PD-ABD-110
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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR (LAC)

FROM: LAC/DR, Irwin A. Levy Irwin Levy

SUBJECT: Uruguay FY 1987 ESF Economic Recovery Program PAAD Amendment, No. 528-0107

Action Required: Authorization of an $11,522,000 Amendment to the ESF Cash Transfer Program for Uruguay in FY 1987.

Background: The purpose of the proposed Program assistance is to provide balance of payments support to the Government of Uruguay (GOU) in order to assist in the implementation of its economic recovery program. The provision of a cash transfer will support the GOU's economic program which during 1987 will require between $62 million and $120 million of additional foreign exchange in order to achieve the GOU's target of four percent GDP growth.

The proposed assistance is being provided to comply with the Congressional earmark contained in the International Development and Security Assistance Act of 1986 which provides that Economic Support Funds be provided to Uruguay.

This assistance supplements the FY 1986 ESF program of $14.355 million which was divided into two components: (1) a $14.0 million cash transfer to support balance of payments requirements; and (2) a $355,000 grant to carry out an administration of justice initiative and technical assistance, studies and other support to the GOU's economic recovery program.

Discussion: The FY 1987 Cash Transfer Program, together with a IBRD Structural Adjustment Loan currently being negotiated by the GOU (of which $40 million would be disbursed in 1987), will substantially cover this year's projected balance-of-payments gap.

The 1986 ESF Program's only economic conditionality requirement was that the GOU covenant to maintain implementation of its economic stabilization and recovery program. In general, the GOU was able to satisfactorily manage its economic recovery program through appropriate economic policies including: (1) utilization of market-determined prices; (2) a unitary floating exchange rate; (3) market-determined interest rates; (4) encouragement of an export-oriented rather than an import substitution economic growth strategy; and (5) some reduction of effective tariff protection. Given the relatively small amount of Program Assistance to be provided by A.I.D. and the significant measures to which the GOU will be committed under the IBRD loan, the PAAD proposes that no specific A.I.D. performance conditionality be required. However, the GOU will covenant to continue to implement its economic recovery program.

In accordance with current A.I.D. statutory requirements, the amended agreement will require that the dollars be deposited in a separate account and will provide for tracking their use. In Uruguay, the Central Bank does not ration or otherwise control foreign exchange availabilities for private sector imports. The GOU has proposed in the letter of application that the ESF dollars be used for petroleum imports from Venezuela and Mexico made by a state-owned enterprise. The Program Agreement Amendment and/or Program Implementation Letters will limit procurement of petroleum imports to Code 935 eligible countries.

Programming of the FY 1987 GOU-owned local currency deposits made in conjunction with this amendment will be similar to the uses under the initial cash transfer. Major uses include: counterpart to IDB loans, support to private sector and non-governmental activities in micro-enterprise development, employment generation, and export promotion, and an A.I.D. trust fund. Local currency will also support a new GOU activity to rationalize agricultural production in southern Uruguay. Two issues related to the local currency program were discussed at the DAEC. These were: (1) a proposal in the PAAD to make available approximately $300,000 equivalent in local currency for program expenditures for the A.I.D. trust fund; (2) the possible need to increase A.I.D. monitoring of local currency funded activities.

The PAAD proposes that the percentage of local currency allocated to the A.I.D. trust fund be increased from 2.5 percent to 5 percent for this funding tranche. Most of the additional local currency in the trust fund resulting from this percentage increase would be used for program expenditures, generally in the form of small HB 13-type grants.

The proposed policy on uses of local currency requires that the regional Assistant Adiministrator approve the use of trust funds to support discrete new projects or activities. Your approval is being sought for a number of very small but important development activities which both the GOU and the U.S. Mission are very interested in supporting but for which the Mission believes that direct GOU support may be politically inadvisable and for which no alternative source of A.I.D. funding is available.

The activities proposed for financing through the trust fund are innovative in the Uruguayan context and would be expected to have considerable impact beyond that of the trust fund-financed activities through demonstration effects and mobilization of other resources. The activities to be financed, examples of which are detailed in the PAAD, include support for: (1) organization of a training center for labor leaders; (2) strengthening management training programs at the Catholic University; (3) family planning activities; and (4) expansion of the local base for the Partners of the Americas program. Total trust allocations for these activities would not exceed the equivalent of $300,000.

Because these activities will be very small and will be carried out by private Uruguayan entities, the management burden on the A.I.D. representative will not be excessive. Recipient institutions would normally be responsible for any procurement/contracting actions under these grants. Should it be necessary to use A.I.D. direct contracting procedures, the Regional Contracting Officer in Quito would execute the contract(s).

There was considerable concern expressed by participants at the DAEC meeting about the advisability of using the trust fund mechanism for local currency program expenditures because of uncertainty about the consequences should the funding source for such activities become widely known in Uruguay. However, the A.I.D. representative has clarified that these activities will be identified in the amendment to the Memorandum of Understanding on local currency and/or in the Amendment to the Trust Fund Agreement.

Oversight/monitoring of the local currency program was identified as a major concern by the DAEC, particularly if use of the A.I.D. trust fund for program expenditures is approved. In addition to the trust fund activities, a major portion of this burden would derive from the allocation of local currency resources by the GOU for a variety of small innovative employment generation and technology transfer activities

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carried out by non-governmental organizations and by private enterprises themselves. In order to address the monitoring/oversight concern the A.I.D. Representative has stated that it is his intention to hire a PSC on a full-time basis to monitor local currency activities. In addition, he will rely, where appropriate, on other U.S. Embassy staff, e.g., the labor attache and local staff in the economic/commercial office to assist in monitoring/oversight. The regional controller would continue his quarterly visits to review financial aspects of the local currency program. The A.I.D. Representative will also evaluate the utility of contracting a local accounting firm to assist in monitoring the local currency program.

The Cash Transfer Program Amendment is proposed as a grant. The rationale for this is the same upon which the A.I.D. Administrator approved the provision of the Cash Transfer as grant assistance in FY 1986. That is, because of the political nature of the assistance and the difficulties which the GOU would have in obtaining legislative approval to receive assistance on a loan basis.

The FY 1986 Cash Transfer Program Agreement was signed by the A.I.D. Administrator. The A.I.D. Representative in Uruguay does not have authority to sign program agreements or amendments. Therefore an ad hoc redelegation of authority to negotiate and execute the amendment to the Program Agreement is required.

Authorization of a $600,000 amendment to the on-going technical assistance grant is also recommended but the action memo and authorization amendment for this project will be processed separately.

Recommendation: (1) That you authorize a $11,522,000 ESF cash transfer program amendment by signing the attached PAAD facesheet;

(2) That you redelegate authority to the A.I.D. Representative in Uruguay to negotiate and execute amendments to the Program Agreement dated June 17, 1986, to the Memorandum of Understanding dated September 30, 1986, and to the Trust Account Agreement dated August 28, 1986 ~~provided that~~ GC/LAC has cleared said amendments;

JUL 9 1987

Approve: Malcolm Butler Date:

Disapprove: ______________________ Date: ______

and (3) That you approve the use of not more than the equivalent of $300,000 from the A.I.D. trust fund for new small projects and activities which have been agreed to in writing by the GOU.

Approve: ______________ Date: ______________

Disapprove: Malcolm Butler Date: JUL 9 1987

Clearance page



and (3) That you approve the use of not more than the equivalent of $300,000 from the A.I.D. trust fund for new small projects and activities which have been agreed to in writing by the GOU.

Approve: ______________ Date: ______

Disapprove: /s/ Malcolm Butler Date: JUL 9 1987

LAC/DR/SA:RJordan:1505P

Clearances:

ARA/ECP:DDiPaolo draft Date 7/1/87
PPC/EA:JHeriot draft Date 6/30
LAC/DP:ASchoepfer draft date 6/29
LAC/DP:WWheeler ______
GC/LAC:CBrown draft Date 6/30
ARA/SC:DBolton draft Date 7/1/87
LAC/SAM:KJohnson draft date 6/29
DAA/LAC:MButler ______

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CLASSIFICATION:

AID 1120-1

PAAD

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO: 528-K-602 528-0107

2. COUNTRY: Uruguay

3. CATEGORY: Cash Transfer

4. DATE: June 27, 1987

5. TO: AA/LAC, Dwight Ink

6. OYB CHANGE NO:

7. FROM: LAC/DR, Irwin Levy

8. OYB INCREASE: None

TO BE TAKEN FROM:

9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 11,522,000

10. APPROPRIATION: LES7-87-35528-KG31 (770-65-528-00-50-71

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

12. LOCAL CURRENCY ARRANGEMENT: ☒ INFORMAL ☐ FORMAL ☐ NONE

13. ESTIMATED DELIVERY PERIOD: N/A

14. TRANSACTION ELIGIBILITY DATE: June 17, 1986

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE

U.S. only:

Limited F.W.:

Free World:

Cash: 11,522,000

17. ESTIMATED SOURCE

U.S.:

Industrialized Countries:

Local:

Other:

18. SUMMARY DESCRIPTION

The purpose of this Program Assistance is to provide immediate balance of payments support to the Government of Uruguay (GOU) in order to assist in the implementation of its economic recovery program.

The $11,522,000 grant assistance is provided as an amendment to a $14,000,000 ESF Cash Transfer Program which was initially approved in FY 1986. The total approved program is now $25,522,000.

The dollars will be disbursed as a cash transfer into a separate U.S. bank account of the GOU which will use them to purchase petroleum and/or petroleum derivatives from A.I.D. Geographic Code 935 eligible countries and the U.S.

Upon disbursement of the assistance, the GOU will make available an equivalent amount of new pesos, calculated at the highest rate of exchange for any transaction which is not illegal. These funds will be used for mutually agreed upon development purposes consistent with the general criteria of the Foreign Assistance Act, especially Sections 103-106, and a portion will be used for OE local currency trust fund purposes.

| 19. CLEARANCES | DATE |
|---|---|
| LAC/SAM, KJOHNSON (draft) | 6/29/87 |
| LAC/DP, WWHEELER | |
| LAC/DR, ILEVY | 7-2-87 |
| GC/LAC, GDAVIDSON | 7-2-87 |
| ARA/ECP, DDIPAOLO (draft) | 7/1/87 |
| DAA/LAC, VBUTLER | |
| FM, CCHRISTENSEN | 7-2-87 |

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE

DATE: JUL 9 1987

TITLE: Assistant Administrator, LAC

CLASSIFICATION

URUGUAY ESF PAAD AMENDMENT
FY 1987 PROGRAM

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# URUGUAY
# ECONOMIC RECOVERY PROGRAM

(Program No. 528-0107)

## I. SUMMARY

In 1986 the freely elected civilian government made significant progress in implementing its economic recovery program while maintaining democratic institutions which had been restored in 1985 after 12 years of military government. To assist the Government of Uruguay's economic recovery efforts, $14,355,000 of Economic Support Funds were provided during 1986. Of this amount $14,000,000 was provided through a Cash Transfer Grant Agreement (528-0107). The remaining $355,000 was obligated as a grant project (528-0108) in order to support an administration of justice initiative and to finance U.S. technical assistance for public and private sector activities that represent a high priority for the Government of Uruguay (GOU).

To comply with the Congressional earmark contained in the International and Security Assistance Act of 1986 which provides that Economic Support Funds be provided to Uruguay, this PAAD Amendment recommends the approval of a $12,122,000 1987 ESF Program and authorization of an $11,522,000 amendment to the FY 1986 Cash Transfer Agreement. The provision of a Cash Transfer will support the GOU's economic program which during 1987 will require between $62 million and $120 million of additional foreign exchange in order to achieve the GOU's target of four percent GDP growth during 1987. Authorization of a $600,000 amendment to the on-going technical assistance grant is also recommended but the authorization amendment will be processed separately.

## II. ECONOMIC ANALYSIS

### A. Introduction.

The analysis reviews economic developments during 1986, projects macroeconomic accounts for 1987, and evaluates the adequacy of the GOU's policy framework to bring about sustained medium term recovery.

After several years of significant economic recovery resulting from the implementation of free market economic policies beginning in 1974, the Uruguayan economy entered a period of wrenching economic adjustment beginning in 1982. A number of factors contributed to this downturn, including weakening world demand for Uruguay's exports, rising debt service obligations, a serious deterioration in the public sector fiscal position, and finally, capital flight in anticipation of exchange rate adjustment as the peso became increasingly overvalued. In response, the government of the day abandoned the preannounced exchange rate and attempted to reduce the fiscal deficit which, including quasi-fiscal losses of the central bank, had reached 18.3 percent of GDP by 1982. The government succeeded in reducing the fiscal deficit to 9.5 percent of GDP in 1984 and 6.6 percent in 1985, despite persistent problems in the financial system associated with the effects of exchange rate depreciation and economic deterioration in general, both on the financial condition of firms which had borrowed extensively in dollars, and on their commercial bank lenders.

During the same period, the GOU succeeded in stabilizing the balance of payments. Despite a continuing deterioration in merchandise exports, the overall deterioration was reduced to financeable dimensions and preparatory work was begun for a multiyear rescheduling of maturing commercial bank debt. Nonetheless, the balance of payments situation remained fragile as of the end of 1985.

This analysis will not attempt a detailed investigation of the origins of the recent economic downturn, which was reviewed in considerable depth in the original PAAD, prepared in April 1986, and which has been subject to detailed analysis in recent publications both of the IMF and the World Bank.

## B. SUMMARY OF ECONOMIC DEVELOPMENTS DURING 1986.

During the course of 1986, Uruguay experienced extraordinary improvement in both its domestic and international accounts. This improvement was due in part to continuing effective management by the GOU but also to a series of unexpected favorable external developments. These included a major expansion of export opportunities to Brazil, sharp declines in the price of imported petroleum and in international interest rates, and to a major inflow of private capital.

1. Merchandise Export Trends. Most important among the favorable external "shocks" experienced by the Uruguayan economy during 1986 was a major expansion of export opportunities to Brazil. This resulted from a combination of a reduction of Brazilian trade barriers, to continuing strong expansion of the Brazilian economy, and to a drought in Brazil which substantially increased Brazilian demand for beef and other agricultural products. Total exports to Brazil increased by 130 percent and accounted for 24 percent of all Uruguayan exports.

TABLE 1

URUGUAY: MERCHANDISE EXPORTS

(VALUE IN MILLION US DOLLARS, VOLUME IN MT)

| | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | |
|---|---|---|---|---|---|---|---|---|---|
| TOTAL EXPORTS | 788 | 1059 | 1215 | 1023 | 1045 | 925 | 854 | 1047 | 22.60% |
| | | | | | | | | | |
| ANIMALS, MEAT & FISH | 169 | 264 | 362 | 290 | 365 | 229 | 204 | 298 | 46.23% |
| LIVE ANIMALS | 11 | 8 | 14 | 15 | 31 | 9 | 6 | 11 | 74.80% |
| BEEF | 95 | 155 | 230 | 170 | 223 | 130 | 104 | 150 | 44.37% |
| VOLUME | 73461 | 107889 | 173795 | 155474 | 212957 | 127384 | 117244 | | |
| UNIT PRICE | 1291 | 1441 | 1323 | 1096 | 1047 | 1018 | 886 | | |
| MUTTON & LAMB | 3 | 15 | 25 | 21 | 15 | 7 | | 23 | |
| FISH & SHELLFISH | 36 | 48 | 58 | 47 | 43 | 48 | 47 | 60 | 26.81% |
| DAIRY PRODUCTS | 12 | 18 | 26 | 18 | 35 | 19 | 47 | 48 | 2.13% |
| OTHER | 12 | 19 | 10 | 19 | 18 | 16 | | | |
| | | | | | | | | | |
| VEGETABLE PRODUCTS | 89 | 108 | 186 | 152 | 139 | 129 | 81 | 78 | -3.51% |
| RICE | 61 | 64 | 109 | 92 | 77 | 58 | 81 | 78 | -3.51% |
| VOLUME | 166854 | 141913 | 224062 | 245745 | 195964 | 151914 | | | |
| UNIT PRICE | 366 | 452 | 488 | 376 | 391 | 381 | | | |
| CITRUS | 10 | 10 | 9 | 6 | 11 | 12 | | | |
| OTHER | 18 | 33 | 67 | 54 | 52 | 59 | | | |
| | | | | | | | | | |
| FATS & OILS | 11 | 19 | 8 | 5 | 9 | 7 | | | |
| FOOD, BEV. & TOBACCO | 25 | 33 | 32 | 18 | 30 | 28 | | | |
| MINERAL PRODUCTS | 14 | 13 | 20 | 4 | 2 | 4 | | | |
| CHEMICAL PRODUCTS | 25 | 31 | 33 | 43 | 24 | 30 | | | |
| PLASTICS, RUBBER, ETC. | 20 | 21 | 26 | 19 | 12 | 10 | | | |
| LEATHER, HIDES, ETC. | 149 | 144 | 138 | 140 | 139 | 147 | 61 | 137 | 123.93% |
| HIDES & SKINS | 47 | 40 | 51 | 73 | 75 | 92 | 61 | 137 | 123.93% |
| LEATHER MANUFACTURES | 49 | 52 | 45 | 38 | 39 | 30 | | | |
| OTHER | 54 | 52 | 43 | 29 | 24 | 24 | | | |
| | | | | | | | | | |
| TEXTILE MAT. & PROD. | 178 | 307 | 331 | 293 | 267 | 282 | 262 | 307 | 17.21% |
| GREASY WOOL | 29 | 103 | 116 | 113 | 74 | 58 | 52 | 54 | 2.72% |
| VOLUME | 11239 | 34901 | 40042 | 40100 | 28378 | 21235 | 19668 | | |
| UNIT VALUE | 2618 | 2940 | 2892 | 2814 | 2615 | 2723 | 2667 | | |
| WASHED WOOL | 14 | 23 | 22 | 15 | 27 | 17 | 17 | 26 | 51.96% |
| VOLUME | 6643 | 9549 | 10723 | 8546 | 14697 | 9346 | 9831 | | |
| UNIT VALUE | 2042 | 2405 | 2038 | 1757 | 1865 | 1776 | 1725 | | |
| TOPS | 58 | 87 | 98 | 77 | 67 | 90 | 95 | 112 | 17.97% |
| BLOUSSE | 5 | 5 | 4 | 3 | 5 | 5 | | | |
| COMBED WOOL | 3 | 3 | 4 | 4 | 12 | 1 | 0 | 0 | |
| WOVEN WOOL | 15 | 19 | 20 | 19 | 19 | 21 | | | |
| CLOTHING & ACCESS. | 33 | 35 | 35 | 63 | 62 | 90 | 98 | 116 | 18.21% |
| OTHER | 21 | 32 | 31 | 0 | 0 | 0 | | | |
| SHOES & OTHER | 28 | 20 | 14 | 10 | 9 | 10 | | | |
| STONE, CERAMIC & GLASS | 18 | 22 | 16 | 12 | 8 | 9 | | | |
| METALS & MANUFACTURES | 12 | 14 | 9 | 8 | 6 | 8 | | | |
| MACHINERY & ELECT. | 17 | 20 | 13 | 7 | 5 | 7 | | | |
| TRANSPORT EQUIP. | 20 | 24 | 12 | 6 | 8 | 6 | | | |
| OTHER | 15 | 21 | 16 | 15 | 22 | 20 | 246 | 265 | 7.74% |

SOURCE: IBRD, COUNTRY ECONOMIC MEMORANDUM ON URUGUAY, AUGUST 12, 1986, TABLE 3.2

Although the 22.6 percent increase in exports recorded during the year was led by the increase in beef exports to Brazil, the country also experienced strong export growth with most of its principal trading partners and in virtually all product categories. Exports to Argentina grew by 48 percent; those to the European Common Market by 50 percent. Only exports to socialist countries declined in relation to their levels of 1985.

Among product categories, in addition to a 44 percent increase in beef exports, textiles other than wool increased by 64 percent, and leather products by 124 percent after an exceptionally bad year in 1985.

2. Other Balance of Payments Items. Developments during 1986 in the non-trade portions of the balance of payments are summarized in Table 2, together with corresponding items for 1984 and 1985. Overall, the balance on current account improved sharply during 1986 to a $50 million surplus, from a $135 million deficit in 1985. In addition to the strong improvement in merchandise exports discussed above, this resulted from a significant reduction in net factor service payments resulting from a decline in international interest rates. Overall, net factor service payments declined from $356 million in 1985 to $290 million in 1986. In addition, ther was a moderate improvement in non-factor services equal to about $40 million.

Developments in the capital account were dominated by the very sharp reversal in private capital movements (including errors and omissions) from a $94 million capital outflow in 1985 to a $63 million inflow in 1986 made up of $250 million net amortization payments on loans offset by $313 million in other private capital items and errors and omissions. The precise composition of the latter is not entirely clear but may represent a combination of the acquisition by Brazilian and Argentine residents of dollar-denominated accounts in the Uruguayan banking system and some repatriation of foreign held assets by Uruguayan residents in response to improved investment opportunities in Uruguay.

To the extent that the large 1986 inflow of private capital represents speculation by Argentine and Brazilian residents against the Cruzado and the Austral, these flows represent a potentially troublesome factor in Uruguayan planning. It is very likely that a large exchange rate adjustment on the part of either or both of these large neighboring countries would lead to a reversal of these flows. Indeed, an important cautionary note in projecting developments for 1987, below, is that the Uruguayan economy is extremely sensitive to economic and policy developments in its two large neighbors and that sudden shifts in policy in either country could drastically alter the prospects for Uruguay. Consequently, the large accumulation of net reserves during 1986, shown on Table 2, should be seen as an appropriate precautionary measure in the face of possible, and even likely, private outflows in the future.

TABLE 2
URUGUAY: BALANCE OF PAYMENTS
(MILLION US DOLLARS)

| | 1981 | | | 1982 | | | 1983 | | |
|---|---|---|---|---|---|---|---|---|---|
| | CREDIT | DEBIT | NET | CREDIT | DEBIT | NET | CREDIT | DEBIT | NET |
| CURRENT ACCOUNT | 1824.8 | 2294.9 | -470.1 | 1483.0 | 1909.1 | -426.1 | 1376.7 | 1565.8 | -189.1 |
| GOODS & SERVICES | 1812.3 | 2292.1 | -479.8 | 1469.6 | 1906.1 | -436.5 | 1362.6 | 1562.7 | -200.1 |
| MERCHANDISE FOB | 1215.4 | 1695.7 | -480.3 | 1022.9 | 1086.8 | -63.9 | 1045.1 | 788.3 | 256.8 |
| FREIGHT & INSURANCE | 11.2 | | 11.2 | 16.9 | | 16.9 | 11.3 | | 11.3 |
| TRAVEL | 283.0 | 203.0 | 80.0 | 106.0 | 304.0 | -198.0 | 89.7 | 259.1 | -169.4 |
| INVESTMENT INCOME | 145.8 | 219.6 | -73.8 | 147.2 | 334.8 | -187.6 | 62.5 | 350.3 | -287.8 |
| OTHER | 156.9 | 173.8 | -16.9 | 176.6 | 180.5 | -3.9 | 154.0 | 165.0 | -11.0 |
| TRANSFERS | 12.5 | 2.8 | 9.7 | 13.4 | 3.0 | 10.4 | 14.1 | 3.1 | 11.0 |
| CAPITAL ACCOUNT | 1106.7 | 635.6 | 471.1 | 1849.7 | 2223.1 | -373.4 | 1421.4 | 1252.5 | 168.9 |
| PUBLIC SECTOR LONG-TERM | 269.3 | 61.5 | 207.8 | 267.9 | 63.5 | 204.4 | 238.8 | 118.5 | 120.3 |
| FINANCIAL PUBLIC SECTOR | 16.3 | 2.1 | 14.2 | 270.5 | 2.4 | 268.1 | 689.1 | 4.8 | 684.3 |
| PUB. SECTOR SHORT-TERM | 81.4 | | 81.4 | 1071.7 | 471.6 | 600.1 | 490.9 | 858.0 | -367.1 |
| PRIVATE SECTOR | 739.7 | 572.0 | 167.7 | 239.6 | 1685.6 | -1446.0 | 2.6 | 271.2 | -268.6 |
| FINANCIAL | 485.0 | 384.2 | 100.8 | 225.9 | 212.2 | 13.7 | | 128.9 | -128.9 |
| OTHER | 254.7 | 187.8 | 66.9 | 13.7 | 1473.4 | -1459.7 | 2.6 | 142.3 | -139.7 |
| SDR ALLOCATION | 10.9 | | 10.9 | | | 0.0 | | | 0.0 |
| OVERALL BALANCE | | | 11.9 | | | -799.5 | | | -20.2 |
| VALUATION ADJUSTMENT | 13.1 | | 13.1 | 214.9 | | 214.9 | 102.2 | | 102.2 |
| CHANGE NET FOR. ASSETS | | | -25.0 | | | 584.6 | | | -82.0 |
| ASSETS | | | -26.4 | | | 343.9 | | | -76.6 |
| LIABILITIES | | | 1.4 | | | 240.7 | | | -5.4 |

SOURCE: IMF, RECENT ECONOMIC DEV., MAY 7. 1986, TABLE 62., AND MISSION ESTIMATES

TABLE 2 (CONT'D)
URUGUAY: BALANCE OF PAYMENTS
(MILLION US DOLLARS)

| | 1984 | | | 1985 | | | 1986 | | |
|---|---|---|---|---|---|---|---|---|---|
| | CREDIT | DEBIT | NET | CREDIT | DEBIT | NET | CREDIT | DEBIT | NET |
| CURRENT ACCOUNT | 1389.6 | 1514.0 | -124.4 | 1329.4 | 1464.0 | -134.6 | 1560.1 | 1510.0 | 50.1 |
| GOODS & SERVICES | 1376.6 | 1511.0 | -134.4 | 1314.2 | 1459.6 | -145.4 | 1544.1 | 1505.0 | 39.1 |
| MERCHANDISE FOB | 924.6 | 758.3 | 166.3 | 845.0 | 715.2 | 129.8 | 1047.0 | 839.0 | 208.0 |
| FREIGHT & INSURANCE | 14.8 | | 14.8 | 15.5 | | 15.5 | 18.1 | | 18.1 |
| TRAVEL | 210.0 | 153.9 | 56.1 | 235.2 | 162.1 | 73.1 | 249.0 | 175.0 | 74.0 |
| INVESTMENT INCOME | 87.2 | 448.8 | -361.6 | 72.3 | 428.3 | -356.0 | 65.0 | 355.0 | -290.0 |
| OTHER | 140.0 | 150.0 | -10.0 | 146.2 | 154.0 | -7.8 | 165.0 | 136.0 | 29.0 |
| TRANSFERS | 13.0 | 3.0 | 10.0 | 15.2 | 4.4 | 10.8 | 16.0 | 5.0 | 11.0 |
| CAPITAL ACCOUNT | 1143.9 | 1074.5 | 69.4 | 1141.5 | 1043.0 | 98.5 | 550.3 | 345.0 | 205.3 |
| PUBLIC SECTOR LONG-TERM | 174.4 | 149.6 | 24.8 | 167.6 | 78.3 | 89.3 | 237.3 | 95.0 | 142.3 |
| FINANCIAL PUBLIC SECTOR | 42.5 | 8.7 | 33.8 | 9.5 | 14.2 | -4.7 | | | 0.0 |
| PUB. SECTOR SHORT-TERM | 560.6 | 533.1 | 27.5 | 763.6 | 655.8 | 107.8 | | | 0.0 |
| PRIVATE SECTOR | 366.4 | 383.1 | -16.7 | 200.8 | 294.7 | -93.9 | 313.0 | 250.0 | 63.0 |
| FINANCIAL | 323.0 | 189.5 | 133.5 | 27.8 | 247.0 | -219.2 | | 250.0 | -250.0 |
| OTHER | 43.4 | 193.6 | -150.2 | 173.0 | 47.7 | 125.3 | 313.0 | | 313.0 |
| SDR ALLOCATION | | | 0.0 | | | 0.0 | | | 0.0 |
| OVERALL BALANCE | | | -55.0 | | | -36.1 | | | 255.4 |
| VALUATION ADJUSTMENT | 4.4 | | 4.4 | | 18.5 | -18.5 | | | -3.8 |
| CHANGE NET FOR. ASSETS | | | 50.6 | | | 54.6 | | | -251.6 |
| ASSETS | | | 78.8 | | | -50.4 | | | |
| LIABILITIES | | | -28.2 | | | 105.0 | | | |

SOURCE: IMF, RECENT ECONOMIC DEV., MAY 7. 1986, TABLE 62.

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TABLE 3
MERCHANDISE IMPORTS 1985-1986
(MILLION U.S. DOLLARS)

| | 1985 | 1986 | PERCEN GROWTH | PERCENT OF 1986 TOTAL |
|---|---|---|---|---|
| TOTAL IMPORTS CIF | 715.2 | 839.0 | 17.3% | 100.0% |
| NON-PETROLEUM IMPORT | 491.7 | 674.0 | 37.1% | 80.3% |
| PETROLEUM | 223.5 | 165.0 | -26.2% | 19.7% |
| OTHER MINERAL | 22.7 | 35.2 | 55.4% | 4.2% |
| FOOD, BEV., & TOBACC | 50.7 | 47.4 | -6.5% | 5.7% |
| CHEMICALS | 106.5 | 140.4 | 31.9% | 16.7% |
| RUBBER & PLASTICS | 49.0 | 63.9 | 30.4% | 7.6% |
| PAPER & CARDBOARD | 16.6 | 23.3 | 40.3% | 2.8% |
| TEXTILES | 32.1 | 37.5 | 16.7% | 4.5% |
| METAL PRODUCTS | 34.0 | 45.3 | 33.3% | 5.4% |
| ELECTRICAL PRODUCTS | 97.4 | 147.1 | 51.0% | 17.5% |
| TRANSPORT EQUIP. | 32.7 | 61.5 | 88.1% | 7.3% |
| MISCELLANEOUS | 49.9 | 72.3 | 44.9% | 8.6% |

SOURCE: IBRD, COUNTRY ECONOMIC MEMORANDUM, AUG. 12, 1986, TABLE 3.4 AND MISSION ESTIMATES AND RAMON P. DIAZ, MONTHLY ECONOMIC REPORT, JANUARY 1987. 1986 IMPORTS ARE ESTIMATED 1986 IMPORTS ARE ESTIMATED FROM DATA FOR FIRST 10 MONTHS.

3. Merchandise Imports. Total merchandise imports during 1986 are estimated in Table 3, based on apreliminary figures. Thus, these estimates are subject to some revision when final year end figures become available. Nonetheless, the underlying trend is very clear; despite the sharp drop in the value of petroleum imports and the resulting very strong recovery in the terms of trade, the total value of imports increased 17.3 percent. Although estimates of the unit value of imports are not yet available, it would appear that the volume of imports increased by approximately 30 percent.

Although it is difficult to break down the import data as reported by tariff classification into capital goods, consumer goods, and industrial inputs, it would appear that capital goods imports increased at a somewhat higher rate than other categories. Certainly, the categories of transportation equipment and electrical products increased by more than the average of all imports. The significance of this for future investment prospects will be discussed in a later section.

The overall increase in merchandise imports is somewhat surprising in light of the 6.3 percent increase in GDP reported by GOU officials based on preliminary data. Central Bank (BCU) officials attributed the very large increase in imports to restocking by businesses after several years of running down imports. Nonetheless, the very large increase in imports reported for 1986 is striking.

4. Trends in GDP. Largely as a result of the relaxation of the foreign exchange constraint and the monetary expansion associated with capital inflow, domestic demand expanded considerably during 1986. The sectoral composition of this output, based on preliminary estimates, are shown on Table 4. Agricultural output grew strongly throughout the year, based largely on the enormous expansion of beef and other agricultural exports to Brazil. Manufacturing output grew strongly based largely on the expansion of domestic demand. Electricity and other utilities also exhibited strong growth in response to the expansion of industrial output. In contrast, construction continued its pattern of decline, but with a leveling off in the second half of 1986, so that, for the year as a whole, construction declined by 1.4 percent. The increase in wholesale and retail trade mirrors the expansion of agricultural and particularly manufacturing output.

In contrast to the rather sketchy data currently available on the sectoral composition of GDP, little is yet known about its functional composition in 1986. Table 5 summarizes the functional distribution of output for the period 1981-85. The most striking development during that period was the steady decline in investment. Fixed capital formation declined from 17.1 percent of GDP in 1981 to 8.0 percent in 1985. Of this, the largest part of the decline was in private sector investment, which declined from 12.1 percent of GDP to 5.0 percent. While the substantial expansion of output which has occurred in

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TABLE 4

URUGUAY: GROSS DOMESTIC PRODUCT
(MILLION 1978 NEW PESOS)

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|
| GDP AT FACTOR COST | 30179 | 27345 | 25745 | 25119 | 25271 | 26866 |
| AGRUCULTURE, LIVESTOCK & FORESTRY | 3439 | 3200 | 3245 | 3025 | 3186 | 3294 |
| FISHING | 157 | 132 | 157 | 146 | 148 | 145 |
| MANUFACTURING | 6662 | 5536 | 5148 | 5292 | 5186 | 5814 |
| CONSTRUCTION | 1593 | 1545 | 1026 | 831 | 748 | 738 |
| COMMERCE | 5327 | 4185 | 3731 | 3530 | 3523 | 3925 |
| TRANSPORT & COMM. | 2025 | 1802 | 1717 | 1707 | 1687 | 1846 |
| UTILITIES | 430 | 435 | 444 | 443 | 455 | 488 |
| HOUSING | 1848 | 1859 | 1864 | 1877 | 1892 | 1943 |
| OTHER | 8698 | 8651 | 8413 | 8268 | 8446 | 8674 |

URUGUAY: GROSS DOMESTIC PRODUCT
(PERCENT CHANGE)

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|
| GDP AT FACTOR COST | 1.9% | -9.4% | -5.9% | -2.4% | 0.6% | 6.3% |
| AGRUCULTURE, LIVESTOCK & FORESTRY | 5.0% | -6.9% | 1.4% | -6.8% | 5.3% | 3.4% |
| FISHING | 18.1% | -15.9% | 18.9% | -7.0% | 1.4% | -2.0% |
| MANUFACTURING | -4.6% | -16.9% | -7.0% | 2.8% | -2.0% | 12.1% |
| CONSTRUCTION | 3.0% | -3.0% | -33.6% | -19.0% | -10.0% | -1.4% |
| COMMERCE | 2.8% | -21.4% | -10.8% | -5.4% | -0.2% | 11.4% |
| TRANSPORT & COMM. | -0.8% | -11.0% | -4.7% | -0.6% | -1.2% | 9.4% |
| UTILITIES | 5.4% | 1.2% | 2.1% | -0.2% | 2.7% | 7.3% |
| HOUSING | 1.0% | 0.6% | 0.3% | 0.7% | 0.8% | 2.7% |
| OTHER | 6.0% | -0.5% | -2.8% | -1.7% | 2.2% | 2.7% |

URUGUAY: GROSS DOMESTIC PRODUCT
(PERCENT OF TOTAL)

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|
| GDP AT FACTOR COST | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| AGRUCULTURE, LIVESTOCK & FORESTRY | 11.4% | 11.7% | 12.6% | 12.0% | 12.6% | 12.3% |
| FISHING | 0.5% | 0.5% | 0.6% | 0.6% | 0.6% | 0.5% |
| MANUFACTURING | 22.1% | 20.2% | 20.0% | 21.1% | 20.5% | 21.6% |
| CONSTRUCTION | 5.3% | 5.7% | 4.0% | 3.3% | 3.0% | 2.7% |
| COMMERCE | 17.7% | 15.3% | 14.5% | 14.1% | 13.9% | 14.6% |
| TRANSPORT & COMM. | 6.7% | 6.6% | 6.7% | 6.8% | 6.7% | 6.9% |
| UTILITIES | 1.4% | 1.6% | 1.7% | 1.8% | 1.8% | 1.8% |
| HOUSING | 6.1% | 6.8% | 7.2% | 7.5% | 7.5% | 7.2% |
| OTHER | 28.8% | 31.6% | 32.7% | 32.9% | 33.4% | 32.3% |

SOURCE: 1981-1985, IMF, RECENT ECONOMIC DEVELOPMENTS, MAY 7, 1986, TABLE 29; 1986, MISSION ESTIMATES

TABLE 5

NATIONAL ACCOUNTS

(MILLION 1978 PESOS)

| | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| CONSUMPTION | 31416 | 28709 | 26248 | 24888 | 25080 |
| GENERAL GOVERNMENT | 4562 | 4452 | 4322 | 4332 | 4316 |
| PRIVATE | 26854 | 24257 | 21926 | 20556 | 20764 |
| GROSS DOMESTIC INVEST. | 5888 | 4815 | 3052 | 2791 | 2504 |
| FIXED CAPITAL FORMATION | 6067 | 5165 | 3471 | 2690 | 2377 |
| PUBLIC SECTOR | 1780 | 2485 | 1266 | 886 | 857 |
| PRIVATE SECTOR | 4287 | 2680 | 2205 | 1804 | 1520 |
| CHANGE IN INVENTORIES | -179 | -350 | -419 | 101 | 127 |
| EXPORTS OF GOODS & NFS | 6483 | 5801 | 6697 | 6741 | 7086 |
| IMPORTS OF GOODS & NFS | -8318 | -7187 | -5740 | -4888 | -4932 |
| GDP AT MARKET PRICES | 35469 | 32138 | 30257 | 29532 | 29738 |

NATIONAL ACCOUNTS

(PERCENT CHANGE)

| | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| CONSUMPTION | 3.1% | -8.6% | -8.6% | -5.2% | 0.8% |
| GENERAL GOVERNMENT | 7.5% | -2.4% | -2.9% | 0.2% | -0.4% |
| PRIVATE | 2.4% | -9.7% | -9.6% | -6.2% | 1.0% |
| GROSS DOMESTIC INVEST. | -8.9% | -18.2% | -36.6% | -8.6% | -10.3% |
| FIXED CAPITAL FORMATION | -3.0% | -14.9% | -32.8% | -22.5% | -11.6% |
| PUBLIC SECTOR | N.A. | 39.6% | -49.1% | -30.0% | -3.3% |
| PRIVATE SECTOR | N.A. | -37.5% | -17.7% | -18.2% | -15.7% |
| CHANGE IN INVENTORIES | -186.9% | 95.5% | 19.7% | -124.1% | 25.7% |
| EXPORTS OF GOODS & NFS | 6.2% | -10.5% | 15.4% | 0.7% | 5.1% |
| IMPORTS OF GOODS & NFS | 1.0% | -13.6% | -20.1% | -14.8% | 0.9% |
| GDP AT MARKET PRICES | 1.9% | -9.4% | -5.9% | -2.4% | 0.7% |

NATIONAL ACCOUNTS

(PERCENT OF GDP)

| | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| CONSUMPTION | 88.6% | 89.3% | 86.8% | 84.3% | 84.3% |
| GENERAL GOVERNMENT | 12.9% | 13.9% | 14.3% | 14.7% | 14.5% |
| PRIVATE | 75.7% | 75.5% | 72.5% | 69.6% | 69.8% |
| GROSS DOMESTIC INVEST. | 16.6% | 15.0% | 10.1% | 9.5% | 8.4% |
| FIXED CAPITAL FORMATION | 17.1% | 16.1% | 11.5% | 9.1% | 8.0% |
| PUBLIC SECTOR | 5.0% | 7.7% | 4.2% | 3.0% | 2.9% |
| PRIVATE SECTOR | 12.1% | 8.3% | 7.3% | 6.1% | 5.1% |
| CHANGE IN INVENTORIES | -0.5% | -1.1% | -1.4% | 0.3% | 0.4% |
| EXPORTS OF GOODS & NFS | 18.3% | 18.1% | 22.1% | 22.8% | 23.8% |
| IMPORTS OF GOODS & NFS | -23.5% | -22.4% | -19.0% | -16.6% | -16.6% |

SOURCE: IBRD, COUNTRY ECONOMIC MEMORANDUM ON URUGUAY, AUG. 12, 1986, TABLE 2.4

1986 was made possible by the existence of significant excess capacity, the achievement of anything like the GOU's four percent growth objective for the medium term will require increases in investment well in excess of those experienced in recent years.

Whether investment will be available to fill this requirement is still an open question. On the public sector side, based on data from the fiscal accounts, investment did increase during 1986. On the private sector side, the evidence is mixed. As indicated previously, imports of capital goods increased substantially, perhaps by a greater percentage than the 30 percent overall increase in real imports. On the other hand, the continuing decline in construction activity suggests that, if businessmen have increased their planned investments, those plans are not well advanced. Anecdotal evidence is mixed. The best that one can say at this time is that there is some evidence that the long decline in private sector investment has leveled off and that some increase may be in prospect.

Despite the substantial increase in domestic demand, a major obstacle to increases in private sector investment lies in the poor financial condition of many private sector firms. A substantial (and steadily increasing) portion of banking system deposits in Uruguay are denominated in dollars. Consequently, most business loans are denominated in dollars as well. This situation obviously poses some risk for firms oriented toward production for the domestic market. Many firms have yet to recover from the major capital losses inflicted on them by the major devaluation of the peso in 1982. As a result, many private sector firms whose business prospects are reasonably good, are not in a position to undertake debt financed new investment. Indeed, there is a good deal of anecdotal evidence that this, rather than a lack of loanable funds or lack of business opportunities, is the major obstacle to expanded private sector investment in Uruguay. The IBRD has long planned a major loan to provide long-term refinancing of such private sector loans. However, the negotiations for that loan have proceeded slowly.

5. Inflation. The GOU was less successful in 1986 in its attempts to reduce the rate of inflation. On a December-to-December basis, inflation declined only to 73 percent from 83.0 percent in 1985. This limited success against inflation was an unavoidable result of the authorities' attempt to deal with the very large, and probably temporary, inflow of private capital. To prevent an appreciation of the peso, with all its consequences for the dollarized financial system, the authorities purchased large volumes of dollars, significantly increasing the money supply. In addition, the large increase in export volumes led, in certain instances to supply bottlenecks for the domestic market.

6. Fiscal Situation. At this point, detailed estimates for 1986 are available only for the Central Government. These results are shown on Table 6. Largely as a result of the substantial increase in economic activity, Central Government revenues from taxes on domestic activity increased from 12.4 percent of GDP in 1985 to 13.0 percent in 1986. Similarly, the large increase in non-oil imports contributed to an increase in taxes on foreign trade from 2.1 percent of GDP to 2.9 percent.

On the expenditure side, the GOU succeeded in maintaining expenditure discipline. Central government wage and social security payments declined by 1.1 percent of GDP. Purchases of goods and services, on the other hand, increased by 0.7 percent of GDP. Transfer payments continued their long-term decline, while government interest payments declined as a result of reductions in world interest rates on dollar loans, since both foreign and domestic GOU debt is dollar-denominated. As a result of all these factors, the deficit of the central government was reduced from 2.9 percent of GDP to 1.5 percent.

Although detailed results of the rest of the public sector are not yet available, they appear to be essentially unchanged, with the deficit of the rest of the public sector apparently having increased from 0.1 percent in 1985 to 0.2 percent in 1986.

A major disappointment in the fiscal accounts has been the inability of the GOU to reduce the quasi-fiscal losses of the Central Bank. At the present time, these losses represent largely the results of the controversial portfolio purchase arrangement undertaken in 1984 in which the GOU attempted to preserve the solvency of the financial system by purchasing portions of each bank's problem loans in return for a purchase by the banks of government bonds equal in value to approximately three times the amount of loans purchased. Despite repeated promises that the Central Bank would increase its efforts to collect on these problem loans or begin liquidation procedures, little progress has been made. At the moment, the entire matter is tied up in the broader question of the terms under which firms will be able to obtain long-term refinancing of outstanding loans. As a result, the quasi-fiscal losses of the Central Bank only declined from 3.4 percent of GDP in 1985 to 3.2 percent in 1986.

Overall, the GOU has succeeded in reducing the fiscal deficit only from 6.4 percent to 4.9 percent of GDP. Indeed, as shown on Table 7, the domestic financing of the deficit actually increased slightly, by 0.1 percent of GDP. In the Uruguayan context, because of the substantial degree of dollarization of the financial system, a deficit equal to approximately 5 percent of GDP is unacceptably large. The large proportion of financial assets held in dollars results in a very small peso monetary base in relation to the size of the economy. As a result, even relatively small expansions of the peso money supply can produce significant inflationary pressures. As a result, the GOU

TABLE 6

URUGUAY: CENTRAL GOVERNMENT OPERATIONS

(PERCENT OF GDP)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|---|
| TOTAL REVENUES | 16.2% | 17.4% | 15.2% | 15.9% | 14.0% | 15.0% | 15.5% |
| DOMESTIC TAXES | 13.4% | 14.0% | 12.6% | 11.9% | 11.2% | 12.4% | 13.0% |
| TAXES ON GOODS & SERV. | 10.1% | 11.1% | 10.0% | 9.1% | 9.5% | 10.4% | |
| OF WHICH VAT | 6.2% | 7.0% | 6.2% | 5.3% | 5.5% | 5.9% | |
| INCOME TAXES | 2.6% | 2.0% | 1.6% | 1.7% | 1.0% | 1.2% | |
| TAXES ON PROPERTY | 0.8% | 0.9% | 1.0% | 1.1% | 0.7% | 0.9% | |
| OTHER DOMESTIC TAXES | 0.1% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | |
| TAXES ON FOREIGN TRADE | 3.0% | 2.9% | 2.2% | 2.6% | 2.1% | 2.1% | 2.9% |
| ADJUSTMENTS | -1.6% | -1.7% | -2.0% | -1.9% | -1.4% | -1.0% | -1.2% |
| NON-TAX REVENUE | 1.3% | 2.2% | 2.4% | 3.3% | 2.1% | 1.4% | 0.8% |
| TOTAL EXPENDITURES | 16.1% | 17.4% | 23.8% | 19.9% | 19.2% | 17.8% | 17.0% |
| CURRENT EXPENDITURES | 14.2% | 15.5% | 21.4% | 17.9% | 17.5% | 16.3% | 15.4% |
| GOODS & SERVICES | 12.9% | 14.2% | 19.2% | 15.2% | 13.3% | 12.7% | 12.3% |
| WAGES | 5.7% | 6.3% | 7.4% | 6.0% | 5.1% | 5.3% | 4.8% |
| SOCIAL SECURITY | 4.6% | 5.4% | 9.4% | 7.3% | 5.8% | 5.2% | 4.6% |
| OTHER | 2.7% | 2.5% | 2.4% | 1.9% | 2.4% | 2.2% | 2.9% |
| TRANSFERS | 0.9% | 0.7% | 1.2% | 1.2% | 2.3% | 1.5% | 1.1% |
| INTEREST PAYMENTS | 0.4% | 0.4% | 0.9% | 1.5% | 1.8% | 2.1% | 1.9% |
| EARMARKED REVENUES | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | .0% |
| CURRENT SURPLUS/DEFICIT | 2.0% | 1.9% | -6.2% | -2.0% | -3.5% | -1.3% | 0.1% |
| CAPITAL EXPENDITURES | 2.0% | 1.9% | 2.5% | 1.9% | 1.7% | 1.5% | 1.6% |
| SURPLUS/DEFICIT | 0.1% | -0.1% | -8.6% | -3.9% | -5.2% | -2.9% | -1.5% |
| TOTAL FINANCING | -0.1% | 0.1% | 8.6% | 3.9% | 5.2% | 2.9% | 1.5% |
| FOREIGN LOANS | -0.1% | 0.7% | 0.3% | 0.1% | 0.9% | -0.4% | |
| MONETARY AUTHORITIES | -0.2% | 0.3% | 6.9% | 3.1% | 2.6% | 0.3% | |
| OTHER | 0.2% | -1.0% | 1.5% | 0.7% | 1.7% | 3.0% | |

TABLE 7
PUBLIC SECTOR DEFICIT AND ITS FINANCING
(PERCENT OF GDP)

| | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|
| DEFICIT OF NON-FINANCIAL PUBLIC SECTOR | 10.1 | 4.4 | 4.8 | 3.0 | 1.7 |
| QUASI-FISCAL LOSSES OF CENTRAL BANK | 8.3 | 8.5 | 4.7 | 3.4 | 3.2 |
| AGGREGATE PUBLIC SECTOR DEFICIT | 18.4 | 12.9 | 9.5 | 6.4 | 4.9 |
| FINANCING | 18.4 | 12.9 | 9.5 | 6.4 | 4.9 |
| INCREASE IN DOMESTIC CURRENCY AND BANK RES. | 1.2 | 1.3 | 1.2 | 2.8 | 3.1 |
| LOSS OF NET INT'L RES. | 8.0 | 0.4 | 0.9 | 1.3 | -2.0 |
| OTHER DOMESTIC DEBT | -10.6 | 1.7 | 0.3 | 0.5 | 0.3 |
| FOREIGN DEBT | 19.8 | 9.5 | 7.1 | 1.8 | 3.5 |

SOURCE: RAMON DIAZ, MONTHLY ECONOMIC REPORT, NOV. 24, 1986 continues to face difficult problems of monetary management if it is to avoid inflationary pressures on the one hand or private sector credit compression on the other.

C. BALANCE OF PAYMENTS PROJECTIONS FOR 1987

1. Exports. The outlook for exports during 1987 is subject to a more than usual degree of uncertainty. The export boom of 1986 was led by the extraordinary increase in demand from Brazil. However, the relaxation of trade restrictions by Brazil was carried out on a case-by-case basis and there are indications that, by year end, Brazil's import policy toward Uruguay was becoming significantly less liberal. Similar y, the recent sharp depreciation of the austral makes it unlikely that exports to Argentina will maintain anything like their recent pace. Indeed, in the tourism account (in which receipts are heavily concentrated in the first two months of the year), receipts for 1987 are already down sharply because of the relative lack of competitiveness of Uruguayan destinations. A similar effect in the trade account is likely. Finally, there are likely to be some capacity constraints, particularly in the beef sector, to any significant expansion of output in 1987. All these factors suggest, at best, a modest expansion of exports in 1987. A very tentative destination-by-destination projection for 1987, together with 1986 and 1985 figures, is shown on Table 8.

Several GOU officials have publicly predicted a figure of 5 percent for the nominal increase in exports for 1987. However, this projections seems to be based on a feeling that any export growth in 1987 will be modest, rather than on a detailed product-by-product and destination-by-destination analysis. Given the uncertainty about access to the Brazilian market, such caution appears warranted.

2. Other BOP Items. The non-trade items of the balance of payments accounts for 1987 are projected on Table 9. Two alternative import requirements are shown as alternative 1 and alternative 2. These will be explained in the following section. In the service account, freight and insurance are projected as a proportion of exports in line with the pattern of recent years. In the travel account, earnings are projected to drop sharply in line with the reduction already apparent in hotel bookings during the 1987 summer season. In contrast, travel payments are projected to rise sharply, reflecting the recent sharp rise in disposable income and the relative decline in competitiveness vis-a-vis Argentina and, to some extent, Brazil. Factor services are projected to remain essentially unchanged, reflecting no change in international interest rates in 1987 compared with their average for 1986, and reflecting essentially no increase in external debt during 1986. "Other" services are essentially extrapolated from the trend of recent years. Similarly, transfers are essentially extrapolated from the trend of recent years.

TABLE 8

EXPORT PROJECTIONS FOR 1987 BY DESTINATION

| | (MILLION US DOLLARS) 1985 | 1986 | 1987 | EXPORT GROWTH 1987 |
|---|---|---|---|---|
| TOTAL | 853.6 | 1056.0 | 1112.5 | 5.4% |
| WESTERN HEMISPHERE | 374.9 | 573.5 | 595.5 | 3.8% |
| BRAZIL | 143.4 | 320.9 | 330.5 | 3.0% |
| ARGENTINA | 63.1 | 79.6 | 82.0 | 3.0% |
| OTHER LAFTA | 31.3 | 33.1 | 36.1 | 8.9% |
| US | 125.6 | 127.9 | 134.1 | 4.9% |
| OTHER | 11.5 | 12.0 | 12.9 | 7.5% |
| WESTERN EUROPE | 201.2 | 259.2 | 329.6 | 27.2% |
| EASTERN EUROPE | 69.3 | 45.2 | 30.4 | -32.8% |
| OTHER | 208.2 | 178.2 | 157.0 | -11.9% |

SOURCE: RAMON DIAZ, MONTHLY ECONOMIC REPORT, NOVEMBER 24, 1986, TABLE 9 AND MISSION ESTIMATES

TABLE 9
URUGUAY: BALANCE OF PAYMENTS
(MILLION US DOLLARS)

| | 1987 ALTERNATIVE 1 | | | 1987 ALTERNATIVE 2 | | |
|---|---|---|---|---|---|---|
| | CREDIT | DEBIT | NET | CREDIT | DEBIT | NET |
| CURRENT ACCOUNT | 1570.9 | 1578.4 | -7.5 | 1570.9 | 1636.7 | -65.8 |
| GOODS & SERVICES | 1555.9 | 1575.4 | -19.5 | 1555.9 | 1633.7 | -77.8 |
| MERCHANDISE | 1120.7 | 835.4 | 285.3 | 1120.7 | 893.7 | 227.0 |
| FREIGHT & INSURANCE | 20.2 | | 20.2 | 20.2 | | 20.2 |
| TRAVEL | 210.0 | 205.0 | 5.0 | 210.0 | 205.0 | 5.0 |
| INVESTMENT INCOME | 65.0 | 365.0 | -300.0 | 65.0 | 365.0 | -300.0 |
| OTHER | 140.0 | 170.0 | -30.0 | 140.0 | 170.0 | -30.0 |
| TRANSFERS | 15.0 | 3.0 | 12.0 | 15.0 | 3.0 | 12.0 |
| CAPITAL ACCOUNT | 241.0 | 295.0 | -54.0 | 241.0 | 295.0 | -54.0 |
| PUBLIC SECTOR LONG-TERM | 241.0 | 95.0 | 146.0 | 241.0 | 95.0 | 146.0 |
| FINANCIAL PUBLIC SECTOR | | | 0.0 | | | 0.0 |
| PUB. SECTOR SHORT-TERM | | | 0.0 | | | 0.0 |
| PRIVATE SECTOR | 0.0 | 200.0 | -200.0 | 0.0 | 200.0 | -200.0 |
| SDR ALLOCATION | | | 0.0 | | | 0.0 |
| OVERALL BALANCE | | | -61.5 | | | -119.8 |
| | | | -61.5 | | | -119.8 |

In the capital account, public sector capital flows are projected based on the World Bank's recent report. They assume a consummation of the commercial bank rescheduling and other arrangements and the signing of the Bank's own private sector refinancing loan. Private sector capital flows are obviously subject to a more than usual degree of uncertainty. The $250 million inflow recorded in 1986 in part probably represents more or less permanent placements of funds in Uruguay and in part, speculations against their own currencies on the part of Argentine and Brazilian residents. The assumption made on Table 9 is that the bulk of the 1986 inflows represent speculative movements which will be reversed in 1987. Thus a net private outflow of $200 million has been assumed for 1987.

3. Imports Required to Sustain 4 Percent Growth. The key item needed to estimate the unfinanced balance of payments gap for 1987 is the import requirement needed to sustain the GOU's target level of growth. This figure is not a projection of the actual level of imports for the year by an estimate of the level would be required if the target growth level is to be achieved. The GOU growth target for 1987, stated in several recently published interviews by the Minister of Finance, is 4 percent. This is slightly less than the growth actually achieved during 1986 but well above performance in recent years.

Two separate estimates of the relationship between the import requirement and growth are available. The first is implicit in the World Bank's multiyear projections reported in its August 12, 1986 report. The assumption there, the basis of which is not entirely clear, is that the import requirement has an elasticity of 2. That is, the achievement of a growth rate of x requires an increase in real imports of 2x. This figure is essentially the one used in the preparation of the 1986 PAAD.

To shed more light on this question, the mission carried out a statistical analysis, using a series of regressions of real imports on growth and the real exchange rate, based on data for the period 1970-1984. (Since the equation fitted was in log form, the coefficients can be interpreted as elasticities.) The results are summarized on Table 10.

TABLE 10
ELASTICITIES OF IMPORTS WITH RESPECT TO GROWTH AND EXCHANGE RATE
(BASED ON 1970-1984 DATA--NUMBERS IN PARENTHESIS ARE T-STATISTICS)

| EQUATION | REAL EXCHANGE RATE | REAL GDP | R-SQUARE | D.F. |
|---|---|---|---|---|
| (1) TOTAL IMPORTS | -.08 (2.46) | 4.24 (8.48) | .90 | 12 |
| (2) IMPORTED RAW MATERIALS AND SEMI-FINISHED PROD. | -.08 (1.55) | 3.22 (4.25) | .68 | 12 |
| (3) IMPORTED CAPITAL GOODS | -.29 (4.76) | 6.51 (7.12) | .81 | 12 |
| (4) IMPORTED FOOD | -.20 (3.17) | 4.60 (4.84) | .67 | 12 |
| (5) IMPORTED CONSUMER GOODS | -.32 (2.47) | 6.81 (3.47) | .50 | 12 |

Source: Mission Estimates

In general, the results presented on Table 10 are statistically rather good. The equations are well behaved; all estimators have predicted signs; most are significant at a 95 percent confidence level. There are problems of serial correlation of residuals in the case of the consumer goods and the imported inputs equations. However, the Durbin-Watson statistic is above the lower critical level for the remainder of the equations.

While the implied import demand elasticities reported on Table 10 are surprisingly large, the equations are consistent. Therefore, in estimating imports required to achieve 4 percent growth on Table 9, an elasticity of 4 is assumed for alternative 2. Alternative 1 is based on the World Bank's assumed elasticity of 2. In both cases, an increase of three percent in the unit value of inputs is projected.

4. Estimated Financing Gap. As shown on Table 9, the balance of payments gap implied by projected levels of the various balance of payments items is $61.5 million under alternative 1 and $119.8 million under alternative 2.

5. Possible Financing and Consequences if not Financed. Under the assumptions about private capital outflow discussed above, and assuming that the Uruguayan authorities do not permit any loss of reserves, the gap will be closed by a decline in imports. In the absence of additional financing, and

assuming an increase in the unit value of imports of three percent, this decline represents an 8 percent decline in real imports. Under the assumptions of alternative 1, this would imply a decline in real GDP of about 4 percent. Under the assumptions of alternative 2, the decline would be about 2 percent.

The provision of $12 million of ESF funding would permit a small reduction in the import and output decline based on these assumptions. The ESF funding would reduce the proportionate decline in imports to about 7 percent which, under the assumptions discussed above, would reduce the decline in real output to about 3.5 percent under alternative 1 and to about 1.75 percent under alternative 2.

Obviously all these estimates must be viewed with a great deal of caution. One particular point of caution is that the very large increase in imports in 1986 may represent a considerable degree of inventory restocking. To this extent, the required increase in imports for 1987 would be reduced and the reduction in output from the target level would be less. In addition, the assumption that the authorities would permit no reduction in reserves in response to a large capital outflow after accumulating $400 million in reserves in response to a large private capital inflow, is somewhat arbitrary. Finally, it must be emphasized that the direction, much less the magnitude, of these private capital flows is extremely uncertain and subject to a variety of events, most beyond the control of the Uruguayan authorities.

## D. ADEQUACY OF GOU POLICY FOR MEDIUM-TERM GROWTH

In general, it must be said that the economic policies of the GOU are in accordance with those generally recommended by economists to maximize growth. The exchange rate is market determined and exporters are not required to surrender exchange earnings. Interest rates, both on loans and deposits are also market determined and peso interest rates appear to be in line with reasonable projections of future rates of inflation. Two particular areas of concern are whether rates of domestic investment are sufficient to assure an adequate expansion of aggregate supply and, in a closely related question, whether the domestic public sector borrowing requirement is such as to unreasonably constrain the expansion of private sector credit.

1. Investment Levels. While the relationship between growth and investment is by no means as close and automatic as was once thought, there is no question that sustained medium term growth requires an adequate level of domestic investment. The recent historical trend of investment as a share of GDP is shown on Table 11. While it is difficult to find any reliable year-to-year trend, it is clear that periods of rapid growth in the Uruguayan economy (in the range of 5 to 6 percent per year) have been associated with levels of gross domestic investment in the range of 16 to 18 percent of GDP,

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while periods of little or no growth have been associated with levels of gross investment of 9 to 10 percent of GDP or less. In this connection, it is striking that gross investment in 1985, at 8.4 percent of GDP, was the lowest of any year since 1970. It is clear that sustained growth at anything like the 5 percent of 1986 or the 4 percent GOU target for 1987 will require something like a doubling of gross investment from its 1985 levels.

The reason for the very low levels of investment of 1984 and 1985 are not entirely clear. The most common factor cited by both officials and private businessmen is the problem of the debt overhang facing most private businesses as a result of the 1982 devaluation. The refinancing of this debt at long maturities, assisted by an IBRD loan, probably represents the most urgent development problem facing the GOU.

2. Credit Availability and Adequacy of Fiscal Effort. The ultimate test of the adequacy of fiscal and resource mobilization policies is the size and rate of growth of credit available for the private sector. Recent trends in aggregate banking system accounts are summarized on Table 12. Data there are expressed as a percentage of GDP and in terms of constant 1978 pesos (note that since banking system aggregates are measured at year end, GDP is measured as the average of current year and following year nominal GDP).

One particular note of caution at the outset is that the accounts of the banking system do not, in practice, distinguish between deposits by domestic residents and domestic by private foreigners. Thus a large portion of the "liabilities to the private sector" are, in fact, liabilities to foreigners. This fact accounts for the very high level of total banking system liabilities as a proportion of GDP.

This factor of Uruguay's role as a regional banking center has two consequences for the rest of the domestic economy, one positive and one negative. On the positive side, a substantial volume of real financial resources are potentially available to support an expansion of credit to the private sector. On the negative side, the banking system is subject to a considerable degree of instability due to events and policy decisions on the part of its two neighboring sta es over which it has no control.

On final preliminary point to be emphasized is that the predominance of foreign currency deposits means that the bulk of system lending is also denominated in dollars. As a result, the system is extremely sensitive to change in the real exchange rate such as occurred in late 1982.

In general terms, the volume of banking system credit to the private sector appears adequate. The volume of such credit increased sharply in 1982, from 40.2 percent of GDP to 60.0 percent. This, of course, represents the effects

TABLE 11

GROSS DOMESTIC PRODUCT BY EXPENDITURE

(PERCENT OF GDP)

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 |
|---|---|---|---|---|---|---|---|---|
| GROSS DOMESTIC PRODUCT AT MARKET PRICES | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% |
| CONSUMPTION | 95.24% | 96.21% | 96.76% | 99.96% | 96.29% | 93.42% | 88.92% | 87.20% |
| PRIVATE | 79.86% | 81.68% | 83.81% | 87.50% | 83.33% | 81.48% | 76.57% | 75.41% |
| PUBLIC | 15.38% | 14.53% | 12.95% | 12.46% | 12.96% | 11.94% | 12.34% | 11.79% |
| GROSS DOMESTIC INVEST. | 11.63% | 13.10% | 11.36% | 9.07% | 9.13% | 10.95% | 12.73% | 14.75% |
| FIXED INVESTMENT | 11.63% | 12.36% | 10.45% | 7.90% | 8.48% | 11.25% | 13.88% | 14.71% |
| CHANGE IN STOCKS | 0.00% | 0.74% | 0.92% | 1.17% | 0.65% | -0.30% | -1.15% | 0.05% |
| IMPORTS, G & NFS | 18.73% | 20.42% | 18.82% | 20.15% | 18.42% | 18.99% | 18.68% | 19.99% |
| EXPORTS, G & NFS | 11.85% | 11.11% | 10.70% | 11.11% | 13.00% | 14.63% | 17.03% | 18.04% |
| CHANGE IN GDP (PERCENT CHANGE) | | -1.03% | -3.48% | 5.49% | 3.14% | 5.86% | 3.98% | 1.17% |

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|---|---|
| GROSS DOMESTIC PRODUCT AT MARKET PRICES | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% |
| CONSUMPTION | 86.45% | 86.68% | 87.55% | 88.57% | 89.33% | 86.75% | 84.27% | 84.34% |
| PRIVATE | 74.10% | 73.58% | 75.36% | 75.71% | 75.48% | 72.47% | 69.61% | 69.82% |
| PUBLIC | 12.35% | 13.10% | 12.19% | 12.86% | 13.85% | 14.28% | 14.67% | 14.51% |
| GROSS DOMESTIC INVEST. | 16.01% | 18.67% | 18.56% | 16.60% | 14.98% | 10.09% | 9.45% | 8.42% |
| FIXED INVESTMENT | 15.98% | 17.91% | 17.97% | 17.11% | 16.07% | 11.47% | 9.11% | 7.99% |
| CHANGE IN STOCKS | 0.03% | 0.76% | 0.59% | -0.50% | -1.09% | -1.38% | 0.34% | 0.43% |
| IMPORTS, G & NFS | 20.34% | 23.30% | 23.66% | 23.45% | 22.36% | 18.97% | 16.55% | 16.58% |
| EXPORTS, G & NFS | 17.88% | 17.95% | 17.54% | 18.28% | 18.05% | 22.13% | 22.83% | 23.83% |
| CHANGE IN GDP (PERCENT CHANGE) | 5.26% | 6.17% | 6.00% | 1.90% | -9.39% | -5.85% | -2.40% | 0.70% |

of the 1982 devaluation which vastly increased the real value of dollar-denominated loans. The need to carry out a long-term refinancing of these loans represents the most important unresolved problem of the Uruguayan financial system. The volume of private sector credit outstanding gradually declined toward more normal levels throughout 1983 and 1984, then contracted very sharply in 1985. Although 1986 figures are not yet available, it would appear that both the volume of foreign deposits and the volume of lending to the private sector increased significantly.

Fortunately, the 1985 reduction in foreign-currency-denominated deposits coincided with an absolute reduction in real terms of lending to the public sector. The total volume of such lending (including the quasi-fiscal losses of the central bank, which accounts for most of the change in "other net domestic assets") declined sharply in 1985 to 19.1 percent of GDP after rising substantially in the three previous years for reasons discussed previously. Again, it appears that the GOU has made some further progress in reducing banking system lending to the public sector. However, progress in reducing the quasi-fiscal deficit has been extremely slow.

In terms of the adequacy of the policy and institutional environment to support medium term growth, a reasonable assessment would be that, in general, given the size of the financial system, the demands currently being placed on that system to finance the fiscal and quasi-fiscal deficit are manageable. Far more important than further reducing the fiscal deficit is the completion of arrangements to refinance the private sector dollar debt acquired prior to 1983, so that firms will be able to undertake further capacity expansion.

This is not to say that the GOU should not attempt further fiscal improvement. Such gains would be useful, if only to reduce the vulnerability of the system to fluctuations in the level of foreign deposits.

3. Exchange Rate The general importance of maintaining an adequate exchange rate in a small open economy is self-evident. In the case of Uruguay, there is the additional factor that extensive foreign-exchange-denominated lending by domestic firms can have a serious impact on the financial condition of these firms. The exchange rate system of Uruguay is essentially a market determined one, with no requirement for the surrender of exchange receipts or restrictions on international capital flows. The Central Bank and the state-owned Bank of the Republic (BROU) do buy and sell foreign exchange in an attempt to smooth short-term fluctuations. Trends in inflation, devaluation, and the real effective exchange rate are summarized on Table 13. The real effective exchange rate is calculated by the IMF on a trade weighted basis. It is clear from Table 13 that the GOU has been quite successful since 1983 in maintaining and even improving its external competitiveness.

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TABLE 12
URUGUAY: SUMMARY ACCOUNTS OF THE BANKING SYSTEM
(MILLION 1978 PESOS)

| | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| NET INT'L RESERVES | 2891 | -698 | -467 | -3794 | -1438 |
| ASSETS | 4284 | 6238 | 6914 | 5949 | 3942 |
| LIABILITIES | 1393 | 6936 | 7381 | 9743 | 5380 |
| MEDIUM AND LONG-TERM FOREIGN LIABILITIES | 349 | 2782 | 12299 | 14525 | 8660 |
| NET DOMESTIC ASSETS | 12592 | 25301 | 32044 | 38164 | 25752 |
| PUBLIC SECTOR (NET) | 281 | 3920 | 6891 | 8245 | 4400 |
| CENTRAL GOV'T | 696 | 4217 | 4341 | 5525 | 2857 |
| REST OF PUB. SECT. | -414 | -297 | 2550 | 2720 | 1543 |
| CREDIT TO OFFICIAL BANK | 213 | 1740 | 3991 | 4623 | 3036 |
| CREDIT TO BANKS IN LIQUIDATION | -1 | -3 | -3 | 100 | 150 |
| CREDIT TO PRIVATE SECTO | 13818 | 21642 | 21130 | 21790 | 14669 |
| INTERBANK FLOAT | -112 | -149 | 8 | 200 | -53 |
| OTHER | -1605 | -1849 | 28 | 3208 | 3550 |
| MEMO: PUBLIC SECTOR PLUS "OTHER" | -1324 | 2071 | 6918 | 11452 | 7950 |
| LIAB. TO PRIVATE SECTOR | 15134 | 21362 | 19278 | 19846 | 15654 |
| MONEY | 2691 | 2710 | 1955 | 1979 | 2315 |
| CURRENCY IN CIRC. | 1681 | 1811 | 1289 | 1198 | 1342 |
| DEMAND DEPOSITS | 1010 | 899 | 666 | 781 | 972 |
| QUASI MONEY | 12444 | 18651 | 17323 | 17867 | 13339 |
| IN LOCAL CURRENCY | 5028 | 4421 | 3697 | 3438 | 3694 |
| IN FOREIGN CURRENCY | 7416 | 14231 | 13626 | 14428 | 9645 |

The year 1986 has been a particularly difficult one for exchange rate management. The large volume of private capital inflows has tended to appreciate the real exchange rate, while the purchase of such foreign exchange by the Central Bank or the BROU with pesos tends to increase the peso money stock, increasing inflationary pressures in the economy. Calculations by a private Uruguayan economist suggest that, as of September, the trade weighted exchange rate had appreciated about six percent from the end of December 1985. Given the enormous pressures involved, this is a reasonably satisfactory result.

Overall, the real effective exchange rate appears to be adequate to achieve medium term growth. Moreover, given the experience of the 1978-82 period, the Uruguayan authorities are acutely aware of the risks associated with real exchange rate appreciation, not only because of their effect on international competitiveness, but also because of the devastating effect which subsequent adjustment can have on domestic firms with dollar-denominated liabilities.

Table 13

EXCHANGE RATE, DEVALUATION, AND REAL EFFECTIVE EXCHANGE RATE

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|---|---|
| NOMINAL DOLLAR EXCHANGE RATE (ANNUAL AVERAGE) | 6.05 | 7.84 | 9.08 | 10.79 | 13.85 | 34.38 | 55.89 | 101.43 |
| MONTEVIDEO COST OF LIVING (1978=100) | 100.0 | 166.8 | 272.7 | 365.6 | 435.0 | 649.1 | 1008.0 | 1736.1 |
| REAL EFFECTIVE EXCHANGE RATE (TRADE WEIGHTED, 1978=100) | 100.1 | 108.6 | 135.7 | 152.7 | 164.3 | 103.8 | 98.9 | 95.8 |

SOURCE: IBRD, COUNTRY ECONOMIC MEMORANDUM ON URUGUAY, AUGUST 12, 1986, TABLES 9.1, 9.6, AND 9.7.

4. Trade Policy. Along with most Latin American countries, during the 1950s and 1960s, Uruguay followed a development policy which emphasized import substitution through very high tariff barriers. Beginning in 1974, the GOU began to implement a development strategy which emphasized export expansion along lines of comparative advantage. Quantitative restrictions were

TABLE 14
TRENDS IN TARIFF PROTECTION
(PERCENT)

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|
| MAXIMUM TARIFF | 90% | 75% | 55% | 55% | 60% | 60% |
| WEIGHTED AVERAGE TARIFF | 19% | 19% | 17% | 15% | 15% | 22% |

SOURCE: ROW 1: IBRD, COUNTRY ECONOMIC MEMORANDUM ON URUGUAY, TABLE 12
ROW 2, MISSION ELABORATION

eliminated in 1975 and the maximum tariff rate was gradually reduced from 346 percent in 1974 to 55 percent in 1983. At the same time, the average tariff was reduced until it reached 15 percent in 1985. (The weighted average tariff rose to 22 percent in 1986 solely because of the changed composition of import values.)

Overall, then, there remains more that could be done in reducing both the average tariff, which acts as a disincentive to exports, and the dispersion of tariffs, which provides distorted incentives to domestic producers. However, the urgency of this is probably not great.

5. Conclusion. In general, it should again be emphasized that the overall direction and content of GOU economic policy are more than adequate to produce sustained economic recovery in the medium term. The existing public sector fiscal deficit, although higher than desirable, is certainly capable of being financed by Uruguay's large and flexible financial system without a compression of private sector credit. Private incentives resulting from a combination of exchange rate and tariff policy, certainly appear adequate to permit Uruguayan producers to compete in international markets. Indeed, the principal obstacle to a steady growth in export volumes appears to be erratic trade policies on the part of Uruguay's principal trading partners. A solution to that problem is not readily apparent.

The low level of business investment experienced in recent years remains a matter of serious concern. However, a close examination of the matter suggests that the principal reason for this low level is the continuing problem of the debt burden resulting from the 1982 devaluation. A resolution of that problem through long-term refinancing still appears to be the most urgent item of economic policy on the agenda.

Beyond that, the GOU should continue its efforts to reduce the overall fiscal deficit, primarily to reduce inflationary pressures, and to reduce the dispersion of import duties in order to increase the efficiency of domestic production. Neither of these matters appears to be of particular urgency, however.

## III. 1987 ESF Program

### A. Summary of FY 1986 Program.

The FY 1986 ESF program of $14.355 million was divided into two components: (1) a $14.0 million cash transfer to support balance of payments requirements; and (2) a $355,000 grant to carry out an administration of justice initiative and technical assistance, studies and other support to the GOU's economic recovery program. The $14.0 million cash transfer was made on September 17, 1986. In accordance with the Program Ageement, the GOU will attribute $14 million to the importation of specific categories of goods from the United States during the twelve months following the signature of the Agreement. The GOU is also depositing the equivalent of $14 million in local currency into a special account to be used for mutually agreed upon development purposes. The procedural framework for disbursing and monitoring local currency deposits were agreed upon in a Memorandum of understanding which was signed in August 1986. The MOU established that the grantee will deposit all local currency deposits into a special account within a twelve month period on a schedule agreed upon with A.I.D. The GOU Central Bank made an initial deposit into the Special Account of $3.0 million in local currency equivalent in early October. In accordance with implementation letter instructions, $1.0 million in local currency equivalent is being deposited into the Special Account at the beginning of every month. By May 30, 1987, $10.0 million equivalent had been deposited and by September, 1987 the full $14.0 million equivalent will have been deposited.

The currently programmed distribution of uses of GOU-owned local currency resulting from the $14.0 million of FY 86 ESF cash transfer program is as follows:

| | | |
|---|---|---|
| 1. | The GOU Counterpart to IDB loans: | $ 8,000,000 |
| 2. | Support to Private Sector and NGO Activities. | $ 3,455,000 |
| 3. | The GOU Counterpart to UNDP technical assistance activities | $ 1,495,000 |
| 4. | Counterpart to A.I.D. Administration of Justice ($500,000) and Technical Assistance ($200,000) Grant | $ 700,000 |
| 5. | A.I.D. O.E. Trust Fund (2.5 percent) | $ 350,000 |
| | Total ESF Cash Transfer | $14,000,000 |

To date the GOU has disbursed the equivalent of approximately $700,000 from the special account including disbursements to the A.I.D. operating expense trust fund.

The $355,000 which were obligated as a small grant project are being used to carry out an administration of justice activity and to provide U.S. technical assistance to private enterprises affected by the economic turmoil of the early 1980's.

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B. FY 1987 Program Overview

1. Justification for a Cash Transfer Program and Small Grant Technical Assistance and Training Project.

The proposed uses of the FY 1987 Economic Support Funds are essentially to continue the program initiated in FY 1986. The cash transfer program will continue to be the most effective way to support the GOU's economic recovery program by facilitating a greater volume of imports than could otherwise occur. The alternatives, a Commodity Import Program or fully projectized assistance, imply a long disbursement period and would rquire a significant increase in A.I.D. staff to monitor these activities. Nevertheless, there continue to be certain technical assistance and training needs to support the GOU's economic recovery program. Additional U.S. technical assistance will be provided to Uruguay's private sector in support of economic recovery. The GOU has also requested that $400,000 be set aside for long term participant training in the U.S. in order improve its human resource base. Training will be provided in areas such as economics, health policy, computer science, public administration, and agriculture.

2. Justification for Grant Funding.

Grant funding was provided for the FY 1986 because of the political basis of this program and because of the fact that the Government of Uruguay has a minority in the Uruguayan Congress which may be reluctant to approve loans entered into by the GOU. Both conditions still obtain for the FY 1987 ESF program. Funds are being provided to Uruguay because of a Congressional earmark in recognition of its return to democracy in 1985. To require that the funds be provided on a loan basis would mean that the Program Agreement would have to be ratified by the Uruguayan Congress -- a process which could well be very time-consuming, thus jeopardizing the possibility of obligating funds during FY 1987 and which would probably create significant controversy about the local currency program.

C. Economic Conditionality Considerations.

The 1986 ESF Program did not impose specific economic conditionality requirements other than that the GOU covenant to maintain implementation of its economic stabilization and recovery program. In general the GOU was able to satisfactorily manage its economic recovery program. It continued to use an appropriate economic policy framework, including: (1) utilization of market-determined prices; (2) a unitary floating exchange rate; (3) market-determined interest rates; (4) encouragement of an export-oriented rather than an import substitution economic growth strategy; and (5) some reduction of effective tariff protection. In general its monetary and fiscal management during 1986 were satisfactory. Although the IMF Stand-by Agreement expired in March, 1987; however, an IMF Mission initiated formal discussions for a new Stand-by Agreement with the GOU in the same month. It is expected that a new Stand-by ageement will be negotiated and signed later this year.

As discussed in Section II.D. the economic policy framework is generally appropriate for recovery of the Uruguayan economy over the medium term. The major remaining obstacle to reactivation of the economy is the lack of investment which appears to result largely from the debt burden for many enterprises remaining from the major 1982 devaluation which occured when many, if not most, Uruguayan productive enterprises had large dollar debts. After devaluation, it became virtually impossible for many firms to repay this debt and the Central Bank purchased a large amount of non-performing loans from the Commercial Banks. To date this debt remains "on the books" and is a major impediment to recovery of manufacturing enterprise in Uruguay. Thus, debt restructuring, which would permit the rehabilitation of viable enterprises, should be the most important priority for government action and therefore should logically be an area for economic conditionality. Nevertheless, the issue is politically contentious. Given the nature of the political relationships between the executive and the Congress, it is unlikely that decisive action can be undertaken at this time by the GOU since any actions would require the agreement of the political opposition.

A major component of the fiscal deficit is Central Government transfers to the social security system. (In 1985 these amounted to about 3.8 percent of GDP). Fundamental adjustment will be necessary to assure long term fiscal stability is reform of the social security system. This reform, however, can only have an impact over the long term since obligations of the system to current retirees cannot be voided. The proposed reform is likely to be very controversial and it is not appropriate the USG condition its assistance on its implementation. It should be noted, however, that the World Bank plans to require that the GOU initiate a social security reform as the major condition of its proposed $80 million structural adjustment loan.

Therefore, given the relatively small amount of assistance to be provided, it is inappropriate to seek specific conditionality at this time in these areas in which political consensus cannot easily be obtained.

While additional efforts to reduce fiscal deficits and average tariffs would also be useful, the GOU has performed satisfactorily in these areas to date. It plans to undertake further measures to comply with the World Bank's Structural Adjustment Loan which include: (1) expansion of the VAT and income tax bases; (2) restructuring of publically owned railways and airlines; and (3) reduction of the maximum import tariff to 45 percent. While specific A.I.D. conditionality does not appear appropriate the GOU will covenant to continue to implement its economic recovery program as set forth in the Letter of Application Annex 1.

D. Utilization and Management of the Dollar Resources.

The 1987 ESF contributions will be obligated through amendments to the two grant agreements signed in FY1986. The $14.0 million cash transfer agreement will be increased by $11.522 million and the $355,000 agreement for administration of justice and technical assistance will be increased by $600,000.

In accordance with current A.I.D. statutory requirements, the amended agreement will provide for tracking of the use of the additional dollar funds provided through cash transfer. In Uruguay, the Central Bank does not ration or otherwise control foreign exchange availabilities for private sector imports. Importers and exporters alike have direct access to a free foreign exchange market operated in the private sector. In reviewing the new requirements for dollar tracking with GOU authorities, they have suggested, as indicated in the letter of application, that the ESF dollars be used for petroleum imports made by a State-owned enterprise, ANCAP, from Venezuela and Mexico. In 1986 petroleum imports totalled $140 million. There are no other public sector imports of significant size.

The grant agreement will require as a condition precedent to disbursement a proposed disbursement calendar and a detailed description of the dollar tracking arrangements. In general terms, the A.I.D. funds will be disbursed into a separate account of the Central Bank, probably in the New York Federal Reserve Bank. The Central Bank will authorize the transfer of these funds as needed to pay for its petroleum imports from suppliers. (Over 50 percent of Uruguay's petroleum imports currently come from Latin America). The Bank will subsequently present to the A.I.D. office its certification of the details of the transaction, i.e., volume, quality, price, source, etc., with copies of any supporting documentation deemed necessary.

All petroleum procurement will be administered by ANCAP in accordance with well established norms and practices that will assure reasonable prices and overall propriety. ANCAP enjoys a sound reputation in the international oil market. Its operations are scrutinized not only by internal and external systems, but also by an active and vigorous Congress. In the event that for reasons unforeseen at this time, it becomes infeasible or administratively impractical to use the ESF for petroleum imports, the only other possible use will be to payment of U.S. and multilateral development bank debt. If it is subsequently determined government that use of the ESF dollars would be desirable, the A.I.D. representative in Uruguay will consult with AID/W before agreeing use.

E. FY 1987 Local Currency Program.

1. Local Currency Programming

The GOU-owned local currency resulting from the cash transfer will be allocated as follows:

| | | |
|---|---|---|
| 1. | Counterpart to IDB loans | $ 6,000,000 |
| 2. | Support to Private Sector and NGO Activities Involving Micro-Enterprise Employment Generation, Technology Innovation, Export Promotion, etc. | $ 2,922,000 |
| 3. | Rationalization of Agricultural Production and Agro-industry promotion for southern Uruguay | $ 1,500,000 |
| 4. | Reserve for Contingency | $ 500,000 |
| 5. | A.I.D. Trust Fund | $ 600,000 |
| | Total FY 1987 ESF Local Currency | $11,522,000 |

The first two uses, totalling $8,922,000 are to supplement activities initiated with 1986 ESF local currency. The counterpart for the IDB loans is planned to be distributed for the two agricultural (rice and dairy) development projects described in Annex 2. Similarly, the support to private sector and NGO activities will be administered as described in Annex 2.

The $1,500,000 for the rationalization of agricultural production and agro-industry promotion for southern Uruguay is the only new local currency activity planned to be supported with the 1987 ESF add-on. This program, recently announced by President Sanguinetti, is directed at the medium and small scale family farms located in the so-called green belt surrounding Montevideo. This area currently accounts for 63 percent of the volume of fruit and vegetable production for the domestic market. Problems include soil erosion, outdated production technologies, and inadequate market structures. The GOU projects a three-year, approximately $15.0 million agricultural development effort that would identify appropriate production strategies for each important micro-region and would work through existing farmer organizations, cooperatives, and private agro-enterprises to provide production and marketing services necessary to achieve those strategies. Emphasis would be placed first on immediate actions involving improvements in forage crops for small scale dairy operations, swine, and rabbits, and in cash food crops requiring more readily manageable marketing support (i.e., garlic, onion, beans, chick peas, lentils, etc.). At the same time, the program will work closely with cooperatives and other private food processors to develop basis for managing the counter season export of fresh fruit and vegetables and processing facilities for local and regional markets. Although the program has already been initiated, the GOU expects to negotiate technical and/or financial assistance from Japan, Italy, and the FAO as studies and pilot experiences demonstrate the need for specific external inputs.

The $500,000 reserve for contingency is being held back from the amount originally programmed for estimated counterpart need of the two IDB loans in order to have the flexibility to add resources to those activities that progress the fastest. In effect, this permits a resource response for good performance. By mid FY1988 it will be possible to gauge whether this amount should be allocated to support the counterpart requirements of the IDB loans as originally planned or for other purposes set forth in the ESF grant agreement and its corollary memorandum of understanding. One of the possible uses, for example, may be to finance the implementation of recommendations that result from the administration of justice program when the costs exceed the financial capacity of the program (e.g., equipment and infrastructure necessary to implement oral hearings, judicial training, and a national legal information system).

The $600,000 allocated to the A.I.D. Trust Fund in the represents the GOU's willingness to increase the percentage for A.I.D. operations and program support from 2.5 to 5 percent. The increase will be used to carry out small scale local currency activities that support GOU development efforts and concerns. These funds will provide the A.I.D. Office with a small amount (less than $300,000) to promote policy dialogue and to serve as seed capital to establish Uruguayan-U.S. linkages of particular A.I.D. interest. Illustrative examples include:

Short-term regional training and training follow-up: A.I.D. sponsored regional workshops are a very effective way of promoting interchange and dialogue on development issues of interest to A.I.D. The recent A.I.D. sponsored workshops in Cali on indigenous PVO's and in Buenos Aires on low-income housing are good examples. The regional workshops periodically offered under A.I.D. auspices in health and family planning represent additional opportunities appropriate for Uruguayan participation. It is also planned to support the development of a directory of Uruguayan participants who have returned from degree programs in the U.S. sponsored by A.I.D. and other U.S. Government organizations as well as the fellows programs of Fulbright, Humphries, Kellogg Foundation, Ford Foundation, IAF, etc. Such a directory could be the basis for a local level effort to form an alumni association. The directory would be indexed by specialty

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and would also be distributed to key GOU officials as well as to potential employers through organizations such as the Uruguayan-American Chamber of Commerce in order to promote the best use of the talent trained with U.S. public and private funds.

Management training: The private Catholic University has a small but growing undergraduate facility of business administration. Traditionally, the GOU does not finance parochial schools at any level. While the GOU is prepared to use local currency to support management training initiatives of a private non-profit institute (ACDE), it cannot channel these funds to the Catholic University without risking severe negative reaction from the State supported national university. ACDE concentrates on short-term, non-degree training of individuals already working as managers. However, ACDE does not fill the need for quality academic training in management at the university level. Small amounts of assistance in teacher preparation, curriculum development, and teaching and reference materials at this stage in the development of Catholic University would have a significant impact on upgrading its program. The A.I.D. funds can be used to build or reinforce linkages to appropriate U.S. institutions or other management training entities such as INCAE, that use U.S. methodologies.

Labor training: Labor union activity was suspended for the 12 years preceding the resumption of the democracy in 1985. Essentially, a generation of potential leaders had no opportunity to develop skills in organization, administration and collective bargaining. Consequentially, Uruguay's labor movement has been easily dominated by leftist elements and has been very conflictive during the first two years of the new administration. However, there are elements within the labor movement that are looking for opportunities to improve the skills of labor leaders without regard to political beliefs. A small amount of local currency support could help these elements initiate a modest training center. (Perhaps training efforts could be coordinated with Catholic University, which is interested in the topic of labor development as part of its management training program). The development of such a nucleus or center would also help identify candidates who can take advantage of the short-term training offered by the U.S. Department of Labor. These efforts will also be coordinated with the on-going, but minimal AIFLD program in Uruguay.

Partners of the Americas: Minnesota is Uruguay's partner State under the A.I.D. supported National Association of Partners of the Americas (NAPA) program. It is an active relationship and, for a strictly volunteer program, has promoted a notable number of linkages supporting development interests. As with many partnerships, it lacks organizational structure and a revenue base. A small amount of A.I.D. funds can be used as seed capital to initiate revenue generation efforts and promote a broader base of participation within Uruguay that can bring about a stronger local level organization.

Family Planning: Although Uruguay has the lowest population growth rate in Latin America, there is an unmet demand for family planning among low income segments of the population as evidenced by increasing (illegal) abortion. Small amounts of local currency funding can develop linkages between an existing private sector family planning organization (AUPFIRH), and several externally-funded (e.g., Kellogg Foundation, PAHO) efforts to develop innovative, low cost maternal-child health care delivery in low income neighborhoods of Montevideo. By funding such linkages, these entities will be able to add to their programs the missing element of family planning at low cost. Despite the cost effectiveness of such assistance, it would be difficult for the GOU to allocate its local currency directly for these programs given the private nature of the entities involved and the constant pressure from the public health sector for more funding.

The general programming of 1987 funds will be agreed upon in an amendment to the MOU. Similarly, any reprogramming between the major categories will be reflected in exchange of letters following consultations. Finally, the $500,000 in unallocated contingency will be assigned based on verbal consultations subsequently reflected in an exchange of letters between OPP and A.I.D.

2. Local Currency Disbursement and Monitoring Procedures.

OPP will maintain detailed financial records for all ESF local currency uses. End use documentation will be maintained in accordance with existing Uruguayan norms by the individual implementing entities.

Disbursement procedures for specific components are as follows:

The support to Private Sector and NGO activities ($3.455 million in FY86 and $2.922 million in FY87) will be distributed by the Office of Planning and Budget (OPP) based on the merits of individual proposals. OPP is just completing its internal processes for reviewing these proposals. During this start up phase OPP has frequently consulted directly with the A.I.D. Representative and this close collaboration will continue. OPP will advise A.I.D. in writing on a monthly basis of the individual activities it has approved. Normally, through its regular consultation process the A.I.D. Representative already will be familiar with the activities being processed, particularly those involving large amounts (i.e., over $250.000 equivalent). Thus, any questionable uses via-a-vis A.I.D. policy concerns likely will have been screened out in advance.

The activity involving the rationalization of agricultural production and agro-industry promotion for southern Uruguay ($1,500,000 of FY87 ESF) is a new endeavor being initiated by the GOU in 1986, but based on ample previous pilot experience. OPP has already provided A.I.D. with a project summary. However, to facilitate financial monitoring, OPP will inform A.I.D. in writing of the specific budget allocations made to the individual public and private sector implementing organizations and the intended uses. Any significant reprogramming necessary as a result of actual experience will also be reflected through a letter from OPP.

The $700,000 in counterpart to the separate A.I.D. grant for administration of justice and technical assistance will be monitored directly by the A.I.D. Representative and the FSN program specialist. The bulk of this amount ($500,000) will be advanced to the project implementing unit, which will provide detailed accounting of end use to the OPP and A.I.D. The balance will be used for studies and technical exchanges that usually will be jointly financed with the A.I.D. grant funds. OPP is actively involved in the supervision of many of the activities to be supported by local currency. All four IDB loan projects selected for counterpart financing are being implemented by OPP divisions. OPP is the principal contact agency of the UNDP and therefore is closely involved in all UNDP programming and project implementation. Given its important role in the budget process, no problem is anticipated in assuring that OPP will have adequate access to the information necessary for proper accounting and reports.

OPP plans to issue monthly financial reports on local currency utilization and has established the ledgers necessary for this purpose. A.I.D. and OPP currently are considering the possibility of automating OPP's record system. The separate A.I.D. grant contains funding that can be used for program support purposes of this nature. Drawdowns of the GOU-owned local currency for the agreed upon purposes are expected to continue through calendar year 1989. Disbursement experience to date has been slow largely because the GOU has not had experience with ESF until the 1986 program, which was initiated late in the fiscal year. (Disbursements as of May 31, 1987 against the FY86 local currency totalled $738,674). However, the local currency disbursing mechanisms are nearly in place and the disbursement rates will pick up during the last half of 1987 notably. The A.I.D. office in Uruguay will monitor closely the drawdown experience and will request reprogramming if delays are encountered with individual activities. The first formal joint review of disbursement progress will be held no later than October 30, 1987.

All Trust Fund expenditures are pre-validated by the Regional Controller in USAID/Bolivia, who also makes at least quarterly site visits for training of national employees and overall financial monitoring. The trust fund agreement which was signed in conjunction with the FY 1986 Program Agreement provides that A.I.D. provide the GOU with periodic financial reports on the utilization of the trust funds. Allocation of trust funds for program, as opposed to operating expenses, will be based on prior verbal consultations with the GOU.

Because of Uruguay's high rate of inflation, local currency deposits into the Special Account in the Central Bank will suffer reduced purchasing power if not promptly used. This problem has been overcome in large measure with respect to the FY86 ESF local currency. As the Central Bank makes the local currency available it is turned over to the state development bank (BROU) and placed in an interest earning account until needed for approval purposes. All earned interest is added to the account, thereby maintaining the dollar equivalent value. To minimize this problem under the FY87 cash transfer program, it is proposed to permit disbursements into the local currency Special Account up to 24 months following A.I.D.'s dollar disbursements in lieu of the normal 12 month requirement.

F. <u>Dollar Financed Technical Assistance and Training</u>.

The GOU has requested that $600,000 of the $12.122 million 1987 ESF funds be reserved to add to the existing Project Grant Agreement for Administration of Justice and Technical Assistance, principally to incorporate a new component to finance post-graduate participant training.

Over the next two years the GOU estimates sending approximately ten of its most promising younger officials for masters level training in the U.S. The benefits to Uruguay of past A.I.D. sponsored training in the 1970's, principally in economics and agriculture, are now widely recognized and appreciated within the GOU. The Office of Planning and Budget is charged with the responsibility for approving all externally financed training in the country and would be actively involved in candidate selection. Economics, health policy, computer science, public administration, and agriculture would be among the priority fields. The estimated costs of this new component would be $400,000, or about $40,000 per candidate, including intensive English and assuming at least a two-year academic requirement. It may be possible to lower costs somewhat by finding candidates with adequate English and academic credentials that permit shorter lengths of study to complete degree work. Utilization of these funds for public sector participant training will permit the LAC regional training funds allocated to Uruguay can be more readily concentrated on private sector long and short-term training needs.

Procedures for administering the new training actiity will be developed jointly with OPP and reflected in an implementation letter. The possibility of utilizing the services of a U.S. training contractor will be considered fully. Alternatively, the A.I.D. office in Uruguay may simply issue individual PIO/P's. The PACD of the amended grant agreement will be extended by two years to December 31, 1990 to allow sufficient time for qualified candidates to be identified and trained.

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The remaining $200,000 of the increase to this grant would be used to provide an additional $150,000 for Private Sector Income and Investment Generation from $150,000 to $300,000 and increase the Program Support component by $50,000.

The increase to the Private Sector activity is based on the successful initiation of a International Executive Service Corps program in which project funds co-finance with selected private enterprises the costs of the volunteer executives. Assuming an average cost sharing of $8,000 to $9,000 per each assignment, it is estimated that approximately 30 additional consultancies will be financed under this component. Given the experience since the start up of the local IESC office in early FY1987 (seven cases are in process), this level appears to be a reasonable target.

The program support component finances studies and technical interchanges that can impact on GOU development policies and programs. It also covers other program support costs such as audit and evaluations.

*Presidencia de la República Oriental del Uruguay*
*Oficina de Planeamiento y Presupuesto*

Montevideo, 19 de mayo de 1987

Nota Nº
1944/87/D

Señor
Representante de la Agencia
Internacional para el Desarrollo (A.I.D.)
D. Paul Fritz
Presente

De mi consideración:

Por la presente, me complace hacer referencia a la nota del Sr. Embajador Wilky de 18 de diciembre de 1986 con referencia a la decisión de la Agencia Internacional para el Desarrollo (AID) por la cual se destinan U$S 12:122.000.- para proseguir el apoyo económico iniciado en el Uruguay ese año, así como la posterior comunicación de fecha 26 de enero de 1987 por la que se solicita información tendiente a la instrumentación del programa.

En primer lugar, tengo el agrado de destacar los principales logros del programa económico del Uruguay en el año 1986. Los resultados obtenidos, en el comienzo de la recuperación de la economía que se encontraba sumida en una profunda crisis al asumir el gobierno democrático, han superado los objetivos planteados. El producto bruto interno se incrementó en un 6.3% (el producto por persona, un 5.8%); la desocupación se redujo en 2 puntos porcentuales sobre la población activa (una disminución del 20% de los desocupados); las exportaciones se incrementaron en más de un 25% con lo que se alcanzó un excedente de la cuenta corriente de U$S 94:000.000 y las reservas internacionales se incrementaron en un 4% del PBI al revertirse fuertemente la fuga de capitales por el ingreso de capitales; el déficit fiscal y parafiscal se redujo de 10% del PBI al asumir el gobierno a un 5% del mismo; el salario real continuó su crecimiento aumentando un 6% en el año y totalizando un 22% en los dos años del gobierno.

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*Presidencia de la República Oriental del Uruguay*
*Oficina de Planeamiento y Presupuesto*

Hoja N° 3

| | | | | |
|---|---|---|---|---|
| A) | Programa de Reconversión y Desarrollo Agroindustrial de la Zona Sur del País | - | U$S | 1:500.000.- |
| B) | Contrapartida de préstamos para el desarrollo en cuencas productivas | - | U$S | 6:000.000.- |
| C) | Fondos de contingencia no asignados y reserva para actividades que promuevan la racionalización de la prestación de servicios del sector público y de la Administración de Justicia. | - | U$S | 500.000.- |
| D) | Para respaldar a organizaciones sin fines de lucro. | - | U$S | 922.000.- |
| E) | Para estimular el desarrollo del Sector privado promoviendo su reactivación, introducción de nuevas tecnologías, inversiones, etc. | - | U$S | 2:000.000.- |

Sin otro particular, le saludo muy atentamente,

PRESIDENCIA DE LA REPUBLICA
OFICINA DE PLANEAMIENTO Y PRESUPUESTO
Cr. ARIEL DAVRIEUX
DIRECTOR

ECH/be

Presidencia de la República Oriental del Uruguay
Oficina de Planeamiento y Presupuesto

Hoja N° 3

| | | | |
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| A) | Programa de Reconversión y Desarrollo Agroindustrial de la Zona Sur del País - | U$S | 1:500.000.- |
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| D) | Para respaldar a organizaciones sin fines de lucro. - | U$S | 922.000.- |
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Sin otro particular, le saludo muy atentamente,

PRESIDENCIA DE LA REPUBLICA
OFICINA DE PLANEAMIENTO Y PRESUPUESTO
A. Davrieux
Cr. ARIEL DAVRIEUX
DIRECTOR

ECH/be

Status of FY 1986 ESF Program Local Currency allocations

The FY1986 ESF program of $14.355 million is divided into two components: (1) a $355,000 grant to carry out an administration of justice initiative and technical assistance, studies and other support to the GOU's economic recovery program; and (2) a $14.0 million cash transfer to support balance of payments requirements. The $14.0 million cash transfer was made on September 17, 1986. The GOU Central Bank made an initial deposit into the Special Account of $3.0 million in local currency equivalent in early October. In accordance with implementation letter instructions, $1.0 million in local currency equivalent is being deposited into the Special Account at the beginning of every month. Thus, as of May 30, 1987, $10.0 million equivalent have been deposited and by September, 1987 the full $14.0 million equivalent will have been deposited.

The original PAAD projected that $12.0 million of the $14.0 million equivalent of local currency use would be used for IDB counterpart, principally for agricultural cooperative and production credit and for pre-export financing. The balance was estimated to be used for small scale employment generation, local counterpart to a separate ESF funded grant for administration of justice and technical assistance, and for an A.I.D. trust fund (2.5 percent).

In developing the final plans for the use of these funds, the GOU through its Office of Planning and Budget (OPP) attached to the Presidency, has opted to give relatively less priority to counterpart uses for credit programs of a general nature and greater priority to targeted development activities.

The currently programmed distribution of uses of GOU-owned local currency resulting from the $14.0 million of FY 86 ESF cash transfer program is as follows:

| | | |
|---|---|---|
| 1. | The GOU Counterpart to IDB loans: | $ 8,000,000 |
| | - New agricultural development programs: | $ 6,770,000 |
| | - Expansion of Northwest Vertex regional development program: | $ 730,000 |
| | - Feasibility and pre-investment studies | $ 500,000 |
| 2. | Support to Private Sector and NGO Activities. | $ 3,455,000 |

| | | |
|---|---|---|
| 3. | The GOU Counterpart to UNDP technical assistance activities | $ 1,495,000 |
| 4. | Counterpart to A.I.D. Administration of Justice ($500,000) and Technical Assistance ($200,000) Grant | $ 700,000 |
| 5. | A.I.D. Trust Fund (2.5 percent) | $ 350,000 |
| | Total ESF Cash Transfer | $14,000,000 |

The $8,000,000 in counterpart to IDB loans will principally support two new agricultural development projects. Consistent with GOU policy, these projects will promote the specialization of agricultural production based on the comparative advantage of selected regions. Uruguay's four eastern Departments already account for essentially all of the country's rice production. Yields are already good and private rice producers organizations are well developed. A $27.3 million IDB loan will finance investments in access road improvement and conversion of irrigation pumps from diesel to electricity supplied by the country's recently completed hydroelectric facility. These investments will enable private sector producers to hold down costs of production and marketing and thereby maintain their market position. No significant expansion of land under cultivation is planned.

Similarly, Uruguay's four southern Departments are best suited for dairy production. Individual dairy producers are already served by a large, businesslike cooperation (CONAPROLE) that provides technical assistance, processing and marketing services. A $36 million IDB loan will finance: (a) the development of new forage materials under irrigated practice in order to reduce the drop in milk production levels currently experienced during winter months; improved animal breeding and reproduction services aimed principally at the small producers; access road improvement; and extension of electric distribution. Again, the focus is more on reduction of production and marketing costs in order to maintain comparative advantages rather than expansion of land under cultivation.

The northwest vertex regional development project (VERNO) financed by a 1984 $21.8 million IDB loan is furthering the comparative advantage of this area in fruit and vegetable production. Capitalizing on the availability of irrigation facilities and on the mild winters, the individual private farmers in this area are diversifying away from sugar cane production and into fruit and vegetables for early season fresh food regional markets (Montevideo, Buenos Aires, Brazil) and for c unter-season markets in the Northern Hemisphere. Freezing facilities are also being constructed. The IDB loan, channelled through cooperative organizations to serve individual farmers, has already had an important impact on job generation. Because of internal migration, the Bella Uni n area is the only secondary city in the country registering a sharp increase in population growth. However, the benefits of this effort remain to be fairly concentrated and in stark contrast to smaller towns nearby. The local currency allocated to VERNO counterpart will be used to promote development activities in these outlying areas so that a greater number of low-income farmers will benefit from this new growth pole being established as a result of this IDB loan. Small scale holding ponds are being constructed to permit irrigation and agricultural crop production by individual farmers (e.g., early season fruit and vegetables and legumes). A honey production program is being directed specifically at low income families. Cooperative infrastructure (i.e., buildings and equipment) is being financed in order to strengthen farmer service capacity. Also, the VERNO implementing unit will be strengthened through the financing of project related studies, technical assistance, and staff training.

The balance of the ESF local currency program allocated as IDB counterpart will complement a recent $7.0 million loan for preinvestment studies. A number of study priorities have been identified, including energy, transport, agriculture and forestry, mining, industry and urban development, health, and education. Both public and private sector entities can apply for soft subloans to carry out studies.

<u>The allocation of $3,455,000 for private sector and NGO support activities</u> represents an almost three-fold increase over the level originally contemplated for these activities. This increase reflects a GOU policy interest in reactivating a weak private sector through support to specific activities selected on the basis of their individual merit.

Slightly more than two thirds of the amount ($2,550,000) have been deposited in the State development bank (BROU) to assist profit making enterprises test or develop activities that involve technology innovation, new exports, or important local level employment generation impacts. BROU will extend financing to support these private initiatives based on OPP instructions. Although most activities financed will be on a soft-term loan basis, there will be instances of direct contribution. (One example is the OPP decision to contribute approximately $5,000 towards the local costs of a pre-investment study carried out by a potential U.S. investor with partial financing under the Trade and Development Program, TDP). The principal object is not to create a permanent revolving fund, but to help underwrite sound private sector initiatives that may lead the way to a more innovative and aggressive private sector.

The balance ($900,000) is earmarked for financing proposals received by OPP from indigenous PVO's and NGO's. OPP will emphasize proposals having a productive impact (e.g., micro-enterprise development, appropriate technology promotion, handicrafts export, etc.).

Management training also is eligible for financing under both subcomponents. Specifically, ACDE (Asociacion Cristiana de Dirigentes de Empresa) has presented a request for approximately $500,000 for helping to finance its counterpart to an IDB grant to support its management training efforts. ACDE is an established and prestigious non-profit private sector institute that carries out in-service training through short-term, non-degree courses directed at specific needs of individuals already in management positions. Its program with IDB will develop institutional linkages with the A.I.D. supported business training initiative, INCAE, in Costa Rica.

The $1,495,000 in UNDP counterpart will support a variety of in-country programs indicated in the UNDP's basic agreement with OPP. Important on-going activities include export development and investment promotion being implemented by the UNDP in close collaboration with the GOU's Office of Planning and Budget. A new program, also to be supported with local currency, will promote in-country graduate level training and related applied research in selected basic sciences considered important to the country's development. Eligible areas are biology (including bio-chemistry, micro-biology, genetics and zoology), physics (including solid state physics and solar energy), information sciences, mathematics, and chemistry. Proposals for individual sub-projects will be evaluated by a joint commission established by the GOU's Ministry of Education and the autonomous national university.

The $700,000 in counterpart to the A.I.D. dollar program (grant project 528-0108) is largely to support an Administration of Justice initiative being implemented collaboratively with the UNDP. The $355,000 A.I.D. dollar grant allocates $100,000 for Administration of Justice, $150,000 for technical assis ance and interchanges for the private sector and $105,000 for policy studies and other support costs. The GOU counterpart for Administration of Justice is planned at $500,000. To date, an implementing unit for the Administration of Justice program has been contracted and a draft workplan prepared. Delays were encountered, however, in activating an interagency steering group. These problems have been resolved and the program has resumed its activities. The second component of this dollar grant is being used largely to help finance the costs of technical assistance provided by the International Executive Service Corps (IESC) to Uruguayan private enterprises. Procedures have been developed for selecting firms and determining cost sharing arrangements. A local IESC agent has been selected and trained by the IESC country director stationed in Paraguay. The first volunteer executive assignment has been completed and several more cases are currently being processed. Studies being considered under the third component of the grant include: (1) the cost-effectiveness of Uruguay's private sector health maintenance organizations aimed at bringing about greater administrative efficiency and increased reliance on market forces for pricing of health care services; and (2) the establishment of a financial administration system within the Ministry of Education to improve management of the investment and operational budget and supervision process for public sector education. These proposed studies are still under consideration.

The $350,000 Trust Fund has been functioning without problem. To date, USAID has requested and received the deposit of $ 102,000 in local currency equivalent for start-up and operating costs of the new A.I.D. office. In addition, and in accordance with the terms of the Trust Agreement, these funds have also been used to support Uruguayan participation in A.I.D. sponsored regional conferences such as the workshop on indigenous PVO's in Cali, Colombia, supported by the ADC program in Colombia and the low-income housing seminar in Buenos Aires carried out by RHUDO/Panama. All Trust Fund expenditures are pre-validated by the Regional Controller in USAID/Bolivia, who also makes at least quarterly site visits for training of national employees and overall financial monitoring.