1. Key development issues and rationale for Bank involvement

The global crisis has had a moderate impact on the Uruguayan economy to date but it remains vulnerable to external shocks. The economy’s resilience is linked to a generally solid macroeconomic framework, greater exchange rate flexibility, rising international reserves, and improvements in the banking system, which lessened the impact of the recent crisis and placed it in a favorable position to benefit from a global recovery. Despite considerable progress in terms of macro stability, important challenges remain, including a sizeable public debt which is largely denominated in foreign currency, and vulnerability to global and regional economic and financial conditions.

The government has requested this new series of two DPLs for three main reasons. First, to support and recognize policy reforms during 2009-2010. Second, to anchor the policy reform agenda set by the newly elected government through 2011. While the world economy is slowly recovering from the 2008/2009 crisis, there are downside risks to global growth prospects. Facing uncertainty and a large concentration of amortization payments that will fall due in 2011, the government is following a prudent debt management strategy focused on securing financing to contribute in meeting its medium-term borrowing requirements. In this context, the new DPL series makes available resources of about US$200 million over the period 2010-2011. The new programmatic series of DPLs will be a cornerstone of the Uruguay CPS currently under preparation.

This proposed development policy loan (DPL) is the first of a new programmatic series of two loans, each one amounting to US$100 million. The series supports the implementation of a program of policy reforms in three main areas: public sector management, competitiveness and social inclusion. Through 2008-2010, the Government established a vision of converging to the standards of OECD countries, and potentially becoming a member. It assisted in sustaining economic growth by reducing macroeconomic vulnerability and by contributing to increased FDI and trade flows. It also strengthened the country’s
human development. Uruguay has nearly achieved universal primary education, its social protection programs have enhanced targeting and coverage, and the health system is under reform to achieve universal insurance coverage. Going forward, remaining public policy objectives include: (i) strengthening the efficacy of the public sector; (ii) improving competitiveness; and (ii) promoting social inclusion, through further improvements in efficiency and equity of social sector delivery. These areas of reform are among the key priorities set by the new government inaugurated on March 1, 2010.

2. Proposed objective(s)

The main development objectives of the loan are the following: (i) strengthening public sector administration; (ii) improving competitiveness through measures seeking to facilitate trade, strengthen the business environment and develop financial markets; (iii) improving social inclusion through measures seeking to enhance the equity and efficiency of health, education and social protection systems. The loan fits into three of the four pillars identified in the CPS (currently under preparation), namely: (i) macroeconomic/public sector management; (ii) competitiveness; and (iii) social inclusion and equity.

3. Preliminary description

The proposed loan will be the first of two programmatic DPLs to continue World Bank support to the implementation of the new government’s priority reforms. The policy content reflects the government’s commitment to support economic growth and social inclusion. The loan’s development objective is related to three priority reform areas: (i) Public Sector Management: Improve the efficiency of public sector administration while promoting macroeconomic stability; (ii) Competitiveness: Improve the quantity and quality of investment, through improvements in the business climate and financial markets development, and thereby contribute to growth; (iii) Social inclusion: Improve the equity and efficiency of social sector delivery (education, health and social protection).

The operation is designed to contribute to the debt management strategy of the government. The proposed loan is intended to provide Uruguay with a risk management tool in the event that market borrowing is interrupted and the government falls short in meeting its borrowing requirements by 2011. The DPL series provides financing for US$200 million over the next two years (with the first loan expected to be disbursed in the second half of 2010 and the second loan in the second half of 2011). The DPL funds would provide alternative financing resources to meet maturing public sector debt obligations in case of reduced market access of increased sovereign risk spreads. During the global crisis, Uruguayan sovereign risk spreads rose over the regional average, in spite of its strong macroeconomic fundamentals but mainly due to the small size of its domestic financial market that affected the liquidity of the Uruguayan securities.

The government has made good progress in implementing the reforms anchored by the previous DPL series. Since the Board approval of PRIDPL-II in February 2008, the government has made good progress in implementing the policy program. In some areas, progress slowed down through 2009 as this was an electoral year. Annex 4 provides a detailed discussion of progress of triggers supported by the PRIDPL –II since its approval.

This new loan series builds and expands on these achievements and will be a cornerstone of the Uruguay CPS (2010-2015). The proposed loan supports the consolidation of reforms supported by the PRIDPL series whose implementation continued through 2009 and 2010. It also supports government’s efforts in other areas that were not supported by the PRIDPL series. In particular, upon the government’s request, the proposed loan recognizes recent achievements in public sector management, business climate and
social service delivery (prior actions for DPL-I). The policy matrix also anchors the new government’s reform agenda through 2011 (indicative triggers for DPL-II).

4. Environment Aspects

The proposed operation is not likely to have any significant effects on the environment, forests, and other natural resources. However, to the extent that actions supported by the loan program are successful, over time, in attracting new private investment, there will be a need to continue strengthening Uruguay’s institutional capacity to identify and address environmental policy and regulatory issues.

Environmental policies and regulations are in place, and implementation is improving. The Ministry of Housing, Planning and Environment (Ministerio de Vivienda, Ordenamiento Territorial y Medio Ambiente, MVOTMA), through the National Environment Directorate (Dirección Nacional de Medio Ambiente, DINAMA) is responsible for the formulation, execution, supervision, and evaluation of the national plan for environmental protection and for proposing and implementing national policy, harmonizing the needs of environmental protection with sustainable development. Uruguay's large new foreign-financed investments in the pulp industry have elevated the public awareness of, and government commitment to, monitoring and compliance with environmental regulations. Uruguay was one of the first countries in the region to complete its Second National Communication on Climate Change in 2004 and has subsequently moved quickly to benefit from innovative financing through the carbon market. Carbon and GEF strategies are being implemented since 2009 to improve solid waste management in its two largest cities, as well as initiate multiple investments in renewable energy.

5. Tentative financing

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<tr>
<td>International Bank for Reconstruction and Development</td>
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<td>Total</td>
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6. Contact point

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