithstanding its preoccupation with crisis management.

Adjustment lending provided much-needed additional financial support and, at the same time, helped the government to address newly-exposed structural weaknesses that had not received full recognition prior to the crisis itself. In particular, a currency mismatch between the assets and liabilities of the banking system was shown to be an important source of vulnerability. In that context, Bank-support reform of the National Mortgage Bank (BNH) furnished by structural adjustment lending will both improve financial sector efficiency and provide a much more secure foundation for housing policies, including the provision of low-cost housing for the poor.

The Bank was very active with analytic and advisory work throughout the 2000 CAS period. A major study entitled "Maintaining Social Equity in a Changing Economy" provided an important analytic anchor which enabled the government to deal more effectively with issues of poverty that were provoked by the economic crisis. Once the crisis struck, analytic and advisory work was merged with operational work in the preparation of two SALs and two Special SALs. Free-standing studies of the financial sector, trade and competitiveness were postponed because the macroeconomic environment was in a state of flux but they were later incorporated into a major study of "Sources of Growth" (FY05) which provides a comprehensive analytic framework for dialogue with the incoming 'Frente Amplio' administration. A poverty update (FY04) also provides an important point of departure for further dialogue.

13. See Implementation Status Report (ISR) No. 04 dated 12/01/2004

PART C – OVERALL BANK PERFORMANCE AND LESSONS LEARNED

When the 2000 CAS was drafted, the Bank had good reason to be satisfied with the development progress of Uruguay. In its implementation review of the previous 1997 CAS, the OED had rated the overall outcome as highly satisfactory. Structural reforms in the financial and public sectors were judged to be satisfactory and institutional development was rated as substantial. From that perspective the 1999 recession appeared to be a temporary setback that did not, in itself, warrant serious concern. Longer-term considerations appeared to suggest that Uruguay was firmly on the path towards graduation from Bank lending.

That is not to say that the Bank was unmindful of possible sources of vulnerability. It is noteworthy that, in a section of the 2000 CAS entitled “Downside Risks”, the two most important risks were stated as follows:

“The most obvious external downside risk would be a recession (or even more severe economic crisis) in either Argentina or Brazil”. (para. 70)

And then:

“Another potential threat is a change in Argentina that encourages Argentine residents to withdraw their deposits in Uruguayan Banks”. (para. 71)

Both of those risks materialized to the great detriment of Uruguay. Clearly, the Bank understood the likely serious consequences of an economic crisis in Argentina and the equally serious consequences of a run on Uruguayan Bank deposits. Yet, nonetheless, the executive summary of the 2000 CAS referred to “Uruguay’s relatively modest vulnerability to external shocks” as justification for a lower program of Bank lending and the concluding paragraph of the 2000 CAS opened with the comforting assurance that:

“In relative terms, there are few risks associated with the Bank’s operations in Uruguay”. (para. 123)

The Bank was not alone in underestimating the likely prospect of an impending crisis. In March 2001, an IMF review of recent economic developments in Uruguay began by asserting that “The Uruguayan economy is gradually emerging from the 1999-2000 recession”. As late as October 2001, in a second review of a Stand-By arrangement, the IMF was still of the opinion that “the economy is adjusting but output

is not expected to pick up until 2002” (page 3 of the executive summary).

The experience of the 2000 Uruguay CAS contains, therefore, some important lessons for country risk assessment. It is one thing to simply acknowledge the presence of risks. It is quite another thing to assess the probability attached to those risks. There are many possible reasons why the CAS failed to acknowledge how close Uruguay was to the brink. It may be that, in 2000, the Bank regarded the likelihood of an economic crisis in Argentina to be remote. There may have been a reluctance to step out of line with the opinion of other international financial institutions such as the IMF. Or, the Bank may have been reluctant to flag the prospect of an impending economic crisis in Argentina for fear of invoking a self-fulfilling prophecy and/or incurring the displeasure of the government. Clearly, in such situations, the Bank has to weigh its response, taking into account many different factors. **A lesson to be learned from the experience of the 2000 Uruguay CAS is that the Bank, in addition to identifying possible sources of risk, needs to assess the probability that the risk will materialize.**

Consistent with normal Bank practice, the 2000 CAS made references to a high case and a low case program of Bank operations depending upon country performance. It is noteworthy, however, that, although the 2000 CAS acknowledged the catastrophic risk of a possible economic crisis in Argentina, it made no proposal as to how the Bank might respond to such a dire eventuality. In the absence of a pre-considered country-specific plan, a standard Bank-wide instrument – the Special SAL – was invoked to deal with the crisis when it arose. While the Special SAL provided effective short-term relief for Uruguay it also created a medium-term payments problem. **A lesson to be learned is that, in circumstances where there is a clear and present danger of a catastrophic risk, the CAS should propose contingency plans for dealing with the risk in a manner appropriate to the country situation.**

Once the crisis broke out, the Bank was able to respond quickly and effectively. In part that was possible because the Bank had already assembled a broad body of country experience through a diverse operational program and through extensive analytic work. The country knowledge and experience gained from an active and long-standing country

program could be mobilized quickly to assemble an emergency program of support for crisis management. At the same time, a broad and deep country dialogue over many years, not only with the government, but also with the private sector, academia and civil society was instrumental in fostering an effective partnership with the client. **Another lesson to be learned, therefore, is that a strong corpus of country knowledge and a strong client relationship is a**

necessary prerequisite for the effective delivery of emergency Bank assistance.

Bank assistance for crisis management in Uruguay was part of a concerted effort with other international financial institutions. The Bank alone would not have been able to manage the task.

Another lesson to be learned, therefore, is the need to maintain and sustain close cooperation between donors.

URUGUAY CAS RESULTS SUMMARY MATRIX

Objectives of 2000 CAS	Country Performance Indicators 2000 CAS	Bank Instruments 2000 CAS	Bank Instruments 2002 CAS Update	Progress on 2000 CAS Objectives and Revised Objectives of 2002 Progress Report	Progress to Date Since the 2002 CAS Progress Report
1. Reduction of Poverty and Social Exclusion					
Enhanced Social Protection	<ul style="list-style-type: none"> - Poverty indicators - Household incomes - Social expenditures: amount and composition 	<ul style="list-style-type: none"> Social Expend Review (00) Poverty Assessment II (00) Poverty Update (05) 	SAL I	<ul style="list-style-type: none"> The Social Expenditure Review and Poverty Assessment II were combined into a single report (01) The 2002 CAS Update focused more broadly on crisis-induced general increase in poverty. 	<ul style="list-style-type: none"> Budget allocations for basic social programs were protected. Improved coordination of social programs and enhanced efficiency of public spending. Unemployment insurance reformed
Improved Access of Poor to Education Services	<ul style="list-style-type: none"> - Percentage of children in school. - Dropout rate - Average number of years of schooling - Attendance of children from poor families 	<ul style="list-style-type: none"> - Social Expend Review (00) - Second Basic Education Project (under supervision) - Basic Education III (02) 	- Special SAL II	<ul style="list-style-type: none"> With support from the Basic Education Quality Improvement Project II a new pedagogical full-time school model was introduced and resulted in significant improvements in language and mathematics skills The project also supported an expansion of preschool coverage from 51% in 1993 to nearly 95% in 2002. 	<ul style="list-style-type: none"> Continued expansion of full-time school model. Improvements in teacher training for adoption of new education technologies Budget allocations for education were protected. Improvement of education administration at national level.
Access of poor to Health Services	<ul style="list-style-type: none"> - Incidence of public health expenditures by income level of recipients 	<ul style="list-style-type: none"> - Health Reform Project (ongoing) - Community-based social development (03) - Health Project (05) 	Special SAL II	<ul style="list-style-type: none"> The Health Sector Development Project supported the piloting of public hospitals decentralization which quickly expanded to all departmental hospitals throughout the country. Dropped as result of crisis Now planned for FY06 	<ul style="list-style-type: none"> Regressive subsidies removed to increase efficiency and equity of public hospital expenditures. Management reforms to help sustainability of public expenditure on complex medical care.

Objectives of 2000 CAS	Country Performance Indicators 2000 CAS	Bank Instruments 2000 CAS	Bank Instruments 2002 CAS Update	Progress on 2000 CAS Objectives and Revised Objectives of 2002 Progress Report	Progress to Date Since the 2002 CAS Progress Report
2. Environmental/Economic/Sustainable Development Nexus					
				Bank assistance has progressed well, although due to worsening of the macro situation. Foot and Mouth disease became new focus after epidemic struck.	Focus on NRM (both IBRD lending and blended GEF grant resources), and GEF stand-alone projects (both climate change and biodiversity).
Strengthen Sustainable Land Use Practices	<ul style="list-style-type: none"> - Access to markets - Agricultural and livestock productivity - Water quality and availability 	<ul style="list-style-type: none"> - Irrigation and Natural Resource Management Project (ongoing) - Forest Products Transport (ongoing) - Rural Development (02) - Rural Conditions Study 	<ul style="list-style-type: none"> Satisfactory project implementation Satisfactory project implementation -Rural Development (05) -Rural Access (05) 	<p>Natural Resources Management and Irrigation Development project helped to deepen crop diversification by expanding irrigation to 40,000 hectares of agricultural land.</p> <p>Cost-efficient transport of forest products to port-of-exit improved through rehabilitation of transport infrastructure.</p> <p>Postponed due to crisis</p> <p>Natural Resources Development operation to be approved.</p> <p>To be approved</p>	<p>Project completed satisfactory in 2003. Follow-up operation has been prepared but is awaiting negotiation with new government.</p> <p>A sector report "The Rural Sector and Natural Resources" was published in 2002</p>
Strengthen Sustainable Water Use Management	<ul style="list-style-type: none"> - Water quality measures - Water availability 	Water Sector APL (00)	Delivery of lending program, satisfactory implementation	The coverage and sustainability of water supply and sanitation services has been increased	
Improve air quality		<ul style="list-style-type: none"> GEF mid-size grant for Methane Gases (01) GEF for Energy Efficiency (02) 		Methane Gas Project fully implemented. Landfill gas is being captured and used to fuel power generation plant.	Satisfactory Implementation
Strengthen Sustainable Fisheries and Animal Husbandry		Maritime Management Project with accompanying GEF (01)	Foot and Mouth Disease ERL (01)	<p>The maritime project was prepared with PHRD grant financing. Final processing and approval was shelved due to crisis.</p> <p>Emergency Aftosa Project. Six vaccination campaigns undertaken since May 2001 helped contain the outbreak of aftosa.</p>	The project successfully completed the epidemiological containment phase and is now focusing on the implementation of improved Monitoring, Surveillance and Control Systems.

Objectives of 2000 CAS	Country Performance Indicators 2000 CAS	Bank Instruments 2000 CAS	Bank Instruments 2002 CAS Update	Progress on 2000 CAS Objectives and Revised Objectives of 2002 Progress Report	Progress to Date Since the 2002 CAS Progress Report
3. Role of the State, Public Enterprise Reform and Governance					
Reform of infrastructure and public services	<ul style="list-style-type: none"> - Sector laws enacted - Management structures improved - Regulatory agencies established and functioning 	<ul style="list-style-type: none"> - Transport II (ongoing) - Water APL (ongoing) - Water APL (04) - Power Transmission and Distribution (ongoing) - Public Services TA (ongoing) 	Satisfactory implementation of ongoing portfolio	<p>Introduction of a performance based contract system for maintenance of main highways and a program of outsourcing rural roads maintenance. The performance based contract system is a model throughout the region.</p> <p>The Bank loan to OSE has helped improve the company's efficiency through the implementation of a first phase of institutional reforms, including a public information system</p> <p>Now planned for FY07</p> <p>Working with the national electricity company UTE, the power Transmission and Distribution Project has helped strengthen the electricity sector regulatory framework</p> <p>Good progress made with private participation in telecommunications and ports and the establishment of independent regulatory authorities. Weak policy definition capacity in some ministries remains a problem. TA Loan has provided support for developing regulatory frameworks and strengthened institutions for water, sanitation, energy, communications and rail sectors.</p>	<p>The Megaconcession and private sector participation has been successful in securing road user charges and channeling them toward the cost-effective maintenance of the most important sections of the network.</p> <p>In October 2004, the government awarded a concession contract for the construction and operation of a new port for bulk cargo (wood and cereals)</p>

Objectives of 2000 CAS	Country Performance Indicators 2000 CAS	Bank Instruments 2000 CAS	Bank Instruments 2002 CAS Update	Progress on 2000 CAS Objectives and Revised Objectives of 2002 Progress Report	Progress to Date Since the 2002 CAS Progress Report
3. Role of the State, Public Enterprise Reform and Governance					
Fiscal Consolidation	-GDP growth -Fiscal Deficit -Debt sustainability indicators	- Social Expenditure Review (00) - Sources of Growth (05)	SAL I SAL II Special SAL I and II	Policy dialogue focused on the need for: (i) large fiscal adjustment (switch from 1% of GDP primary deficit in 2000 to 4% GDP primary surplus in 2003); (ii) flexible exchange rate, moving to a float in June 2002 and (iii) debt sustainability	Limit non-financial public sector wages. Increase tax revenues. Maintain Satisfactory macroeconomic framework including fiscal targets Protect budget allocation for basic social programs. Improve efficiency of public expenditures
Financial Sector Strengthening	-M3/GDP -Public sector share of banking system -Banking sector portfolio performance	FSAL (00) Financial Sector Review (00)	SAL I	Bank supported improvements in prudential regulation for the financial sector. Dialogue with government on financial sector issues.	Improved regulation of public banks with increased transparency. Reform of Mortgage Bank (BHU) including: Legal framework for securitization. Improved governance.
Establish Clear Legal Framework for public procurement, consolidating /refining existing set of laws and their enforcement	New legal framework enacted, and put into practice	CPAR (00) IDF grant to improve procurement (01)	Successful assistance in developing new law		The Integrated System for Procurement (SICE) became operational in about 50% of the executive units of the Central Administration.
Establish more transparent accounting and budget processes than existing today	Improved dissemination of budget information	Financial sector policy dialogue on accounting for quasi-fiscal expenditures			Calls for bids and awards as well as making direct procurement were made available on-line Annual savings occurred as a result of efficiency gains in State purchasing and in contracting.

ATTACHMENT 2 - COMPARISON OF PROGRAMMED AND ACTUAL LENDING FY01-FY05

Loan Amounts (US\$ Millions)			
Operations Proposal and/or Approved	2000 CAS Base Case Program	2002 Progress Report Base Case Program	Actual Lending
FY01			
Maritime Management	20.0	-	-
TA Regulation	2.0	6.0	6.0
FY02			
Basic Education III	40.0	42.0	42.0
Rural Development	30.0	-	-
Foot and Mouth Disease	-	18.5	18.5
FY03			
Community Based Social	20.0	-	-
SAL I	-	150.0	151.5
SSAL I	-	150.0	151.5
SAL II	-	150.0	151.5
SSAL II	-	-	101.0
FY04			
Water Supply OSE II	40.0	-	-
SSAL II	-	100.0	-
FY05			
Health II	20.0	35.0	-
Rural Development ²	-	20.0	30.0 ¹
Rural Access ²	-	35.0	70.0

1. Natural Resources Development

2. To be approved

ATTACHMENT 3

Comparison of programmed and actual AAA FY00-FY05			
Fiscal Year	2000 CAS	2002 Progress Report	Actual Delivered
FY00	<ul style="list-style-type: none"> - Local Government Finance - Financial Sector Review - Health Policy Note - Social Expenditure Review - Poverty Assessment - Policy Option Notes 	<ul style="list-style-type: none"> 	<ul style="list-style-type: none"> Done Done Done Combined into one report: "Maintaining social equity in a changing economy" (01) Discussions held with government on basis of informal notes
FY01	- Rural Conditions		Natural Resources Irrigation Review (02)
FY02	- Financial Sector Update		Dropped due to crisis but later covered by Sources of Growth Study (05)
FY03	- Trade in Mercosur		Incorporated into Sources of Growth Study (05)
FY04	- Competitiveness Study		Sources of Growth Study (05)
FY05	- Poverty Assessment		Poverty Update (04)

PUBLIC DEBT SUSTAINABILITY

Under the base case macroeconomic scenario, the debt of the public sector of Uruguay as a share of GDP is projected to decline gradually over time. This outcome hinges on a number of assumptions, including sustained good fiscal performance and implementation of structural reforms to underpin fiscal performance and foster economic growth—as well as the absence of new large external shocks. Under the base case assumptions, the public debt is projected to fall from 92 percent of GDP in 2004 to 60 percent of GDP by 2010 (Table 2).

Three key factors underpinning debt sustainability are economic growth, fiscal policy, and the real exchange rate. Growth improves debt sustainability by increasing resources available to finance the public debt. Fiscal policy, in particular a significant primary surplus, contributes directly to debt sustainability by reducing the Government's borrowing requirement. Achieving the primary surplus target will hinge on structural reforms in tax, pensions, health, and state modernization, as well as in infrastructure and public services to support private sector participation—thereby reducing pressure on the public investment budget. Debt sustainability in Uruguay is sensitive to the path of the real exchange rate given the large share of public debt denominated in foreign currency. As demonstrated by the crisis, a sharp drop in the value of the peso can dramatically increase the domestic currency value of Uruguay's external debt. Under the base case, the peso is projected to appreciate moderately in line with sustained economic recovery. However, this will depend not only on credible macroeconomic policies but also on structural reforms to improve the investment climate, thereby attracting capital inflows. Finally, debt sustainability also hinges on continued support from the international financial institutions and access to financial markets at interest rates commensurate with economic growth proposals.

Fiscal discipline is a major pillar required for debt sustainability. In the base case it is assumed that the primary surplus remains in the range of the 3.8 percent of GDP level attained in 2004. The Government program includes measures to improve revenues, in particular the increase of the VAT base, reduction of the rate of evasion in social security contributions, and the inclusion of a new personal income tax and elimination of some distortionary taxes. In addition, the new Government has expressed its commitment to keeping expenditures under control. The fiscal projections under base case assumptions assume a modest recovery in wages and pensions from very low levels after the 2002 crisis, followed by stabilization as a share of GDP. Finally, the base scenario includes an increase in capital expenditures, also recovering from very low levels (Table 1). Overall, medium term primary expenditure is projected to remain well below peak levels of 2001-02 under the assumption that the Government implements significant reforms to improve contain expenditure growth. Under the base case scenario, fiscal reforms on both the revenue and expenditure side allow for increases in expenditures as a percent of GDP in parallel with the economic recovery, while maintaining the primary surplus in the target range. Were the revenue increases to generate a lower yield than projected under the base case, then expenditures would need to be tightened in order to maintain the primary surplus.

A second pillar for debt sustainability is GDP growth. In the base macroeconomic scenario, it is assumed that real GDP growth in 2005 is 6 percent, gradually declining to 3 percent by 2008 and remaining at that level thereafter. This growth rate is higher than average historical levels of about 2 percent (average growth through 1965-2004). The 3 percent medium term growth is based on a combination of factors: (a) GDP growth rates higher than those projected have

Table 1: Public Sector Finances ¹

	2001	2002	2003	2004e	2005	2006	2007	2008	2009	2010
in UR\$ billion										
Revenues	80,9	81,1	98,2	113,6	125,8	143,1	159,2	170,9	182,2	194,3
Tax revenues	54,0	57,8	70,1	83,0	92,0	103,2	113,9	121,4	129,5	138,0
Non-tax revenues	15,3	5,3	6,2	7,8	7,9	8,7	9,7	11,0	11,7	12,5
Social security contributions	14,4	12,8	11,8	12,9	14,3	17,4	20,5	22,4	23,8	25,4
Capital	7,2	5,2	10,1	9,9	11,5	13,9	15,1	16,1	17,2	18,3
Primary Expenditure	84,0	81,1	89,5	99,3	111,0	125,9	139,2	149,5	159,4	169,9
Wages and salaries	18,1	18,2	19,7	23,4	25,1	28,8	32,3	34,4	36,7	39,1
Goods and services	12,8	12,1	15,0	16,3	17,0	19,3	21,9	23,4	24,9	26,5
Social security transfers	41,9	42,8	44,2	47,4	56,4	61,9	66,0	70,3	75,0	79,9
Other current transfers	2,1	1,6	2,8	2,9	0,6	0,7	0,8	0,8	0,9	0,9
Capital	9,1	6,4	7,8	9,3	11,7	15,1	18,3	20,6	22,0	23,5
Primary Balance	-3,1	0,1	8,7	14,2	14,9	17,2	20,1	21,4	22,8	24,3
Interest	7,3	12,2	18,9	22,7	23,1	19,7	20,7	21,8	22,4	23,2
Overall balance	-10,4	-12,1	-10,2	-8,4	-8,3	-2,5	-0,6	-0,4	0,5	1,2
percentage of GDP										
Revenues	332,7	31,1	31,1	29,9	29,8	31,0	31,9	32,2	32,2	32,2
Tax revenues	21,8	22,2	22,2	21,9	21,8	22,4	22,8	22,8	22,8	22,8
Non-tax revenues	2,1	2,0	2,0	2,1	1,9	1,9	2,0	2,1	2,1	2,1
Social security contributions ^{5,8}	4,9	3,7	3,4	3,4	3,8	4,1	4,2	4,2	4,2	
Capital	2,9	2,0	3,2	2,6	2,7	3,0	3,0	3,0	3,0	3,0
Primary Expenditure	34,0	31,1	28,4	26,2	26,3	27,3	27,9	28,1	28,1	28,1
Wages and salaries	7,3	7,0	6,2	6,2	6,0	6,3	6,5	6,5	6,5	6,5
Goods and services	5,2	4,6	4,8	4,3	4,0	4,2	4,4	4,4	4,4	4,4
Social security transfers	17,0	16,4	14,0	12,5	13,4	13,4	13,2	13,2	13,2	13,2
Other current transfers	0,8	0,6	0,9	0,8	0,2	0,2	0,2	0,2	0,2	0,2
Capital	3,7	2,5	2,5	2,5	2,8	3,3	3,7	3,9	3,9	3,9
Primary Balance	-1,2	0,0	2,7	3,8	3,5	3,7	4,0	4,0	4,0	4,0
Interest	2,9	4,7	6,0	6,0	5,5	4,3	4,1	4,1	3,9	3,8
Overall balance	-4,2	-4,6	-3,2	-2,2	-2,0	-0,5	-0,1	-0,1	0,1	0,2
Memo: Nominal GDP, UR\$ billion	247	261	316	379	422	461	499	532	567	604

1. Excludes sub-national administrations.

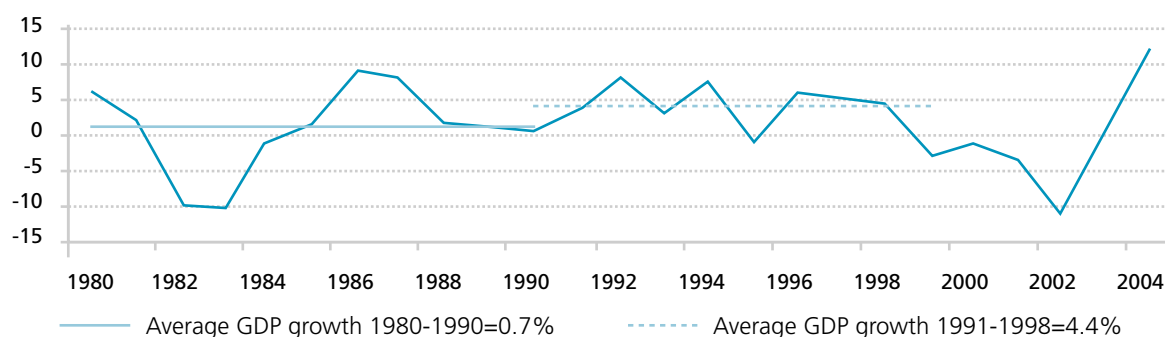
Source: Uruguayan authorities and World Bank staff estimates.

investment rates are higher than historical in the base case by about 2.5-3 percentage points of GDP (the average investment to GDP ratio in 1990-2000 was 15 percent); and (d) successful implementation of structural reforms as outlined in the Development Challenges section of the CAS which could provide significant upward GDP growth potential.

The third pillar is real exchange rate and price stability. Projections under the base scenario are based on the assumption that domestic inflation remains low, converging to international levels by 2007. As a result, there is a modest projected real exchange rate (RER) appreciation from end-2004 relative prices. Under this scenario, the real exchange rate would stabilize in an intermediate range between the level of the 1980s and the level of the 1990s (Figure 2). The real exchange rate is critical to debt sustainability in

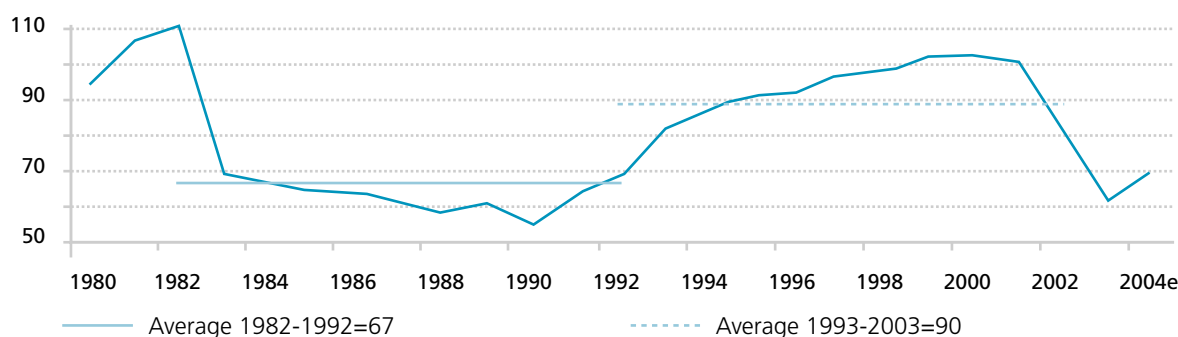
A fourth pillar is sustained Government access to financial markets at interest rates commensurate with economic growth prospects. This is a very important assumption, as it is possible that even if the Government continues with prudent fiscal and monetary policies and commits to structural reforms, exogenous developments in international financial markets may disrupt access to financing. In the base scenario, it is assumed that international spreads for Uruguay remain at 400 basis points (the level of March 2005). This assumption is based on the combination of the following two factors: (a) projected increases in international interest rates (from 2 percent in 2004 gradually increasing to reach 4.5 percent in 2008), a factor that would tend to increase the spread; and (b) the anticipated improvement in creditworthiness of Uruguay in the base case, a factor that would tend to reduce spreads. Therefore, the

FIGURE 1: GDP REAL GROWTH RATE (In percentage, 1980 – 2004)



Source: Central Bank of Uruguay.

FIGURE 2: REAL EFFECTIVE EXCHANGE RATE (2001 = 100, 1980 – 2004e)



Source: International Monetary Fund and World Bank staff estimates.

assumption of a 400 basis points spread through the projected period implicitly assumes that the two factors offset each other.

In the base scenario, gross financing needs (interest plus amortization payments) in 2005 are estimated at US\$2.1 billion. Amortization payments due are US\$1.1 billion, of which the most important are US\$0.5 billion to the IMF, US\$0.2 billion in bonds, US\$0.2 billion to IDB and US\$0.1 billion to the World Bank (Table 2). Peaks in financing needs occur in 2006 (US\$ 2.6 billion) and 2007 (US\$2.3 billion), largely related to repayments to the IMF, and also to a peak in bonds repayments in 2006. In the base scenario, consistency of the financing projection requires that the Government issues bonds for about US\$0.5 billion per year on average through 2005-10. This requirement results from the following financing assumptions: (i) the IMF gradually reduces its exposure in Uruguay under a new program, (ii) the World Bank

lending strategy evolves according to the base case lending program envisaged in the CAS, and (iii) the IADB maintains its exposure broadly constant. In addition, it is assumed that the Government recovers assets from the Stability Fund for a total of US\$400 million during 2005-7. This fund was created to support the financial sector during the banking crisis of 2002.

Sensitivity Analysis

The public debt path projected in the base scenario is sensitive to the primary surplus, growth, and real exchange rate assumptions. Table 3 shows the effect of deviations in the core macroeconomic assumptions on debt sustainability indicators. Changes in assumptions are taken one at a time, and all other assumptions remain as in the base case.

The top section of Table 3 shows the debt sustainability indicators under the base scenario

Table 2: Public Sector Financing – Base Scenario

	2005	2006	2007	2008	2009	2010
In US\$ million, unless otherwise indicated						
Financing Needs	2086	2572	2308	1933	1877	2103
Interest payments	864	714	724	738	731	731
Amortization payments	1201	1838	1565	1195	1146	1372
Bonds	217	584	114	273	227	474
Pipeline	217	554	36	165	83	292
On new bond issues	0	30	78	108	144	182
Deposits	136	100	111	129	130	135
Loans	848	1155	1340	793	789	763
Bilateral	34	15	20	25	30	35
Multilateral	801	1129	1309	757	744	709
o.w. IBRD	104	154	111	80	83	97
Other 1\	169	130	142	140	145	153
Financing Sources	2086	2572	2308	1933	1877	2103
Primary Surplus	555	624	702	724	746	768
Bonds	297	478	304	361	384	591
Multilateral Organizations	668	974	846	478	374	376
o.w. IBRD	176	187	145	100	104	86
Bilateral Organizations	50	50	50	50	50	50
Suppliers (net)	3	3	3	3	4	4
Increase in short term debt	69	25	20	14	15	15
Deposits	150	113	124	143	143	135
Other International Loans	10	20	20	20	20	20
Privatization Proceeds	32	35	38	40	43	44
Asset Recovery (Bank Stability Fund)	150	150	100	0	0	0
Central Bank	100	100	100	100	100	100
Other 2\	265	196	206	221	224	217
Stock of public debt, US\$ billion	12,2	12,1	11,9	11,7	11,6	11,4
Stock of public debt/GDP, percent	77,5	72,3	68,0	65,3	62,6	59,8
Debt Service/GDP, percent	13,1	15,3	13,1	10,8	10,1	11,0
Scenario Assumptions						
GDP real growth rate (%)	6,0	4,0	3,5	3,0	3,0	3,0
Nominal GDP, UR\$ billion	422	461	499	532	567	604
Public Sector Primary Surplus/GDP	3,5	3,7	4,0	4,0	4,0	4,0
Sovereign spread, basis points	400	400	400	400	400	400

1. Includes other international loans and deposits.

2. Includes suppliers (net), increase in short term debt, deposits, other international loans and other proceeds.

Source: Uruguayan authorities and World Bank staff estimates.

target. For example, if the primary surplus were reduced to 3 percent of GDP starting in 2005, the public debt to GDP ratio would still decline but at a slower rate than under the base case, reaching about 67 percent by 2010, that is, 7 percentage points more than under base case assumptions.

Increasing growth rates by one percentage point starting in 2006 results in a decline in the debt ratio to 56 percent by 2010. An equivalent one percentage point reduction in the growth rate results in a debt ratio of 64 percent in 2010. This result is important because it highlights that

maintained and the growth slowdown is limited.

The base case results are quite sensitive to changes in the projected real exchange rate path. If the real exchange rate were to converge to more appreciated levels observed during the 1990s, then the debt ratio would decline to a projected 51 percent by 2010. This improvement is explained not only by the fact that 90 percent of debt is denominated in foreign currency, but also because the projected primary surpluses as measured in dollars are much larger, reducing the need to issue debt for financing purposes. On the other hand, if the real exchange rate were to remain

Table 3: Sensitivity Analysis – Marginal Effects

	2004e	2005	2006	2007	2008	2009	2010
In percentage, unless otherwise indicated							
Base Scenario							
Stock of public debt/GDP	92,2	77,5	72,3	68,0	65,3	62,6	59,8
Stock of public debt, US\$ billion	12,2	12,2	12,1	11,9	11,7	11,6	11,4
Debt Service/GDP	11,7	13,1	15,3	13,1	10,8	10,1	11,0
Debt Service/Revenues	39,0	43,9	49,2	41,1	33,4	31,5	34,3
Multilateral DS/Total DS	50,2	53,3	56,7	69,3	52,4	52,1	44,2
Base Scenario Assumptions							
GDP real agrowth rate (%)	12,3	6,0	4,0	3,5	3,0	3,0	3,0
Nominal GDP, UR\$ billion	379	422	461	499	532	567	604
Real Exchange Rate, 2001=100, CPI based	69	78	79	80	80	80	80
Real Exchange Rate, 2001=100, GDP defl. based	71	80	82	82	82	82	82
Public Sector Primary Surplus, % of GDP	3,8	3,5	3,7	4,0	4,0	4,0	4,0
Sovereign spread	1170	400	400	400	400	400	400
Primary surplus at 5%							
Stock of public debt/GDP	92,2	76,6	70,3	65,0	61,2	57,2	53,2
Stock of public debt, US\$ billion	12,2	12,1	11,7	11,3	11,0	10,6	10,1
Debt Service/GDP	11,7	13,1	15,1	12,8	10,2	9,4	10,0
Debt Service/Revenues	39,0	43,9	48,8	40,0	31,8	29,1	31,1
Multilateral DS/Total DS	50,2	53,3	57,2	71,1	55,2	56,4	48,7
Primary surplus at 3%							
Stock of public debt/GDP	92,2	78,5	74,3	71,1	69,6	68,0	66,5
Stock of public debt, US\$ billion	12,2	12,4	12,4	12,4	12,5	12,6	12,7
Debt Service/GDP	11,7	13,1	15,4	13,5	11,3	10,9	12,1
Debt Service/Revenues	39,0	43,9	49,8	42,1	35,2	34,0	37,6
Multilateral DS/Total DS	50,2	53,3	56,1	67,6	49,8	48,3	40,3
GDP growth converges to 4%							
Stock of public debt/GDP	92,2	77,5	71,6	66,6	63,3	59,9	56,4
Stock of public debt, US\$ billion	12,2	12,2	12,1	11,9	11,7	11,5	11,3
Debt Service/GDP	11,7	13,1	15,1	12,9	10,4	9,7	10,4
Debt Service/Revenues	39,0	43,9	48,8	40,3	32,4	30,2	32,4
Multilateral DS/Total DS	50,2	53,3	56,7	69,3	52,5	52,3	44,5
GDP growth converges to 2%							
Stock of public debt/GDP	92,2	77,5	73,0	69,5	67,6	65,6	63,6
Stock of public debt, US\$ billion	12,2	12,2	12,1	11,9	11,8	11,7	11,5
Debt Service/GDP	11,7	13,1	15,4	13,4	11,1	10,6	11,7
Debt Service/Revenues	39,0	43,9	49,8	41,9	34,6	33,0	36,4
Multilateral DS/Total DS	50,2	53,3	56,7	69,3	52,2	51,7	43,7
Additional RER appreciation: RER appreciates to 1990s level							
Stock of public debt/GDP	92,2	75,1	67,8	61,6	56,9	54,0	51,0
Stock of public debt, US\$ billion	12,2	12,2	12,0	11,8	11,5	11,3	11,0
Debt Service/GDP	11,7	12,7	14,4	11,9	9,4	8,8	9,5
Debt Service/Revenues	39,0	42,7	46,4	37,5	29,4	27,4	29,6
Multilateral DS/Total DS	50,2	53,3	56,7	69,6	53,1	53,4	45,7
Lower RER appreciation: RER remains at 2004 level							
Stock of public debt/GDP	92,2	86,9	83,6	79,4	77,0	74,5	72,1
Stock of public debt, US\$ billion	12,2	12,3	12,2	12,1	12,1	12,1	12,0
Debt Service/GDP	11,7	14,6	17,6	15,2	12,6	12,1	13,2
Debt Service/Revenues	39,0	48,7	56,2	47,3	39,0	37,3	40,9
Multilateral DS/Total DS	50,2	53,3	56,4	68,4	51,0	50,0	42,1
Sovereign spreads at 600 b.p.							
Stock of public debt/GDP	92,2	77,5	72,3	68,1	65,6	63,0	60,4
Stock of public debt, US\$ billion	12,2	12,2	12,1	11,9	11,8	11,7	11,5
Debt Service/GDP	11,7	13,1	15,3	13,2	10,9	10,3	11,3
Debt Service/Revenues	39,0	43,9	49,4	41,4	33,9	32,1	35,0
Multilateral DS/Total DS	50,2	53,3	56,5	68,9	51,8	51,1	43,3
Sovereign spreads at 200 b.p.							
Stock of public debt/GDP	92,2	77,5	72,2	67,9	65,1	62,2	59,3
Stock of public debt, US\$ billion	12,2	12,2	12,1	11,8	11,7	11,5	11,3
Debt Service/GDP	11,7	13,1	15,3	13,0	10,6	10,0	10,8
Debt Service/Revenues	39,0	43,9	49,1	40,8	33,1	31,0	33,6
Multilateral DS/Total DS	50,2	53,3	56,8	69,8	53,0	53,0	45,1

FIGURE 3: PUBLIC DEBT TO GDP RATIO – ALTERNATIVE SCENARIOS

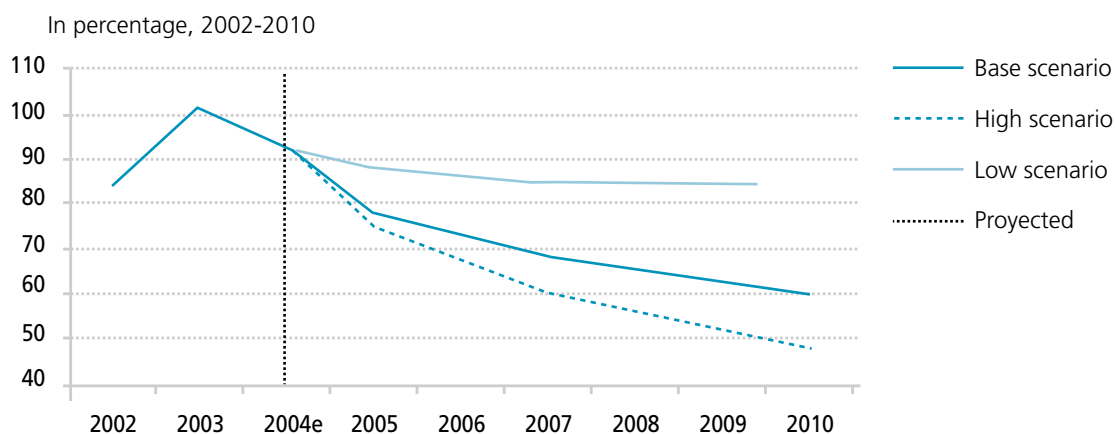


Table 4: High and Low Scenarios

	2004	2005	2006	2007	2008	2009	2010
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In percentage, unless otherwise indicated

High case scenario (growth=base+1, RER appreciates to 1990s level, primary surplus=4%, spread=200bp)

Stock of public debt/GDP	92,2	75,1	67,0	60,1	54,8	51,2	47,6
Stock of public debt, US\$ billion	12,2	12,2	12,0	11,7	11,4	11,1	10,7
Debt Service/GDP	11,7	12,7	14,2	11,6	9,0	8,3	8,8
Debt Service/Revenues	39,0	42,7	45,9	36,5	28,2	25,8	27,4
Multilateral DS/Total DS	50,2	53,3	56,9	70,2	53,8	54,5	46,9

High case scenario assumptions

GDP real agrowth rate (%)	12,3	6,0	5,0	4,5	4,0	4,0	4,0
Nominal GDP, UR\$ billion	379	435	494	556	617	664	715
Real Exchange Rate, 2001=100, CPI based	69	80	84	87	90	90	90
Real Exchange Rate, 2001=100, GDP defl. based	71	83	87	90	93	93	93
Public Sector Primary Surplus, % of GDP	3,8	3,5	3,7	4,0	4,0	4,0	4,0
Sovereign spread	1170	200	200	200	200	200	200

Low case scenario (growth=base-1, RER remains at 2004 level, primary surplus=3%, spread=600bp)

Stock of public debt/GDP	92,2	87,9	86,6	84,5	84,3	84,3	84,5
Stock of public debt, US\$ billion	12,2	12,4	12,5	12,6	12,9	13,1	13,4
Debt Service/GDP	11,7	14,6	18,0	16,0	13,9	13,8	15,6
Debt Service/Revenues	39,0	48,7	57,6	50,0	43,0	42,8	48,4
Multilateral DS/Total DS	50,2	53,3	55,6	66,1	47,8	45,4	37,4

Low case scenario assumptions

GDP real agrowth rate (%)	12,3	6,0	3,0	2,5	2,0	2,0	2,0
Nominal GDP, UR\$ billion	379	379	399	428	452	477	503
Real Exchange Rate, 2001=100, CPI based	69	70	69	70	70	70	70
Real Exchange Rate, 2001=100, GDP defl. based	71	72	71	72	72	72	72
Public Sector Primary Surplus, % of GDP	3,8	2,5	2,7	3,0	3,0	3,0	3,0
Sovereign spread	1170	600	600	600	600	600	600

accompanied by moderate real exchange rate appreciation as under the base case.

Sovereign spread is not a factor to which the base scenario results are highly sensitive. This is because the interest spread only affects new debt issues. Therefore, it takes several years before a given change in spreads fully translates in a change in the average interest rate on public debt. An increase in sovereign spreads to 600 basis points (200 basis points higher than the base case) would result in a projected debt to GDP ratio in 2010 less than one percentage point higher than the base case. On the other hand, a spread of 200 basis points results in a projected debt to GDP ratio marginally below 60 percent in 2010, almost the same as in the base case. This low spread could be possible in a scenario in which sustained fiscal discipline enables Uruguay to regain its investment grade status.

High and Low Case Scenarios

This section presents debt sustainability prospects resulting from combining the above deviations from the base case in an economically consistent direction

(Figure 3). The high case scenario combines the assumptions of higher growth rate, converging to 4 percent of GDP, primary surplus remaining at the base case level, a real exchange rate converging to more appreciated levels, and sovereign spreads at 200 basis points. The results are presented in the top panel of Table 4. In the high scenario, the projected debt to GDP ratio would decline to 48 percent in 2010, and all debt sustainability indicators would show significant improvements.

In a low scenario, the projected public debt would remain in the range of 84 percent by 2010. This scenario combines the assumptions of GDP growth rate converging to 2 percent, the real exchange rate remaining at the level of 2004, primary surplus at 3 percent of GDP and sovereign spreads at 600 basis points. This scenario highlights the vulnerabilities of public sector finances of Uruguay. For example, if the primary surplus were to fall to 2 percent of GDP, with all other assumptions as in the low scenario, projected public debt as a share of GDP would start to increase in 2008, reaching about 91 percent in 2010 (Table 5).

Table 5: Alternative Low Scenario

	2004e	2005	2006	2007	2008	2009	2010
In percentage, unless otherwise indicated							
Low scenario with primary surplus at 2%							
Stock of public debt/GDP	92,2	88,4	87,8	86,7	87,8	89,1	90,7
Stock of public debt, US\$ billion	12,2	12,5	12,7	13,0	13,4	13,9	14,4
Debt Service/GDP	11,7	14,6	18,1	16,3	14,3	14,5	16,7
Debt Service/Revenues	39,0	48,7	57,9	50,7	44,4	45,0	51,5
Multilateral DS/Total DS	50,2	53,3	55,4	65,2	46,2	43,1	35,1
Scenario assumptions							
GDP real agrowth rate (%)	12,3	6,0	3,0	2,5	2,0	2,0	2,0
Nominal GDP, UR\$ billion	379	379	399	428	452	477	503
Public Sector Primary Surplus, % of GDP	3,8	2,0	2,0	2,0	2,0	2,0	2,0
Sovereign spread	1170	600	600	600	600	600	600

URUGUAY - SOURCES OF GROWTH¹

Broad-based growth is defined as growth with wide social participation in both the production of output and the distribution of the benefits. The policy and reform options proposed highlight the importance of social participation in the growth strategy. First, an attempt has been made to evaluate the impact of key policies and reforms on poverty and welfare. For example, increased competition in infrastructure can lead to higher real wages; while reducing bureaucratic obstacles and improving the incentive framework in the labor market can encourage business to create jobs; and pension reform proposals can improve inter-generational equity. Second, health and education policies—which have an impact on the development of human capital—constitute an integral part of the growth agenda. Third, proposals to reformulate the social safety net take into account the important changes that have occurred in the productive structure—including the rising share of uncovered informal workers and self-employed.

The growth strategy proposed envisages three pillars corresponding broadly with policies and reforms to consolidate macroeconomic and financial stability (Pillar 1), improve the investment climate (Pillar 2), and modernize the State to support the private sector and innovation (Pillar 3). In general, benefits from policies based on pillars 1, 2 and 3 are expected to materialize in the short, medium and long term, respectively, but there are exceptions to this generalized timeframe. For example, macroeconomic and financial stability is

an essential requirement for all time periods. Microeconomic policies aimed at improving the investment climate are relevant even in the short term. *Innovation policies, which by their institutional nature require a long implementation, are a priority for the short term.* **The first pillar involves policies to underpin fiscal and financial stability, the efficient operation of factor markets (capital and labor), and the strengthening of social protection.** Such policies can help consolidate economic recovery and alleviate the social situation of vulnerable groups by making use of idle capacity and reallocating factors of production towards more productive companies and sectors. *Improved allocative efficiency of existing factors of production is expected to be the main driver of productivity and growth over the short term.*

The second pillar encompasses policies and reforms aimed to establish an investment climate favorable to the accumulation of physical and human capital; this includes trade and integration policies, the development of a competition framework—particularly in infrastructure; as well as policies in education and health to promote human capital formation. Trade integration—both within and beyond MERCOSUR—can play a particularly important role in the process of expanding export markets, investment and growth. The benefits of trade can be enhanced by improvements in the efficiency of infrastructure services achieved through increased competition and private sector participation to increase Uruguay's global

1. Based on the report "Uruguay – Sources of Growth – Policies for Human Capital Development, Integration, Competition and Innovation", World Bank, March, 2005.

competitiveness. The second pillar also encompasses institutional and policy reforms and investments to improve the quality, efficiency and equity of access to health and education. *The accumulation of physical and human capital combined with technical and allocative efficiency gains are expected to be the drivers of growth in the medium term.*

The third pillar comprises policies and reforms to promote growth driven by innovation; this envisages a thorough transformation of institutional capabilities, entrepreneurial culture and the national system of innovation. Initial benefits of microeconomic reforms included under this pillar--e.g., deregulation and

bankruptcy-- could begin to materialize in the short-term. Other reforms imply more profound institutional transformations--e.g., civil service reform, strategic budget planning, and development of a national innovation system. The benefits of these reforms are therefore more likely to emerge over the medium to long term, with the time lag depending on the commitment and perseverance with which the program is implemented. *Although innovation policies can lead to increased productivity in the short term, it is likely that the full benefits will materialize only in the long term; given long gestation lags, priority should be granted to the pursuit of innovation policies now.*

MILLENNIUM DEVELOPMENT GOALS

Goal	1990	1995	2000	2003/4	Target
1 Eradicate extreme poverty and hunger					
Poverty; percentage of population below \$1 per day; urban (CEDLAS)	0,4 ¹	0,6	0,4	0,9	0,2
Official poverty; percentage of population below moderate official poverty line; urban (INE)	29,7	17,4	17,8	30,9	n.s.
Children under 5 moderately or severely underweight; per cent (MSP estimates)	4,6	4,1	4,9 ⁴	...	2,3
2 Achieve universal primary education					
Education; primary completion rate; both sexes (ANEP)	...	...	91	...	100
Education; net primary enrollment ratio; both sexes (ANEP)	...	...	95	...	100
3 Promote gender equality					
Girls to boys ratio; primary and secondary education; per cent (WDI)	...	107,5	105,1 ³	...	100
Women to men parity index; as ratio of literacy rates; aged 15-24 (UNESCO)	1,01	...	...	1,01	1
4 Reduce child mortality					
Infant mortality rate (0-1 year); per 1,000 live births (INE)	21	20	14	15	n.s.
Children under five mortality rate; per 1,000 live births (UNICEF estimates)	24	23	17	14	8
Children 1 year old immunized against measles; per cent (UNICEF estimates)	97	90	89	95	n.s.
5 Improve maternal health					
Maternal mortality ratio; per 100,000 live births (WHO; UNICEF; UNFPA)	85 ⁵	50 ⁵	27 ⁶	...	21
Births attended by skilled health personnel; per cent (WDI)	...	...	100 ³	...	n.s.
6 Combat HIV/AIDS, malaria and other diseases					
Tuberculosis prevalence rate; per 100,000 population (WHO)	54	...	35	33	
Tuberculosis death rate; per 100,000 (WHO)	5	...	3	3	
Tuberculosis; DOTS detection rate; per cent (WHO)	...	76	80	80	
Tuberculosis; DOTS treatment success; per cent (WHO)	...	68	83	82	
AIDS; number of new cases per year (MSP)	...	123	200	235	
AIDS; number of death cases per year (MSP)	28	132 ²	106	...	
7 Ensure environmental sustainability					
CO2 emissions; metric tons per capita (CDIAC)	1,3	1,4	1,7	...	n.s.
Ozone-depleting CFCs consumption; in ODP metric tons (UNEP-Ozone Secretariat)	...	232	107	...	n.s.
Water; percentage of population with no access; urban (CEDLAS)	5 ¹	2	2	2	2
Sanitation; percentage of population with no access; urban (CEDLAS)	42 ¹	41	40	35	21

Source: UN (Statistics Division), CEDLAS and official data.

1. Average 1989 and 1992

2. 1996

3. 2001

4. 2002

5. Data derived from vital registration: good death registration but uncertain attribution of cause of death.

6. Data derived from vital registration: good death registration and good attribution of cause of death.

n.s. Not specified.

Goal	Target
1 Eradicate extreme poverty and hunger	2015 target = halve 1990 \$1 a day poverty and malnutrition rates
2 Achieve universal primary education	2015 target = net enrollment to 100
3 Promote gender equality	2005 target = education ratio to 100
4 Reduce child mortality	2015 target = reduce 1990 under 5 mortality by two-thirds
5 Improve maternal health	2015 target = reduce 1990 maternal mortality by three-fourths
6 Combat HIV/AIDS, malaria and other diseases	2015 target = halt, and begin to reverse, AIDS, etc.
7 Ensure environmental sustainability	2015 target = various

Source: WDI, 2004.

URUGUAY CLIENT SURVEY

Methodology

To better understand the development challenges and opportunities in Uruguay, the Bank commissioned a comprehensive client survey of its primary interlocutors and other stakeholders from across Uruguayan society. In addition to generating interesting information on how respondents viewed the overall situation in Uruguay and the country's place in the international community, the survey provides important data on how the Bank's most important partners perceive its role, relevance and effectiveness. The objective has been to use these data—and the perspective—provided by the survey to help the Bank improve the support it provides to Uruguay.

The Survey was conducted in June and July 2004. A total of 256 potential respondents were asked to answer a set of some 25 questions. Of this, 205, or 80 percent, agreed to complete the survey and submit their responses by mail. Participants were drawn from the various levels of government, members of Parliament, agencies implementing Bank projects, partner bilateral and multilateral agencies, the private sector and civil society, media and academia. The majority of respondents, equaling some 25 percent of the total, were from the private sector, followed by academics and then by representatives from federal, regional and local government. As is typical for such surveys, there was significant variation with respect to the respondents' knowledge of the Bank's operations. Some had little or no direct involvement with the Bank, while more than half indicated that they have been involved with or a close observer of World Bank activities for more than three years.

Key Findings

The following is a synopsis and seeks to provide an overview of the main findings of what is a

comprehensive and detailed questionnaire. The first part of the survey was dedicated to establishing a general sense of how the respondents viewed the overall condition of Uruguay. More than 60 percent of respondents answered that the country was "heading in the right direction," with solid majorities believing good progress was being made in ensuring broad access to education and sustaining the economic recovery. Less favorable progress was seen in the areas of health and overall public service delivery to the poor. Nevertheless, a strong majority of respondents were at least "optimistic" about Uruguay's future. These findings are interesting, as they reflect the mood of at least part of the electorate three months before a close election that resulted in a change of Government.

Respondents across the Board believe that Uruguay should maintain its active participation in the international financial community. Some 97 percent indicated that the country should receive "at the least the same as or more assistance from external sources" to address key challenges—with more than 50 percent indicating that more was needed. On what that support should be focused, nearly half indicated that reducing poverty (26%) and generating employment (21%) were the most critical challenges facing Uruguay. Improving the business climate, strengthening the economy and improving government effectiveness followed. These five areas together accounted for nearly 90 percent of the "most important" responses.

The World Bank

Regarding the World Bank, 71 percent of respondents indicated that the Bank should be "more involved in Uruguay's development strategies." An additional 28 percent said the current level was appropriate; leaving only 1 percent of all respondents saying the Bank

should be less involved in Uruguay. In terms of where the Bank could make the greatest contribution, the strongest responses centered on supporting economic growth and poverty reduction, with some interesting differences among stakeholder groups. Respondents from the private sector, for example, rated helping to create employment opportunities for the poor as the most important area for Bank involvement, while civil society organizations believed the Bank's focus should be on strengthening the financial system. For their part, government officials from both the central and regional level identified the Bank's role in improving the efficiency of the public sector as paramount. These are notable findings and suggest the sophistication of the various stakeholder groups in Uruguay.

There were other interesting findings about where respondents saw the Bank's greatest value-added. Nearly 60 percent of respondents thought investment lending to finance development projects was the Bank's most effective means of support, while just under a quarter thought providing lending to promote policy reform was most important. This corresponded fairly closely with a separate question on the greatest challenges for the Bank, with some 33 percent of respondents finding that the Bank's development policy lending should better reflect the political realities of the country, and another 24 percent feeling that the Bank should be more open to alternative policy options. At the same time, on a personal level, the Bank has clearly established good relations with Uruguay, with all respondents indicating that the Bank treats clients and stakeholders with respect, and that staff are straightforward and accessible.

From the Bank's perspective, the overwhelming preference of respondents for maintained and stepped up support and cooperation is welcome news. The challenge ahead, according to the survey, will be to do a better job ensuring greater effectiveness in those interventions perceived as most important. As it stands, the survey shows that there is a potentially troubling mismatch, with the Bank seen as more effective in areas considered important, but of relatively less urgency (infrastructure, governance), than in those areas more directly related to poverty reduction and social protection, where the Bank's involvement is considered by the majority of respondents to be absolutely critical. Perhaps this finding should not be surprising given the complexity of poverty reduction in normal times, let alone when the impact of severe crisis is still evident and far-

reaching. Nevertheless, it provides a valuable guide for the Bank as it seeks to move forward in transforming its support from crisis response to long term development.

Overall, the Bank is perceived to be relatively effective, though more needs to be done. It is important to note that the overall rating obscures important differences among the respondent groups. Perhaps most notable, there is a strong correlation between a respondent's familiarity with the Bank and how s/he rated its overall effectiveness. For example, ratings were significantly higher than the average among respondents from agencies that implement Bank supported projects. Conversely, respondents with the lowest level of familiarity with the Bank—from civil society organizations, academics, and the private sector—gave the lowest ratings for effectiveness. While this demonstrates the continued need for the Bank to improve the effectiveness of all of its interventions, it also suggests the need for stepped-up outreach to, and communication with, a broader spectrum of Uruguayan society. This particularly appears to be the case with the private sector, which made up a quarter of all respondents, was near the bottom of the scale in its familiarity with the Bank and gave overall mediocre ratings in terms of effectiveness.

The client survey has proved to be a helpful tool in identifying where the Bank can be most effective in its support to the Uruguayan authorities, and has complemented the productive meetings Bank staff and senior management held with the incoming administration during the transition period. Indeed, it may prove useful at some point in the future to conduct a follow-up survey with the same stakeholders in Uruguay to assess progress in the key areas identified above.

URUGUAY SAL II AND SSAL II – LETTER OF UNDERSTANDING

**Ministry of Economy and Finance
Oriental Republic of Uruguay**

Montevideo, May 4, 2005

Mr. James D. Wolfensohn
President
The World Bank Group
Washington D.C.

Dear Mr. Wolfensohn:

I am pleased to address you on behalf of the new Government that took office in the Oriental Republic of Uruguay last March 1st., after having obtained the absolute majority of votes in the first round of the general elections held in October 2004. The new Government, led by our President, Dr. Tabaré Vázquez, represents an important democratic transition and is the result of a deep desire of change that the Uruguayan people was craving for. The changes we are undertaking in a participatory way have the consensus of our society, as well as the diligent and enthusiastic support of all the friends of the country, including the international financial institutions.

At present we are developing multi-annual cooperation programs with the World Bank, the Inter-American Development Bank and the International Monetary Fund. In particular, we are finalizing with the World Bank the new Country Assistance Strategy (CAS) for the upcoming five years, under which we expect to define together a new assistance program for Uruguay with the institution that you represent. In this context, we have already identified the development programs and projects with highest priority, as well as the ongoing projects which were initiated by the former administration and that we are interested in completing successfully.

Within this context -and as you know- on April 8th., 2003, the World Bank Board of Directors approved a Structural Adjustment Loan (UR-71640) – SAL II and a Special Structural Adjustment Loan (UR-71650) – SSAL II. These programs contain general objectives of economic growth reactivation, improvement of Uruguay's economy competitiveness and improvement of the population's general welfare. The loans, negotiated and approved as part of the assistance package mobilized by the international institutions for our country in response to the serious financial crisis we faced on 2002, were signed jointly and made effective by the parties on April 22nd. of the same year. SAL II focuses on increasing efficiency in the public and infrastructure services, while SSAL II aims to improve the impact of public expenditures on the education and health sectors.

Currently, SSAL II (Social Sectors) is well-advanced, the financial and economic conditions in our country have improved remarkably and Uruguay no longer needs the exceptional financing that was granted at that time through special loans. Therefore, having evaluated in the light of the present situation the different options to complete both programs, we have decided to request the cancellation of the total amount of the SSAL II loan funds that remain undisbursed as of the present date. Given that the country has achieved even more ambitious goals than those agreed in the SSAL II, we are making this request with the conviction that we will soon finalize successfully the current negotiations in the context of the new CAS, which we trust will be conducive to the implementation of a new operation in support of our social programs.

Regarding SAL II (Public Services and Infrastructure) implementation, we would like to reiterate the commitment of the Oriental Republic of Uruguay both to the general and specific objectives of this operation. These goals were shared by our Administration ever since the political campaign which eventually led us to the Presidency, given the priority we accord to reforms aimed at reducing prices, improving quality and coverage and increasing efficiency of investment, production and distribution of public and infrastructure services.

Strategy

The strategy this Government has adopted to achieve the general and specific objectives of SAL II includes the implementation of reforms directed to: first, fostering competition in the markets; strengthening and consolidating regulatory entities, and legal and regulatory frameworks for the public sectors and infrastructure services; strengthening the entities responsible for defining policies and planning the development of each sector, and clarifying the difference between the responsibilities of these institutions and those charged with regulatory functions.

Second, to improve the efficiency of public expenditures by means of a better corporate governance, more transparency in public operators' administration, better definition of obligations and responsibilities, and a reduction of tax distortions.

Third, to modernize public operators by strengthening and optimizing their investment, operation and maintenance programs.

And, fourth, to review tariff structures and subsidy policies applicable to public services in order to better complement the Government's social policy in benefit of the low-income population. In particular, attempt to make these consistent among sectors and to focus them on favoring the poorest.

Specific Objectives

The main objectives we are committed to in each sub-sector are:

Energy. The commitment of achieving SAL II's specific objectives in the upcoming nine to twelve months is part of our Government strategy. In the energy sector, this strategy seeks to define --in the context of our national policy that we are defining in a participatory and explicit way-- the strengthening, consolidation and implementation of the legal and regulatory frameworks of the different energy sectors and the regulatory entity, as well as the rationalization of tariffs and prices.

As a result of the referendum held in December 2003, there are some objectives that are more difficult to achieve, such as those that seek to regulate importation and production of petroleum products and to define tariffs and access rules to Montevideo port, and to the ANCAP infrastructure facilities located there. Since in the referendum 62 percent of the Uruguayan population voted in favor of the annulment of a law dated January 2002 that eliminated ANCAP's monopoly of the import, export and refinement of crude oil, and allowed the strategic association of ANCAP with an international operator, our Government now faces the challenge of advancing by means that are compatible with the popular will.

Potable water and sewerage. Our specific objectives in the potable water and sewerage sector are to define and implement a legal and regulatory framework for the sector, as well as to strengthen, consolidate and implement the regulatory entity in charge thereof.

However, as in the case of the energy sector, in October 2004 a second referendum --approved by two thirds of the Uruguayan population-- amended the Constitution making potable water and sewerage services the exclusive domain of the public sector. In fact, this second referendum forbids not only the participation of the private sector through sales of assets and concessions, but also the association of public companies with private firms to provide these services. Also in this area --as in the energy sector--the challenge is to be able to advance with measures compatible with the popular will.

Communications. In this case the specific objectives are the consolidation of the legal and regulatory framework of the telecommunications and postal services sectors, and strengthening market competition. We seek to strengthen the capacity of the competent regulatory entity as well.

Transport. Finally, the specific objective in the transport sector is to consolidate the recent reforms and successful advances through the actions supported by SAL II.

We are optimistic and convinced that working together with the Bank we will be able to face the challenges involved in achieving the objectives we have set for ourselves, and to identify new goals and instruments that will allow us to implement our strategy in the above mentioned sectors.

We are sure that only by improving competition, regulation, corporate governance, social policies and efficiency of operators in the public and infrastructure services sectors will it be possible to improve in a sustainable way the country's competitiveness, and to guarantee its economic growth and the welfare of our population.

Sincerely,

Danilo Astori
Minister of Economy and Finance

URUGUAY: COUNTRY FINANCING PARAMETERS

Item	Parameter	Remarks / Explanation
Cost sharing. Limit on proportion of individual project costs that the Bank may finance.	Up to 100% of total project costs.	Proposed flexibility will be exercised within the Bank's overall planned country lending envelope. The Bank would finance projects where ownership of the overall program and at the sector level is considered satisfactory. The Bank's financing share in individual projects is expected to continue at current levels. However, the Bank will consider financing a higher proportion or 100% in specific situations when this would result in: i) substantially reduced transactions costs; and ii) a substantial impact on poverty alleviation.
Recurrent cost financing. Any limits that would apply to overall amount of recurrent expenditures that the Bank may finance.	No country-level limit.	In determining Bank financing of recurrent costs in individual projects, the Bank will take into account sustainability issues at the sector and project levels. Financing of recurrent costs would continue to take place in exceptional cases, and mainly to finance project operation costs. Increased flexibility may be applied if the need arises when there are special emergency and project circumstances. For example, in the case of an emergency, the Bank would consider financing recurrent costs on a temporary basis to alleviate adverse social or human conditions. The Bank would also consider financing output based contracts containing an element of recurrent cost financing, if project conditions would so require.
Local cost financing. Are the requirements for Bank financing of local expenditures met, namely that: (i) financing requirements for the country's development program exceed public sector's own resources and expected domestic borrowing, (ii) the financing of foreign expenditures alone would not enable the Bank to assist in the financing of individual projects.	Yes.	The Bank may finance local costs in the proportion needed in individual projects.
Taxes and Duties. Are there any taxes and duties that the Bank would not finance?	Import tariffs above 28%, i.e. double the average of the MERCOSUR common external tariff (CET) rate.	The Bank may finance all taxes and duties associated with project expenditures, except import tariffs above 28%, i.e. double the average of the MERCOSUR common external tariff (CET) rate. In projects where such tariffs are material, the government's financial contribution to the project would be at least equal to cover such tariffs. At the project-level, the Bank would also consider whether taxes and duties constitute an excessively high share of project's costs.

SUMMARY OF CONSULTATIONS WITH CIVIL SOCIETY

Introduction

Important activities were carried out in the period preceding CAS preparation to establish a permanent dialogue between the Bank and Uruguayan civil society, and to ensure a constructive feedback from various sectors of civil society. These activities included:

- The **Client Survey** compiled the opinions of key actors from across the spectrum of Government, private sector, civil society and academia on the role of the Bank and its effectiveness.
- **Participatory Workshops** for the preparation of the Sources of Growth study were attended by representatives from Government and the private sector.
- The **Social Monitor** specifically aimed at strengthening the role of civil society in the development and implementation of Bank projects and at developing social accountability mechanisms.

Additional CAS consultations focused specifically on the future Bank assistance strategy in Uruguay. The consultation process took place on April 19-21, 2005 in three areas of the country that ensured diversity and a representative picture of the country's reality. The purpose of the CAS consultations was threefold:

- to consult with civil society on the blueprint of the Country Assistance Strategy for FY05-10 which the Bank was in the process of discussing with the new administration;
- to obtain the views of civil society on the Bank's contribution to Uruguay's development in the recent past; and
- to enlist the support of civil society in the implementation of the Bank strategy, including

new ways to involve civil society in the design and implementation of Bank-funded projects.

Consultation Process

Location: The consultations were organized by the Bank in partnership with the Government of Uruguay and the *Foro Consultivo Económico Social del MERCOSUR (FCES)*. Half day-long meetings were held in three locations: the capital city of Montevideo, Paysandú and Tacuarembó.

- **Montevideo**, the nation's capital, with about 1.3 million inhabitants accounts for more than one third of the country's population. It is the country's political, economic and social center.
- **Paysandú**, a town of about 60,000 inhabitants in the western part of the country, close to the Argentine border, was selected primarily because of its high economic potential, the particularly severe impact of the crisis on the local economy, as well as the active role played locally by civil society organizations. The area has suffered very high levels of emigration and it is struggling to attract investment back to the agricultural sector, once the mainstay of the economy.
- **Tacuarembó**, a rural town of about 40,000 inhabitants in the northern part of the country, was selected because it is one of the country's poorest areas. The local economy, primarily based on agriculture, was severely impacted by the crisis.

Participants: The meetings attracted a high number of participants, more than 200 in total, with a particularly strong attendance in the interior of the country. There was strong participation from the entire spectrum of civil society. The consultations not only included specialized NGOs with expertise on how the World Bank and other multilateral financial institutions work, but also representatives from unions, faith groups, academia, workers' organizations, producers'

FORO CONSULTIVO ECONOMICO-SOCIAL DEL MERCOSUR (FCES)

The consultations on the Bank's strategy were co-organized by the *Foro Consultivo Economico-Social del MERCOSUR (FCES), Seccion Uruguay*. The FCES is a permanent institutional structure of MERCOSUR and has primarily a consulting role. It started to operate at the regional level in 1995. FCES is structured into national chapters, each of which has representation from different levels of civil society: the private sector, the unions and NGOs. The wide variety of its constituencies helps the FCES ensure broad and active participation of all sectors of civil society. It provides an important institutional setting for expressing concerns and for carrying out initiatives of the various segments of civil society.

associations and the media. Government officials at the national, departmental and local level (including the Mayors of both Paysandú and Tacuarembó) also participated in the meetings, providing a critical perspective on important policy issues.

Documentation: Documents and pamphlets especially prepared for the consultations include a profile of all active projects and a summary of the Policy Notes discussed with the Government elect in January. These were distributed to meeting participants to broaden public information on the Bank's role and activities, and policy options discussed with the administration.

Meeting Organization: All meetings were structured around a presentation explaining briefly the role of the Bank in Uruguay in the recent past and illustrating the main objectives of the proposed CAS on the basis of the preliminary agreements reached with the authorities. The presentation was, all in all, well received by participants and generated very constructive and lively discussions, particularly regarding the perceived role of the Bank. Following the presentation, participants split into break-up working groups and were asked to respond to a number of questions outlined in a questionnaire. Attention was given to ensure a broad representation of civil society organizations in each of the groups which were headed by a leader/rapporteur.

The questionnaire was intended to generate discussion and consensus among the groups on two key themes: *equitable growth* and the *impact of the crisis on Uruguayan society*. With respect to the former, the questionnaire aimed at

obtaining civil society's perspective on the following:

- the challenges faced by Uruguay over the last few years in attaining the objective of equitable growth;
- how the Bank has helped in addressing these challenges; and
- the areas which future Bank support should focus on in order to meet the stated challenges.

In regard to the latter, the questions aimed at identifying:

- the principal negative effects of the crisis on Uruguayan society; and
- priority actions that could contribute to alleviate these negative effects and to promote increased wellbeing in Uruguayan society. After about an hour of discussion, the groups were asked to present their conclusions in a plenary.

Main Issues and Perceptions

Main Themes: The meetings at all three locations indicated a significant support for the core principles of the CAS, and there was a high level of coincidence between the challenges singled out by the break-up groups and those being identified in the CAS. The main themes that emerged from the discussion were a general appreciation of the country's fiscal constraints, and particularly the need to ensure a balance between the demands of the education sector, which needs additional resources, and those of the pension system, which continues to place significant demands on the state. In addition, the need to strengthen the public sector was emphasized in the course of the discussions. Participants felt that meeting the main

challenges identified during the consultations will imply a major change in the attitude presently prevailing in Uruguay with respect to work ethics, entrepreneurship, and human capital formation.

With regard to the impact of the crisis on Uruguayan society, civil society representatives placed special emphasis on the costs of the crisis in terms of employment, particularly vis-à-vis women, the youth and other most vulnerable groups. Loss of jobs was linked to increased levels of emigration which depleted the country of qualified manpower. It was noted that the crisis had a severely negative impact on the country's values, both at the family level - leading to increased domestic violence and youth desertion, as well as the individual level - leading to loss of hope, lack of confidence in the future and risk-averse behavior. The sense of disillusionment was more pronounced in the two locations in the interior of the country which have been severely impacted by the crisis and where the effects of the crisis continue to be significant, mainly due to the lack of investment in the service and productive sectors which are potential sources of job creation.

Perceptions of the World Bank: Overall, participants had very limited information about the role of the Bank in the past. This was mainly attributed by participants to the limited openness on the part of previous administrations as well as the Bank, and there was a strong claim for increased public information, a broader outreach strategy and enhanced civil society participation in the future. To this end, participants welcomed the opening of a World Bank representative office in Montevideo which will increase public information on the Bank's programs and will enhance participation by civil society in the design and implementation of Bank-funded projects. Government representatives also stressed the importance of being transparent in the implementation of the country's future strategy, and indicated their openness in this regard.

A number of perceptions about the Bank emerged forcefully throughout the consultations with civil society representatives. Participants believed that the economic growth of the 1990s was artificial, and that it compromised many of the traditional values of Uruguayan society, such as equity and solidarity. Participants attributed part of the responsibility for such loss of values to the Bank, although Bank's involvement in Uruguay during the

1990s was in fact limited. There was also a concern with the impact of the Bank's assistance, as many of the areas in which the Bank has been involved, such as education, continue to present a challenge. However, the perception of the Bank varied across the three locations. While in Paysandú participants focused on past experiences and what went wrong, the attitude of participants in Montevideo and Tacuarembó was more forward-looking.

Despite these difficult perceptions, there was a positive attitude towards developing a constructive dialogue with the Bank in the future, and a positive reception by all groups in terms of a future expansion of the Bank's program in the country. Participants welcomed the idea of the consultations and it was clear that there was a desire from civil society to take a more pro-active role in the implementation of the Bank's strategy in the future.

Proposals for Engagement: A number of areas of future Bank involvement which call for close collaboration with civil society were identified. As a matter of priority, civil society would welcome the opportunity for increased involvement in reconstructing those **values** which are perceived to have been lost as a result of the crisis, and it would be a key partner for the Government in this endeavor.

With regard to **social inclusion**, civil society could play a major role in ensuring that the needs of the most vulnerable groups (including children, youth, the disabled and women) are addressed.

The need for broader reforms in the **education sector** was also identified. In particular, participants stressed that there is a need to go beyond punctual interventions and simple pilot projects, and to elicit the active involvement of teachers in the design of future reforms. Further, there is a need to link efforts aimed at improving education with the demands arising in the productive sector, particularly in the area of professional training.

With respect to the **productive sector**, in addition to policies aimed at increasing productivity and creating an enabling environment for the private sector, participants felt that there is ample scope for civil society participation in the design and implementation of programs targeted at bolstering

small and medium enterprises, micro-enterprises and cooperatives.

Finally, in the area of *state reforms*, participants noted that civil society could play a key role in the monitoring of results obtained by the public sector.

Conclusion

The CAS consultations were invaluable in terms of validating the strategy being discussed with the new administration and in building a stronger link between the Bank and civil society groups across the country. There was overall a strong consensus on the proposal for an expansion of the Bank's role in Uruguay in the coming years and for strong Bank support to the Government's agenda for accelerated growth with equity. The consultations also responded to civil society's appetite for increased information on the Bank's role and programs, and demands for greater openness on the part of Government concerning its development program. The consultations provided a renewed opportunity for a more sustained exchange of information and interaction with civil society on the Bank's country assistance strategy, particularly in the design and implementation of future Bank projects.

URUGUAY AT A GLANCE

Poverty and Social	Uruguay	Latin America & Caribbean	Upper middle Income
Most recent available			
Population, mid-year (millions)	3,4	525	329
GNI per capita (Atlas method, US\$)	3.750	3.280	5.110
GNI (Atlas method, US\$ billions)	12,8	1.721	1.682
Average annual growth			
Population (%)	0,6	1,5	1,2
Labor force (%)	1,1	2,2	1,8
Most recent estimate (latest year available)			
Poverty (% of population below national poverty line)	31	..	..
Urban population (% of total population)	92	76	75
Life expectancy at birth (years)	75	71	73
Infant mortality (per 1,000 live births)	14	28	19
Child malnutrition (% of children under 5)	4	9	9
Access to an improved water source (% of population)	98	86	90
Illiteracy (% of population age 15+)	2	11	7
Gross primary enrollment (% of school-age population)	90	129	104
Male	89	131	104
Female	90	126	104

Development diamond*

Uruguay
Upper-middle-income group

Key Economic Ratios and Long-Term Trends					
	1983	1993	2003	2004	
GDP (US\$ billions)	5,1	15,0	11,2	13,2	<div>Economic ratios*</div> <div>Uruguay Upper-middle-income group</div>
Gross domestic investment/GDP	14,3	15,6	12,6	13,3	
Exports of goods and services/GDP	25,7	19,1	26,1	29,6	
Gross domestic savings/GDP	16,3	15,2	14,1	15,0	
Gross national savings/GDP	10,7	13,6	9,6	10,8	
Current account balance/GDP	-1,2	-2,3	-0,5	-0,8	
Interest payments/GDP	7,0	3,0	6,3	5,0	
Total debt/GDP	64,5	32,3	98,4	87,8	
Total debt service/exports	28,3	22,0	34,9	33,9	
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..
	1983-93	1993-03	2003	2004	2004-07
(average annual growth)					
GDP	2,2	0,6	2,2	12,3	6,4
GDP per capita	1,5	0,0	1,6	11,7	5,8
Exports of goods and services	5,5	2,5	14,5	30,1	12,8

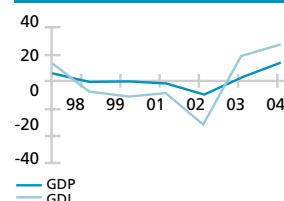
Note: Most recent available data are preliminary estimates.

* 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.

Structure of the Economy

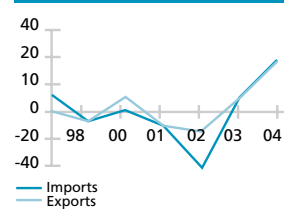
	1983	1993	2003	2004
(% of GDP)				
Agriculture	13,4	7,0	12,4	11,4
Industry	33,1	28,1	25,9	28,5
Manufacturing	25,4	20,0	17,7	20,6
Services	53,5	64,9	61,7	60,0
Private consumption	69,1	72,6	74,6	74,2
General government consumption	14,5	12,2	11,4	10,8
Imports of goods and services	23,6	19,6	24,6	27,9

Growth of investment and GDP (%)



	1983-93	1993-03	2003	2004
(average annual growth)				
Agriculture	1,2	1,6	10,6	12,8
Industry	0,8	-1,4	0,9	16,1
Manufacturing	0,6	-2,1	4,7	21,6
Services	3,1	1,5	-1,6	6,0
Private consumption	3,1	1,1	2,0	12,8
General government consumption	1,6	0,0	-4,8	2,5
Gross domestic investment	1,8	-0,2	18,0	27,0
Imports of goods and services	6,7	2,7	5,8	24,5

Growth of export and imports (%)



Prices and Government Finance

Domestic prices

(% change)

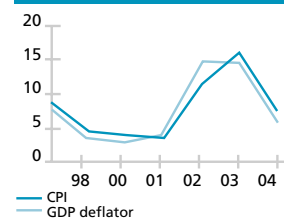
	1983	1993	2003	2004
Consumer prices	49,2	54,1	19,4	9,2
Implicit GDP deflator	53,7	47,9	18,4	7,0

Government finance

(% of GDP, includes current grants)

	1983	1993	2003	2004
Current revenue	..	27,3	27,9	27,3
Current budget balance	..	0,4	-4,0	-2,4
Overall surplus/deficit	..	-1,3	-3,2	-2,2

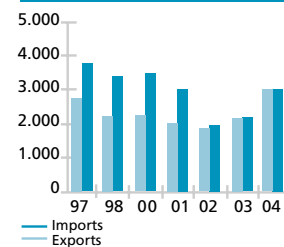
Inflation (%)



Trade

	1983	1993	2003	2004
(US\$ millions)				
Total exports (fob)	1.045	1.645	2.198	3.025
Meat	652	787	1.358	1.750
Vegetables	365	355	688	887
Manufactures	393	858	840	1.083
Total imports (cif)	788	2.326	2.190	2.990
Food	57	212	200	264
Fuel and energy	98	268	381	503
Capital goods	189	950	349	460
Export price index (1995=100)	..	84	87	92
Import price index (1995=100)	..	99	93	99
Terms of trade (1995=100)	..	85	94	93

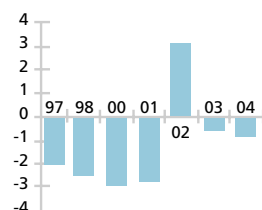
Export and import levels (US\$ mill.)



Balance of Payments

	1983	1993	2003	2004
(US\$ millions)				
Exports of goods and services	1.435	2.661	3.084	4.012
Imports of goods and services	1.212	2.858	2.734	3.675
Resource balance	222	-198	350	337
Net income	-288	-193	-491	-531
Net current transfers	11	53	82	89
Current account balance	-54	-338	-58	-105
Financing items (net)	-11	517	1.439	674
Changes in net reserves	66	-179	-1.380	-570
Memo:				
Reserves including gold (US\$ millions)	808	1.212	2.086	2.656
Conversion rate (DEC, local/US\$)	0	4	28	29

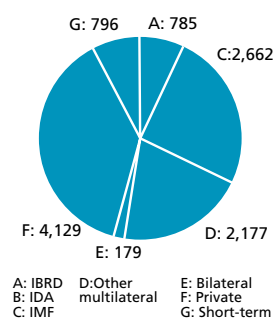
Current account balance to GDP (%)



External Debt and Resource Flows

	1983	1993	2003	2004
(US\$ millions)				
Total debt outstanding and disbursed	3.292	4.848	11.012	11.597
IBRD	92	522	722	785
IDA	0	0	0	0
Total debt service	407	586	1.077	1.362
IBRD	22	88	107	102
IDA	0	0	0	0
Composition of net resource flows				
Official grants	1	18	0	0
Official creditors	11	159	870	250
Private creditors	800	70	-185	340
Foreign direct investment	-6	0	260	312
Portfolio equity	-16	83	-479	-96
World Bank program				
Commitments	45	0	253	0
Disbursements	21	40	97	144
Principal repayments	14	49	78	80
Net flows	7	-9	19	64
Interest payments	8	39	28	22
Net transfers	-1	-47	-9	41

Composition of 2004e debt (US\$ mill.)



SELECTED INDICATORS* OF BANK PORTFOLIO PERFORMANCE AND MANAGEMENT

As of Date 03/01/2005

Indicator	2002	2003	2004	2005
Portfolio Assessment				
Number of Projects Under Implementation ^a	8	11	11	9
Average Implementation Period (years) ^b	3,0	2,7	3,1	4,1
Percent of Problem Projects by Number ^{a, c}	0,0	9,1	0,0	0,0
Percent of Problem Projects by Amount ^{a, c}	0,0	3,1	0,0	0,0
Percent of Projects at Risk by Number ^{a, d}	0,0	9,1	0,0	0,0
Percent of Projects at Risk by Amount ^{a, d}	0,0	3,1	0,0	0,0
Disbursement Ratio (%) ^e	24,9	11,5	21,4	19,4
Portfolio Management				
CPPR during the year (yes/no)	Yes	Yes	Yes	No
Supervision Resources (total US\$)	642	773	691	727
Average Supervision (US\$/project)	64	64	63	81

* Planned

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	33	6
Proj Eval by OED by Amt (US\$ millions)	1.239,9	173,9
% of OED Projects Rated U or HU by Number	9,4	16,7
% of OED Projects Rated U or HU by Amt	9,2	23,5

a. As shown in the Annual Report on Portfolio Performance (except for current FY).

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

c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).

d. As defined under the Portfolio Improvement Program.

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.

* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

PROPOSED IBRD/IDA BASE-CASE LENDING PROGRAM IFC AND MIGA PROGRAM, FY 2002-2005

As of Date 03/01/2005

Proposed IBRD/IDA Base-Case Lending Program^a

Fiscal year	Proj ID	US\$(M)
2005	Transp. Inf. Maint. and Rural Access	70,0
	Integr. Nat. Res. & Biodiveristy Mgmt	30,0
	DPL I	75,0
	Result	175,0
2006	Nat. Health Insurance and Soc. Sec. Support	20,0
	DPL II	75,0
	Infrastructure (Energy)	70,0
	Result	165,0
2007	Innovation/Science & Technology	35,0
	DPL III	75,0
	Water Sector APL II	30,0
	Institution Building	15,0
	Result	155,0
2008	Education	25,0
	Coastal and Marine Resources	30,0
	DPL IV	50,0
	Result	105,0
2009	Social, Institutional and Infrastructure Investments	100,0
	Result	100,0
2010	Social, Institutional and Infrastructure Investments	100,0
	Result	100,0
Overall Result		800,0

a. This table presents the proposed program for the next three fiscal years.

IFC and MIGA Program, FY 2002-2005

Indicator	2002	2003	2004	2005
IFC commitments (US\$m)	21,0	30,0	0,0	1,5
Sector (%)				
Finance & Insurance	100			100
Food & Beverages		100		
Total	100	100	0	100
Investment instrument(%)				
Loans		67		
Equity	43			100
Quasi-Equity	57	33		
Other				
Total	100	100	0	100
MIGA guarantees (US\$m)	20,52	0,00	0,00	0,00

* Planned

URUGUAY - SUMMARY OF NONLENDING SERVICES

As of Date 03/01/2005

Product	Completion FY
Recent completions	
CFAA	FY04
Poverty Update	FY04
Sources of Growth	FY05
Policy Notes	FY05
Underway	
Public Expenditure Review	FY05
Health Strategy	FY05
CPAR	FY06
Planned	
ROSC (Insolvency)	FY06
ROSC (Governance)	FY06
Investment Climate Assessment	FY06
Equity and Quality of Education	FY06
Country Gender Assessment	FY06
Financial Sector Assessment	FY06
Progr. DPR Infrastructure	FY07
Programmatic DPR Social Sector	FY07
Progr. DPR Agriculture & Environment	FY08

URUGUAY SOCIAL INDICATORS

	Latest single year			Same region/income group	
	1975-1980	1985-1990	1997-2003	Latin America & Carib.	Upper-middle-income
Population					
Total population, mid-year (millions)	2,9	3,1	3,4	532,7	333,1
Growth rate (% annual average for period)	0,6	0,6	0,6	1,4	1,2
Urban population (% of population)	85,2	89,0	92,5	76,6	75,4
Total fertility rate (births per woman)	2,9	2,5	2,2	2,4	2,3
Poverty (% of population)					
National headcount index	..	..	..	..	..
Urban headcount index - moderate ¹	..	29,7	30,9	..	..
Urban headcount index - extreme ¹	..	..	2,8	..	..
Rural headcount index	..	..	..	..	..
Inequality					
Lowest quintile (% of income or consumption) ²	..	..	5,1	..	..
Highest quintile (% of income or consumption) ²	..	..	49,0	..	..
Gini coefficient ²	..	..	43,3	..	..
Income					
GNI per capita (US\$)	2.860	2.870	3.820	3.280	5.440
Consumer price index (1995=100)	0	9	268	..	..
Food price index (1995=100)	0	11	208	..	..

	Latest single year			Same region/income group	
	1975-1980	1985-1990	1997-2003	Latin America & Carib.	Upper-middle-income
Social Indicators					
Public expenditure					
Health (% of GDP)	..	..	2,8	3,3	3,4
Education (% of GDP)	..	..	3,2	4,3	4,5
Net school enrollment rate ³					
(% of age group)					
Preschool (4 to 5)	..	58,6	79,4	..	..
Primary	..	94,8	94,7	94	93
Secondary (12 to 17)	..	68,6	75,5	65	69
Access to an improved water source					
(% of population)					
Total	..	..	98	86	..
Urban	..	93	98	94	..
Rural	..	..	93	65	77
Immunization rate					
(% of children ages 12-23 months) ⁴					
Measles	50	97	95	93	94
DPT	53	97	91	89	91
Life expectancy at birth					
(years)					
Total	70	73	75	71	74
Male	66	69	72	68	71
Female	73	76	79	74	77
Mortality					
Infant (per 1,000 live births) ⁵	38	21	15	28	18
Under 5 (per 1,000 live births)	42	24	14	33	22
Adult (15 - 59)					
Male (per 1,000 population)	176	178	185	222	196
Female (per 1,000 population)	91	90	89	125	103
Maternal (per 100,000 live births)	..	85	27	193	67
Births attended by skilled health staff (%)	..	..	100	..	..

Note: 0 or 0.0 means zero or less than half the unit shown.

1. INE

2. CEDLAS. Monitoring the Socio-Economic Conditions Reports (based on ECH 2003).

3. Different data sources: Uruguay, ANEP (1991 and 2002); LAC and Upper-middle

income, WDI.

4. Immunization: refers to children ages 12-23 months who received vaccinations before one year of age.

5. Different data sources: Uruguay, INE; LAC and Upper-middle income, WDI. 2005 World Development Indicators CD-ROM, World Bank

URUGUAY: KEY ECONOMIC INDICATORS

Indicator	Estimate				Projected					
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
National accounts (% of GDP)										
Gross domestic product	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Agriculture ^a	5,8	8,7	12,4	11,4	11,0	10,8	10,8	10,8	10,8	10,8
Industry ^a	25,0	25,2	25,9	28,5	28,6	28,6	28,6	28,6	28,6	28,6
Services ^a	69,2	66,1	61,7	60,0	60,4	60,6	60,6	60,6	60,6	60,6
Total consumption	87,9	86,5	85,9	85,0	84,3	83,7	80,7	79,1	78,3	77,9
Gross domestic investment	13,8	11,5	12,6	13,3	14,7	16,0	16,9	17,7	18,2	18,3
Gross domestic fixed investment	12,5	10,1	9,4	11,4	12,6	13,7	14,5	15,2	15,6	15,7
Government investment	3,2	2,5	2,2	2,0	2,8	3,3	3,7	3,9	3,9	3,9
Private investment	9,3	7,6	7,3	9,4	9,8	10,5	10,9	11,3	11,7	11,8
Change in inventories	1,3	1,4	3,2	1,9	2,1	2,3	2,4	2,5	2,6	2,6
Exports (GNFS) ^b	18,3	22,0	26,1	29,6	27,8	28,3	28,4	28,8	29,0	29,3
Imports (GNFS)	20,0	20,0	24,6	27,9	26,8	28,0	26,0	25,5	25,5	25,5
Gross domestic savings	12,1	13,5	14,1	15,0	15,7	16,3	19,3	20,9	21,7	22,1
Gross national savings ^c	10,0	12,5	9,6	10,8	13,3	14,4	17,7	19,3	20,0	20,0
Memorandum items										
Gross domestic product (US\$ bn, current prices)	18,6	12,3	11,2	13,2	15,8	16,7	17,4	18,0	18,5	19,1
Gross national product per capita (US\$, Atlas method)	5590	4350	3790	4283	4428	4841	5212	5341	5468	5599
Real annual growth rates (% , calculated at 1993 prices)										
Gross domestic product at market prices	-3,4	-11,0	2,2	12,3	6,0	4,0	3,5	3,0	3,0	3,0
Gross Domestic Income	-5,6	-8,0	-3,7	13,6	-0,4	7,7	4,7	3,2	2,1	0,9
Real annual per capita growth rates (% , calculated at 1993 prices)										
Gross domestic product at market prices	-4,0	-11,6	1,6	11,7	5,4	3,4	2,9	2,4	2,4	2,4
Total consumption	-2,7	-16,6	-1,5	9,2	6,3	4,5	1,1	1,2	1,3	1,8
Private consumption	-2,6	-17,7	-1,3	9,3	7,1	4,1	0,3	1,1	1,2	1,7

Indicator	Estimate				Projected					
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Balance of Payments (US\$m)										
Exports (GNFS) ^b	3262	2693	3084	4012	4382	4719	4958	5166	5370	5595
Merchandise FOB	2139	1922	2281	3025	3291	3528	3701	3846	3996	4152
Imports (GNFS) ^b	3722	2492	2734	3675	4224	4673	4889	5090	5243	5400
Merchandise FOB	2915	1874	2098	2990	3498	3918	4069	4203	4329	4459
Resource balance	-459	202	350	337	158	46	69	76	127	195
Net current transfers (including official current transfers)	30	72	82	89	105	109	110	110	111	111
Current account balance (after official capital grants)	-498	382	-58	-105	-126	-153	-108	-103	-88	-93
Net private foreign direct investment	314	121	260	312	561	1123	337	350	364	379
Long-term loans (net)	-78	-2030	66	108	-89	-266	-283	-208	-239	-250
Other capital (net, including errors and omissions)	539	-801	1113	255	-165	-796	68	30	-71	23
Change in reserves ^d	-278	2328	-1380	-570	-181	93	-14	-70	34	-58
Memorandum items										
Resource balance (% of GDP at current market prices)	-2,5	1,6	3,1	2,6	1,0	0,3	0,4	0,4	0,7	1,0
Annual growth rates										
Merchandise exports (FOB, US\$ bn.)	-10,2	-9,6	18,1	37,6	8,8	7,2	4,9	3,9	3,9	3,9
Primary	-11,5	-1,2	26,1	28,9	16,2	7,2	4,9	3,9	3,9	3,9
Manufactures	-8,5	-18,9	7,2	28,9	16,2	7,2	4,9	3,9	3,9	3,9
Merchandise imports (CIF, US\$ bn.)	-11,7	-35,8	11,5	36,5	17,0	12,0	3,9	3,3	3,0	3,0
Public finance (% of GDP)										
Current revenues	29,8	29,1	27,9	27,3	27,1	28,0	28,9	29,1	29,1	29,1
Current expenditures	33,2	33,3	31,9	29,7	29,0	28,3	28,4	28,4	28,2	28,1
Current account surplus (+) or deficit (-)	-3,4	-4,2	-4,0	-2,4	-1,9	-0,3	0,5	0,8	0,9	1,0
Capital expenditure	3,7	2,5	2,5	2,5	2,8	3,3	3,7	3,9	3,9	3,9
Foreign financing	3,2	3,1	7,8	1,2	-0,2	-1,3	-1,3	-0,9	-1,0	-1,1
Monetary indicators										
M2/GDP (at current market prices)	59,9	72,8	67,7	57,5	57,5	57,5	57,5	57,5	57,5	57,5
Growth of M2 (%)	19,0	28,2	12,5	2,1	11,3	9,2	8,2	6,6	6,6	6,6
Private sector credit growth / total credit growth (%)	1,0	0,4	2,4	1,0	1,0	1,0	1,0	1,0	1,0	1,0
Price indices(1993 =100)										
Merchandise export price index	113,0	108,4	114,9	120,6	120,6	120,6	120,6	120,6	120,6	120,6
Merchandise import price index	83,5	83,4	85,1	90,2	90,2	90,2	90,2	90,2	90,2	90,2
Merchandise terms of trade index	135,3	129,9	135,0	133,7	133,7	133,7	133,7	133,7	133,7	133,7
Real exchange rate (US\$/LCU) ^f	123,6	98,0	75,5	81,6	92,5	94,1	95,1	95,1	95,1	95,1
interest rate	10,0	32,0	9,0	6,0	4,0	3,0	3,0	3,0	3,0	3,0
Consumer price index (% growth rate)	4,4	14,0	19,4	9,2	5,0	5,0	4,5	3,5	3,5	3,5
GDP deflator (% growth rate)	5,3	18,7	18,4	9,2	5,0	5,0	4,5	3,5	3,5	3,5

a. GDP components are estimated at factor cost.

b. "GNFS" denotes "goods and nonfactor services."

c. Includes net unrequited transfers excluding official capital grants.

d. Includes use of IMF resources.

e. Should indicate the level of the government to which the data refer.

f. "LCU" denotes "local currency units." An increase in US\$/LCU denotes appreciation.

URUGUAY: KEY EXPOSURE INDICATORS

Indicator	Estimate				Projected						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total debt outstanding and disbursed (TDO) (US\$mn) ^a	8895	8937	10548	11012	11597	11373	11187	10846	10646	10645	10503
Net disbursements (US\$mn) ^a	634	42	1611	464	585	-224	-186	-341	-200	0	-142
Total debt service (TDS) (US\$mn) ^a	1313	1476	1275	1077	1362	1707	2218	2010	1535	1908	1754
Debt and debt service indicators (%)											
TDO/XGS ^b	243	274	392	357	289	260	237	219	206	198	188
TDO/GDP	44	48	86	98	88	72	67	62	59	58	55
TDS/XGS	36	45	47	35	34	39	47	41	30	36	31
Concessional/TDO		..	..	..	..	..	..	..	..	..	..
IBRD exposure indicators (%)^f											
IBRD DS/public DS	9,6	9,0	9,8	16,3	9,2	9,2	9,7	7,5	7,6	7,5	7,7
Preferred creditor DS/public DS (%) ^c	..	..	..	..	..	..	..	..	..	..	..
IBRD DS/XGS	2,7	3,4	3,9	3,5	2,6	3,5	4,5	3,4	2,6	2,5	2,7
IBRD TDO (US\$m) ^d	552	544	703	722	785	858	891	925	945	965	954
Of which present value of guarantees (US\$m)	..	..	..	..	..	..	..	..	..	..	..
Share of IBRD portfolio (%)	0,5	0,4	0,6	0,6	0,7	0,8	0,8	0,8	0,8	0,8	0,7
IDA TDO (US\$m) ^d	0	0	0	0	0	0	0	0	0	0	0
IFC (US\$m)	19	19	37	30	38	..	..	..	..	..	..
Loans	6	6	7	12	24	..	..	..	..	..	..
Equity and quasi-equity ^e	13	12	30	18	14	..	..	..	..	..	..
MIGA											
MIGA guarantees (US\$m)		20,5	..	..	..	..	..	..	..	..	..

a. Includes public and publicly guaranteed debt, external liabilities of the financial system, private nonguaranteed, use of IMF credits and net short-term capital. Excludes external liabilities of the financial system. Source: Central Bank of Uruguay and bank staff estimates.

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

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Excludes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

f. Specified on a calendar year basis.

URUGUAY OPERATION PORTFOLIO (IBRD/IDA AND GRANTS)

As of Date 03/01/2005

Closed Projects	45
IBRD/IDA *	
Total Disbursed (Active)	253,63
of which has been repaid	67,75
Total Disbursed (Closed)	1.698,02
of which has been repaid	1.226,47
Total Disbursed (Active + Closed)	1.951.651.824,24
of which has been repaid	1.294.224.429,26
Total Undisbursed (Active)	284,11
Total Undisbursed (Closed)	0,00
Total Undisbursed (Active + Closed)	284.110.164,21

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

As of Date 02/28/2005

Uruguay Statement of IFC's Held and Disbursed Portfolio

FY Approval	Company	Loan	Held			Loan	Disbursed		
			Equity	Quasi	Partic		Equity	Quasi	Partic
In US Dollars Millions									
1985/1992	Azucitrus	0,0	2,0	0,0	0,0	0,0	2,0	0,0	0,0
2002	Conaprole	18,8	0,0	10,0	0,0	18,8	0,0	10,0	0,0
1995	Consorcio Aerop.	0,6	0,0	2,2	0,0	0,6	0,0	2,2	0,0
2005	Surinvest	0,0	1,5	0,0	0,0	0,0	1,5	0,0	0,0
2001	UMontevideo	2,9	0,0	0,0	0,0	2,9	0,0	0,0	0,0
Total Portfolio		22,2	3,5	12,2	0,0	22,2	3,4	12,2	0,0

Active Projects

Project ID	Project Name	Last PSR Supervision Rating			Original Amount in US\$ Millions					Difference Between Expected and Actual Disbursements ^a	
		DO	IP	FY	IBRD	IDA	GRANT	Cancel	Undisb.	Orig.	FrmRev'd
P063383	UY APL OSE MOD&REHAB.	S	S	2000	27				15,6778	15,6778	6,0708065
P068124	UY Energy Efficiency Project	S	S	2004			6,875		6,875	0,20333	
P074543	UY Foot & Mouth Disease - ERL	S	S	2002	18,5				2,67121	-15,8288	-15,82877
P039203	UY Forest Prod.TSP	S	S	1997	76			5	15,6532	20,6532	
P008177	UY Power TRNMSN & DISTR	S	S	1996	125				39,2442	39,2442	
P070058	UY Public Services Modernization TA	S	S	2001	6				4,68547	3,65214	1,3188053
P078726	UY Public Services & Social Sectors SAL	S	S	2003	151,52				100	100	
P081495	UY Public Services & Social Sectors SSAL	S	S	2003	101,02				75	75	
P070937	UY- Basic Education 3	S	S	2002	42				31,1782	9,64487	
Overall Result					547,04	6,875	5	290,985	248,247	-8,439158	

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

DO: Development Objectives
IP: Implementation Progress
FY: Fiscal Year



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